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BEFORE THE
POSTAL REGULATORY COMMISSION

Annual Compliance Report, 2017	:	**Docket No. ACR2017**

INITIAL COMMENTS OF UNITED PARCEL SERVICE, INC. ON UNITED STATES POSTAL SERVICE'S ANNUAL COMPLIANCE REPORT FOR FISCAL YEAR 2017

(February 1, 2018)

United Parcel Service, Inc. ("UPS") respectfully submits these comments on the United States Postal Service's ("Postal Service") Annual Compliance Report ("ACR") for Fiscal Year ("FY") 2017.

The 2017 ACR confirms the seismic shift in the Postal Service's business that has been occurring in recent years. As the Report acknowledges, the Postal Service is operating in "an environment of falling mail volumes—a trend that accelerated in the past year."[1] As mail volumes continue to decline, the Postal Service is more focused than ever on delivering parcels, including e-commerce packages. As a result, the Postal Service continues to increase its investments in the infrastructure and operations designed to deliver parcels in competitive markets. Over the past two years, the Postal Service has continued to invest heavily in package-sorting equipment, new vehicles, and handheld scanners—all specifically intended to be used to process, deliver, and track packages. The Postal Service has described "continuing growth" in its "Shipping

[1] United States Postal Service FY 2017 Annual Compliance Report, Dkt. No. ACR2017 (Dec. 29, 2017) ("FY2017 ACR"), at 1.

and Packages business."[2] It has invested in an "Enhanced Package Processing System" with Lockheed Martin to address its growing parcel volume.[3] It has increased its use of both "special purpose routes" and poorly-documented, poorly-understood "second runs" to deliver parcels.[4] And it has stated that it deploys special "package carriers" to delivery points around Manhattan.[5]

The cost methodologies that underlie the Postal Service's ACR for FY2017, however, do not reflect this dramatic shift in the Postal Service's focus. Instead, the Postal Service continues to treat parcel delivery as a minor appendage to its letter mail operations, rather than accounting for the many ways in which parcel delivery increasingly is a primary driver of the enterprise's operations overall. And when UPS has identified deficiencies in the Postal Service's cost methodologies, the Postal Service has consistently defended its practices as the best it can do in light of purported limitations in the data it collects.

The resulting levels of cost attribution are puzzling. Although Postal Service executives have repeatedly acknowledged that delivering competitive products is a top priority, and although these products now amount to ***40%*** of what the Postal Service

[2] Motion of United Parcel Service, Inc. for Issuance of Information Request to the United States Postal Service, Dkt. No. ACR2017 (Jan. 12, 2018) ("UPS CHIR Motion"), at 3 (citing UNITED STATES POSTAL SERVICE, ANNUAL REPORT ("2017 USPS Form 10-K") 24 (Nov. 14, 2017)).

[3] *Id.* at 4-5 (citing https://washingtontechnology.com/articles/2017/11/07/lockheed-postal-contract.aspx).

[4] Library Reference USPS-FY17-9, Dkt. No. ACR2017 (Dec. 29, 2017), at 106 (stating that SPR carriers "primarily deliver parcels and perform collection runs in large metropolitan areas").

[5] UPS CHIR Motion at 6 (citing https://www.nbcnewyork.com/news/local/USPS-Cant-Deliver-Packages-Pile-Up-Post-Offices-NYC-No-Building-Access-458310763.html).

delivers in volume by weight,[6] the Postal Service continues to attribute a very low level of the costs it incurs to competitive products. In 2017, for example, the Postal Service attributed just ***16%*** of its costs to competitive products.[7] As reported in the ACR, the Postal Service identified a mere ***$55,000*** in competitive products property and equipment assets that related to the "competitive products enterprise,"[8] out of about ***$15 billion*** in total property and equipment assets.[9] Similarly, ACR data indicates the Postal Service is attributing to competitive products ***less than 7%*** of the depreciation costs associated with its new handheld scanners, even though these scanners were purchased for the very purpose of tracking package deliveries.[10] Illogical results like those exist across many cost pools.

The conclusion is unmistakable that many costs that are driven by competitive products are not being attributed to competitive products. Instead, large portions of these costs are treated as "institutional" or are included in costs attributed to market-dominant products. For the costs that are classified as institutional, the current "appropriate share" requirement percentage has yet to be modified to reflect the

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[6] Domestic competitive revenue as a percent of total fiscal year revenue, calculated using data from FY2017 RPW; Domestic competitive weight (in pounds) as a percent of total fiscal year weight, calculated using data from FY2017 RPW.

[7] Domestic competitive attributable costs as a percent of total fiscal year costs, calculated using data from the FY2017 Cost Segments and Components Report (USPS-FY17-2).

[8] *See* Responses of the Postal Service to Questions 1-15 of Chairman's Information Request No. 8, Dkt. No. ACR2017 (Jan. 29, 2018) ("Responses to CHIR No. 8"), at Q.5(b) (citing USPS-FY17-39).

[9] 2017 USPS Form 10-K at 12.

[10] *See* UNITED STATES POSTAL SERVICE OFFICE OF INSPECTOR GENERAL, PACKAGE DELIVERY SCANNING - NATIONWIDE, AUDIT REPORT (REPORT NO. DR-AR-18-001) 1 (Oct. 27, 2017).

dramatic shifts in the Postal Service's product mix, and is the same low 5.5% level at which it was set in 2007, long before the Postal Service began to focus heavily on parcel delivery. Yet, rather than acknowledging the need for a reasonable appropriate share requirement that truly reflects how competitive products drive the costs of the enterprise overall, the Postal Service has invited the Commission to dispense with the appropriate share requirement altogether. At the same time, the Postal Service asks the Commission and Congress to raise prices above its statutory limit on market-dominant customers to solve its financial woes.

In these comments, UPS outlines several troubling costing issues that appear to result in inappropriately low cost attribution to competitive products. This docket provides an opportunity for the Commission to put in motion plans to address these issues.

I. THE POSTAL SERVICE'S REPORTED COST ATTRIBUTION RAISES IMPORTANT QUESTIONS ABOUT THE TREATMENT OF COMPETITIVE PRODUCTS

A. Peak Season Operations

The Postal Service largely ignores the extent to which its costs increase during its peak season in December. Every December, the Postal Service ramps up its operations to deliver packages for the holiday season. This predictably results in higher costs across the operation.

For example, comparing December 2016 to April 2016, December involved higher city delivery work hours (41 million v. 35 million), higher city delivery salaries ($1.7 billion v. $1.4 billion), higher shipping and package volumes (673 million pieces v. 418 million pieces), but flat to lower mail volumes (12.272 billion pieces v. 12.315 billion pieces).[11] The Postal Service has stated that it hired 29,000 seasonal workers in 2015, and indicated it would hire up to 40,000 "holiday season" workers in 2016.[12] In 2017, the Wall Street Journal reported that the major parcel companies were "brace[d]" to process a "record" number of packages during the pre-Christmas peak season, with the Postal Service alone expecting to deliver more than 850 million packages during that period.[13] The Postal Service itself has stated, for example, that "to accommodate the surge in volume and to avoid service disruptions during the holiday season" it has increased the use of "Sunday delivery service."[14]

The large number of packages the Postal Service delivers during its peak season, combined with the fact that letter mail volumes remain flat or decline during this season, indicates that much if not all of this seasonal variation in cost is caused by competitive products. It remains unclear, however, how these extra costs arising in the peak season are attributed to products, if at all. Despite acknowledging that it increases Sunday deliveries to accommodate the need to deliver more packages in the holiday season, for example, the Postal Service has now stated in this docket that its "total annual cost for Sunday delivery" is "not available."[15] This suggests that existing costing

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11 *Compare* USPS Preliminary Financial Information for December 2016 (Feb. 9, 2017), at 1-4, *with* USPS Preliminary Financial Information for April 2016 (May 24, 2016), at 1-4. Mail volumes correspond to the "Total Mail" figures reported on page 2 of these reports, and exclude shipping and package volumes as well as international volumes.

12 United States Postal Service, Seasonal Hiring 2016 (Sep. 30, 2016), *available at* http://about.usps.com/news/statements/093016.htm.

13 *See* Paul Ziobro, *Delivery Companies Brace for the Pre-Christmas Crush*, WALL ST. J. (Dec. 17, 2017), https://www.wsj.com/articles/delivery-companies-brace-for-the-pre-christmas-crush-1513515610.

14 *See* 2017 USPS Form 10-K at 20.

15 Responses to CHIR No. 8 at Q.1.

models treat Sunday deliveries during peak season in a generic fashion that does not account for the fact that they are driven largely by the parcel business. Indeed, many Postal Service costing models are based on studies that were conducted during non-peak season periods, with their results extrapolated to draw conclusions about peak season periods.

One problem that prevents the peak season from being addressed adequately is the lack of transparent data. Postal Service data is often produced only on an annual or quarterly basis, making it difficult to evaluate how seasonal variation is handled. UPS respectfully requests that the Commission investigate the seasonal variation of costs, and take appropriate action to ensure that the Postal Service reports the cost segments affected by this seasonal variation on a more granular basis. The Monthly Trial Balance reports prepared by the Postal Service are helpful in understanding seasonal cost trends. UPS believes that product-level volume data should also be produced *at least* on a month-by-month basis. The Postal Service should also ensure that the sample files produced in the Postal Service's ACR filing that are used to form distribution keys and form cost pools (*i.e.*, IOCS, TRACS, CCCS, etc.) should contain date and time stamp information that will support the calculation of monthly distribution keys.[16]

Only by requiring granular cost reporting will the Commission be able to take appropriate steps to ensure that the Postal Service is properly attributing these seasonal cost spikes to the products that are causing them. The Commission should

[16] UPS recognizes that the sampling plans for these systems may not have been developed to support the formation of monthly distribution keys. Nonetheless, this information would be useful and informative in understanding seasonal cost trends.

also open a docket to address the failure of existing costing models to account for the higher costs that occur in peak season.

B. <u>Vehicle Costing</u>

The Postal Service, in its FY2017 Annual Report to Congress, discussed recent investments made in its delivery fleet, stating that postal vehicle inventories had increased to 230,939 units in FY2017 (from 227,896 units in FY2016), and that "[v]ehicle fuel and maintenance expenses for our delivery fleet and information technology services largely accounted for the higher-than-expected" expenses of about $100 million.[17] The Postal Service stated in its 2017 Form 10-K report that it "purchased approximately 9,000 new vehicles to add to our fleet during the year ended September 30, 2017."[18] More than 80% of the 9,000 new vehicles are delivery vehicles.

The Postal Service has repeatedly acknowledged that these delivery vehicles are specifically intended and designed to facilitate the delivery of *packages*.[19] Indeed, most of the vehicles purchased are either 2-Ton Morgan Olson (637 cubic feet capacity) or 1-

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[17] United States Postal Service FY 2017 Annual Report to Congress, Dkt. No. ACR2017 (Dec. 29, 2017), at 10, 23.

[18] 2017 USPS Form 10-K at 4. There are also indications that the Postal Service is forced to keep and maintain older vehicles that should be replaced. For example, Postal Service vehicle maintenance costs increased by 5.6% ($85 million) from FY2016 to FY2017. See USPS-FY16-2 (C/S 12) and USPS-FY17-2 (C/S 12). The Postal Service has said that it is maintaining these older vehicles to ensure it has sufficient capacity to handle peak season. *See* United States Postal Service, MTAC Open Session Presentation (Aug. 22, 2017) at 16-20, *available at* https://postalpro.usps.com/node/4155.

[19] Mike Colgan, *Familiar White Postal Service Trucks Too Small For Increasing Amount Of Parcels Being Mailed*, CBS LOCAL (Jan. 19, 2015), http://sanfrancisco.cbslocal.com/2015/01/19/familiar-white-postal-service-trucks- too-small-for-increasing-amount-of-parcels-being-mailed/; Anne Steele, *Postal Service Seeks to Retire the Old Mail Truck*, WALL ST. J. (Feb. 12, 2015), http://www.wsj.com/articles/postal-service-seeks-to-retire-the-old-mail-truck-1423786375 ("'The Postal Service is experiencing record growth in package delivery, and obtaining vehicles that are designed with the changing mail mix in mind will help improve efficiency of delivery operations,' [Postal Service spokeswoman] Ms. Ninivaggi said.").

Ton Ram Promaster (353 cubic feet capacity).[20] Both dwarf the cargo capacity of the traditional "Grumman LLV" delivery vehicle (121 cubic feet capacity).[21] The greater capacity is needed because the Postal Service is delivering more packages, which are much larger than letters.

Notwithstanding that these new vehicles were purchased with parcel delivery in mind, the depreciation of these new vehicles is treated like that of the existing delivery vehicles—vehicles which were purchased during an era in which the Postal Service was focused on delivering letters.[22] The result is that more than ***62%*** of the depreciation associated with these new vehicles is treated as institutional and only ***13.6%*** of those costs are attributed to competitive products.[23] It also results in market-dominant mailers bearing a disproportionately large share of the costs.

It is difficult to accept that any costing methodology that attributes only 13.6% of these vehicle costs to competitive products is functioning properly. Under the test of the Postal Regulatory Commission, the Postal Service is required to attribute the incremental costs associated with each product and to calculate the incremental costs of competitive products as a whole.[24] Surely, a high proportion of the costs of purchasing new, larger, and more expensive vehicles in order to deliver packages is

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[20] Responses to CHIR No. 8 at Q.4(a).

[21] UNITED STATES POSTAL SERVICE OFFICE OF INSPECTOR GENERAL, DELIVERY VEHICLE FLEET REPLACEMENT, MANAGEMENT ADVISORY REPORT (REPORT NO. DR-MA-14-005-DR) 10 (Jun. 10, 2014).

[22] Responses to CHIR No. 8 at Q.4(b).

[23] *Id*. at Q.4(b).

[24] *See* Order Concerning United Parcel Service, Inc.'s Proposed Changes To Postal Service Costing Methodologies, Dkt. No. RM2016-2 (Sep. 9, 2016) ("Order No. 3506"), at 125; Order Accepting Analytical Principles Used in Periodic Reporting, Dkt. No. RM2010-4 (Jan. 27, 2010) ("Order No. 399").

properly viewed, as an economic matter, as costs that are incremental to the package business. UPS respectfully requests that the Commission review the Postal Service's cost models generating this low level of attribution, initiate a special study of this issue, and/or initiate any other appropriate proceedings. This is especially imperative given the Postal Service's heavy investment in vehicles, especially larger vehicles designed to facilitate the delivery of packages.

C. Special Purpose Routes and Second Runs

The costing associated with special purpose routes ("SPRs") and second runs for regular delivery routes continues to be opaque and flawed. For example, the mix of special purpose route costs continues to shift towards parcel-only routes.[25] Current costing procedures, however, treat all SPR costs identically using a 20-year-old methodology.[26] The Postal Service has acknowledged that these routes are managed locally, and that it does not know how many route days they account for.[27] It has itself acknowledged a need for improvement.[28]

Furthermore, it has become clear that there are additional delivery operations—not classified as special purpose routes—that are focused on parcel delivery and yet are treated as if they were letter route costs. The Postal Service has described, for

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[25] *See* "CS06&7-Public-FY17.xlsx" in USPS-FY17-LR32 and previous ACR dockets. In FY17, Parcel Post routes accounted for 39% of total SPR costs, a sizable increase over the 14% share they represented in FY10; *see also* Chairman's Information Request No. 1, Dkt. No. PI2017-1 (May 31, 2017), at Q.5.

[26] *See* Responses of the United States Postal Service to Chairman's Information Request No. 13, Dkt. No. ACR2016 (February 10, 2017), at Q.6.

[27] *See id*. at Q.1b.

[28] Responses of the United States Postal Service to Chairman's Information Request No. 1, Dkt. No. PI2017-1 (June 30, 2017), at Q.5 ("This is not to suggest that an update or revision of the established methodology would not provide a more accurate representation of current activity proportions").

example, how its carriers increasingly need to perform “second run[s]” to ensure they are able to deliver all of their assigned “parcel” volumes.[29] But the Postal Service has not provided details on how often these second runs occur and how costs generated by these second runs are attributed. In fact, the Postal Service appears unaware of how prevalent second run costs are and apparently lacks a methodology by which to measure them.[30]

To attribute these costs, the Postal Service relies on carriers “clocking” their time to particular codes.[31] UPS has been unable to verify the accuracy of carriers’ clocking behavior based on available data, and, as detailed below, a recent OIG report suggests broader problems concerning the ability of data derived from clocking behavior to accurately assign costs.[32] Even if carriers were clocking their time perfectly, however, the Postal Service has said that the costs of second runs by city carriers to deliver parcels are sometimes “classified as letter route costs.”[33] It is unclear why “second run” costs incurred for the primary purpose of delivering overflow parcels should ever be treated like normal letter route costs, only 6% of which are attributed to parcels.[34]

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[29] *See, e.g.,* Responses of the United States Postal Service to Chairman’s Information Request No. 1, Dkt. No. RM2017-9 (Aug. 9, 2017), at Q.15(a) and Q.15(b).

[30] Responses to CHIR No. 8 at Q.15.

[31] *Id*.

[32] *See* Section II *infra*.

[33] *See, e.g.,* Responses of the United States Postal Service to Chairman’s Information Request No. 1, Dkt. No. RM2017-9 (Aug. 9, 2017), Responses to Q.15(a) and Q.15(b).

[34] As indicated in CS06&7-Public-FY17.xlsx in USPS-FY17-32, 13.89% of letter route costs are assigned to the two cost pools associated with parcel delivery, and less than half of those costs end up getting attributed to products. The end result is that **less than 6%** of second runs to deliver parcels are attributed to parcel products.

There are many open questions about how the Postal Service is modeling these types of runs.[35] UPS respectfully requests the Commission initiate special studies of this issue and/or initiate any other appropriate proceedings to ensure the Postal Service is properly modeling and attributing the costs associated with special purpose routes, "second runs," and other methods of dealing with volume overflow.

D. Equipment Depreciation Costs

Since FY 2015, equipment depreciation costs for the Postal Service's new handheld scanners known as Mobile Delivery Devices ("MDD") have increased dramatically.[36] MDD are handheld scanners that allow postal employees to track package delivery.[37] MDD is the successor to IMD. It provides GPS data and allows for real time tracking of packages.[38] Real time tracking is an essential feature of modern package delivery, offered by all of the Postal Service's competitors and expected by consumers.[39] There is no such consumer expectation that ordinary letter mail will be or need be trackable in real time. The Office of the Inspector General explicitly states that MDD are intended to "help the U.S. Postal Service become the shipper of choice for

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[35] *See* Responses to CHIR No. 8 at Q.15.

[36] *See* Library Reference USPS-FY15-8, Dkt. No. ACR2017 (spreadsheet titled "fy15equip.xls" at Tab PAGE IV-4 ("Depreciation Costs" for "MDD" equal to $"23,273,983"); Library Reference USPS-FY16-8, fy16equip.xls, at tab PAGE IV-4 ("Depreciation Costs" for "MDD" equal to $"56,695,792"); Library Reference USPS-FY17-8 (spreadsheet titled "fy17equip.xls" at Tab PAGE IV-4 ("Depreciation Costs" for "MDD" equal to $"62,320,510"). UPS notes that the depreciation costs for the predecessor scanners known as Intelligent Mail Devices ("IMD") have also increased during the same timeframe. It is not clear why the costs associated with this technology that is in the process of being phased out is still growing.

[37] UNITED STATES POSTAL SERVICE OFFICE OF INSPECTOR GENERAL, PACKAGE DELIVERY SCANNING - NATIONWIDE, AUDIT REPORT (REPORT NO. DR-AR-18-001) 1 (Oct. 27, 2017).

[38] *See id.*

[39] *See*, *e.g.,* UPS Tracking, https://www.ups.com/us/en/services/tracking/information.page; FedEx Tracking, https://www.fedex.com/us/fedextracking/.

more customers."[40] Thus, the depreciation costs for these scanners would be expected to be attributed primarily, if not exclusively, to competitive products.

It appears, however, that the depreciation costs for these categories of equipment are attributed roughly in line with city and rural carrier labor costs.[41] As a result, only ***6%*** of IMD depreciation costs and ***7%*** of MDD depreciation costs are attributed to competitive products.[42] The remainder are either attributed to market-dominant products or are classified as institutional costs, which are mostly borne by market-dominant products. This low level of cost attribution does not make sense given the Postal Service's own statements to the effect that these devices were purchased with parcel delivery in mind.[43] UPS respectfully requests that the Commission initiate a special study of this issue, and/or initiate any other appropriate proceedings to assure that the Postal Service is attributing these costs correctly.

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[40] UNITED STATES POSTAL SERVICE OFFICE OF INSPECTOR GENERAL, MOBILE DELIVERY DEVICE DEPLOYMENT AND FUNCTIONALITY, AUDIT REPORT (REPORT NO. MI-AR-15-005) 4 (Jul. 8, 2015).

[41] *See* Library Reference USPS-FY17-31, Dkt. No. ACR2017 (spreadsheet within cost files folder titled "FY17Public.A.xlsx" at Tab CS98.2 at Column AA, Row 63 (formula for "MDD" "Total Domestic Competitive Costs" incorporating distribution keys from "CS6," City Carrier Labor, and "CS10," Rural Carrier Labor).

[42] The total reported domestic competitive costs for MDD is $1,705,074, which is approximately 7% of the total reported costs for MDD, $23,087,444. *See* Library Reference USPS-FY17-31 (spreadsheet within cost files folder titled "FY17Public.A.xlsx" at Tab CS98.2 at Column AA, Row 63 ("Total Domestic Competitive Costs" for "MDD" equal to $"1,705,074"); *id.* at Column AA, Row 69 ("Total Costs" for "MDD" equal to $"23087444").

[43] UNITED STATES POSTAL SERVICE OFFICE OF INSPECTOR GENERAL, PACKAGE DELIVERY SCANNING - NATIONWIDE, AUDIT REPORT (REPORT NO. DR-AR-18-001) 1 (Oct. 27, 2017).

E. New Enhancements & Offerings

The Postal Service continues to experiment with alternative delivery approaches, including parcel lockers.[44] The Postal Service also plans to expand its two-hour delivery service.[45]

It is not clear how the Postal Service has handled or will handle attributing the costs associated with these alternative services. But since these services are apparently being utilized to handle ever-increasing volumes of parcels, they are incremental to competitive products and should be paid for by competitive products. UPS respectfully requests that the Commission closely monitor how the Postal Service attributes costs for these services.

F. Competitive Products Fund

The Postal Service is required to report the "assets and liabilities of the theoretical competitive products enterprise[.]"[46] Yet the Postal Service has only reported three "Micro Computer System[s]" and one "Shredder" as property and equipment assets of the competitive products enterprise, costing a total of $54,761.92.[47] Moreover, the Postal Service has indicated the total "[n]et [b]ook [v]alue" of these assets is only $1,194.04 after "[a]ccumulated [d]epreciation[.]"[48] This statement of property and

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44 Responses of the United States Postal Service to Questions 1-7 of Chairman's Information Request No. 1, PI2017-1 (Jun. 30, 2017), at Q.1.

45 *USPS Expands Test of New Feature – Expected Delivery Time*, POSTAL TIMES (Nov. 29, 2017), https://www.postaltimes.com/postalnews/usps-expands-test-of-new-feature-expected-delivery-time/.

46 *See* 39 C.F.R. § 3060.14.

47 *See* Library Reference USPS-FY17-13, Dkt. No. ACR2017 (spreadsheet titled "FY17-CP03.xlsx").

48 *Id.*

equipment assets for the entire competitive product enterprise, an enterprise with a revenue of "20.691 billion in FY2017[,]"[49] strains credibility.

This accounting is to a large degree a consequence of the Postal Service's narrow view of cost causation. In its Competitive Products Fund Reporting Materials, the Postal Service defines a financial obligation or investment for competitive products to include only those activities where "the activity in question would need to relate solely to the provision of a single competitive product, or solely to the provision of multiple competitive products."[50] This narrow definition of cost causation leads the Postal Service to omit many assets that would not exist but-for competitive products. For instance, the Postal Service continues to purchase and integrate the Small Package Sorter System in downstream operations in order to automate more and more package handling.[51] Similarly, the Postal Service has recently purchased 150 dimensional scanning devices to detect short paid parcels.[52] Yet under the current approach, these examples, as well as several others, are not considered to be assets of the competitive products enterprise.[53]

UPS respectfully requests that the Commission initiate a special study of this issue, and/or initiate any other appropriate proceedings to assure that the Postal

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[49] Library Reference USPS-FY17-13, Dkt. No. ACR2017 (Dec. 29, 2017), USPS.FY17.39.Preface.CPF.Report.pdf at 7 (The Postal Service's Annual Report to the Secretary of the Treasury Regarding the Competitive Products Fund For Fiscal Year 2017).

[50] Responses to CHIR No. 8 at Q.5.

[51] FY2017 ACR at 27.

[52] United States Postal Service, MTAC Open Session Presentation (Aug. 22, 2017) at 16-20, *available at* https://postalpro.usps.com/node/4155.

[53] *See* Library Reference USPS-FY17-13, Dkt. No. ACR2017 (spreadsheet titled "FY17-CP03.xlsx").

Service properly reports the assets of the competitive products enterprise as required by 39 C.F.R. § 3060.14. UPS also notes this same narrow view of cost causation infects the Postal Service cost attribution framework, and has similar consequences, which should likewise be investigated.

II. OIG REPORTS RAISE QUESTIONS ABOUT POSTAL COSTING PRACTICES

Two reports by the Office of Inspector General ("OIG") raise additional questions about Postal Service costing practices.

First, in its report titled "Inbound ePackets Cost Attribution," the OIG reported that the Postal Service "did not capture or attribute the costs associated with returning undeliverable inbound ePackages to the product."[54] As a result, this "inaccurate cost attribution understates the product costs of inbound ePackets and overstates the product costs of outbound international packets between \$1.02 and \$1.13 per returned mailpiece, depending on the destinating country."[55]

Second, in its report titled "Delivery Charge Codes," the OIG reported that Postal Service delivery personnel "did not consistently charge Sunday delivery time to appropriate MODS operation numbers, which resulted in hours being associate with incorrect LDCs," and that between February and June 2017, the OIG "found personnel inappropriately charged about 67,165 hours (3 percent) of the total universe of Sunday delivery workhours to LDCs other than the Sunday delivery LDC."[56] Further, the OIG reports that "of the total 13,053 workhours logged by the 160 sampled delivery

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[54] UNITED STATES POSTAL SERVICE OFFICE OF INSPECTOR GENERAL, INBOUND EPACKETS COST ATTRIBUTION, AUDIT REPORT (REPORT NO. CP-AR-18-003) 1 (Jan. 23, 2018).

[55] *Id.*

[56] UNITED STATES POSTAL SERVICE OFFICE OF INSPECTOR GENERAL, DELIVERY CHARGE CODES, AUDIT REPORT (REPORT NO. CP-AR-18-002) 1 (Jan. 19, 2018).

personnel, supervisors changed or moved 2,578 (20%) of the hours between different MODS operations without documented justification."[57] If this same ratio applies nationally, millions of work hours may be improperly entered without apparent documented justification,[58] raising questions about whether the Postal Service has procedures in place to track this activity or to know the root cause of these changes. In the absence of such procedures, the Postal Service risks relying upon inaccurate data in its ACR submissions.

As noted, in its responses to the Commission's Information Request No. 8, the Postal Service has stated that the "total annual cost for Sunday delivery is currently not available," making it impossible to calculate shares attributable to competitive products or negotiated service agreements.[59] The Postal Service's inability to provide aggregated information on such key costs illustrates a lack of transparency that should be remedied.

III. IMPORTANT POSTAL SERVICE COSTING ISSUES RAISED IN PRIOR DOCKETS REMAIN UNRESOLVED

In addition, two costing issues from past dockets remain unresolved. Each of these outstanding issues continues to warrant the Commission's attention.

A. <u>Order No. 2792</u>

There is still one long outstanding issue from Docket RM2015-7, which dealt with City Carrier Street Time. Although the Commission did not adopt UPS's proposal to

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[57] *Id*.

[58] The Postal Service reported over 428 million city delivery workhours in FY2017. See USPS Financial Information, Sep. 2017 (unaudited) *available at* https://www.prc.gov/docs/102/102488/2017.11.14 September 2017 Monthly Financial Report to the PRC.pdf. 20% of 428 million is roughly 85 million city delivery workhours.

[59] Responses to CHIR No. 8 at Q.1(a).

implement a single equation to model city carrier letter route street time costs, the Commission nonetheless found that UPS's alternative "warrant[ed] further consideration."[60] The Commission noted that "even the Postal Service's expert observes UPS's approach has benefits and challenges[.]"[61] The Commission thus directed the Postal Service to determine whether a single equation city carrier letter route cost model for street time could produce improved variability estimates.[62]

In mid-2017, the Commission opened Docket No. PI2017-1 to "ascertain the Postal Service's progress in its ongoing efforts to update its city carrier cost models and data collection capabilities in accordance with Commission Order No. 2792,"[63] as well as to "review the SPR cost model for street time."[64] In response, the Postal Service filed a status report on its research into a single equation model in August 2017, raising various data quality concerns and suggesting that the model would suffer from multicollinearity issues.[65]

UPS noted that a single equation model would still be an improvement over Proposal Thirteen, and that none of the Postal Service's difficulties were

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[60] Order Approving Analytical Principles Used in Periodic Reporting (Proposal Thirteen), Dkt. No. RM2015-7 (Oct. 29, 2015) ("Order No. 2792"), at 2.

[61] *Id*. at 64.

[62] *Id*. at 65.

[63] Notice and Order Establishing Docket Concerning City Carrier Special Purpose and Letter Route Costs and to Seek Public Comment, Dkt. No. PI2017-1 (May 31, 2017), at 1.

[64] *Id*. at 3.

[65] Report on Research Into the Ability of a Top-Down Model to Accurately Estimate City Carrier Street Time Variabilities Dkt. No. PI2017-1 (Aug. 18, 2017), at 38-39.

insurmountable.[66] UPS urged the Commission to direct the Postal Service to investigate various alterations to its prototype single equation models.[67] As no decision has yet been issued yet, UPS respectfully reiterates that the Commission should direct the Postal Service to investigate UPS's alternative model, with any necessary modifications. The Commission may also consider convening a technical conference to consider the availability and quality of Postal Service data for use in the proposed top-down model.

B. Proposal Four

There is also one outstanding issue arising out of Docket RM2017-8, which considered a proposal to use Form 3999 data to annually update the estimated proportion of time on city carrier routes spent delivering parcels. UPS supported the proposal, but noted that the Postal Service did not account for seasonal bias in Form 3999 route evaluations.[68] The Commission has acknowledged that Form 3999 evaluations are rare in December compared to the spring months.[69] City Carrier time spent on parcels is significantly greater as a proportion of all time in December than the

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[66] Comments of United Parcel Service, Inc. on Notice and Order Establishing Docket Concerning City Carrier Special Purpose and Letter Route Costs and to Seek Public Comment, Dkt. No. PI2017-1 (Sep. 15, 2017), at 7-8.

[67] *Id*. at 18.

[68] Comments of United Parcel Service, Inc. on Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Four), Dkt. No. RM2017-8 (Aug. 9, 2017), at 1-2.

[69] Order on Analytical Principles Used in Periodic Reporting (Proposal Four), Dkt. No. RM2017-8 (Dec. 1, 2017), at 18-19. *See also* 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 Q9—Table 6 indicates that 1,834, or 1.3%, of the 139,548 Form 3999 evaluations that should have been included in cost pool proportion calculations for ACR2016 were conducted in December. In contrast, 18,252 such evaluations—nearly ten times as many—were conducted in May. April and June are also similarly over-represented.

rest of the year due to the holiday gift-giving season. Since Proposal Four did not account for this seasonal bias, it underestimates the time proportions that are allocated to parcels.[70] Based on UPS calculations using publicly available data, this resulted in under-costing of competitive products by about $20 million in FY17.[71]

After hearing responses from both the Postal Service and UPS on this issue, the Commission issued an order adopting Proposal Four without modifications, but recognizing that the Postal Service's explanations "do not resolve the concern that Form 3999 data may not accurately or sufficiently reflect letter route parcel volume increases in the DPA ratio due to the low number of Form 3999 evaluations conducted in December."[72] As such, UPS still considers this to be an open issue and encourages the Commission to consider ways that Proposal Four might be improved.

CONCLUSION

UPS respectfully requests that the Commission initiate proceedings to investigate the Postal Service's costing models, including their treatment of seasonal costs and

[70] Comments of United Parcel Service, Inc. on Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Four), Dkt. No. RM2017-8 (Aug. 9, 2017), at 3-5.

[71] Using updated Form 3999 data produced in ACR2017, seasonality-adjusted street time proportions are calculated using either monthly letter route costs (as a share of annual letter route costs) or monthly delivery days (as a share of annual delivery days) as the basis for this adjustment. *See* Comments of United Parcel Service on Notice of Proposed Rulemaking on Analytical Principles Used In Periodic Reporting (Proposal Four), Dkt. No. RM2017-8 (Aug. 9, 2017) at 6-7 (description of the approach). These adjusted street time proportions are then applied to the existing City Carrier costing model (spreadsheet titled "CS06&7-Public-FY17.xlsx," in USPS-FY17-32). The impact of the proposed seasonality correction is the difference between the costs attributable to competitive products as calculated with the seasonal adjustment to street time proportions and the unadjusted costs attributable to competitive products as reported in ACR 2017, after taking into account a similar adjustment to the base year (FY14). Calculations are available upon request.

[72] Order on Analytical Principles Used in Periodic Reporting (Proposal Four), Dkt. No. RM2017-8 (Dec. 1, 2017), at 17.

special purpose routes. UPS further requests that the Commission convene appropriate proceedings to resolve the issues discussed above relating to Order No. 2792 and Proposal Four. UPS welcomes any guidance from the Commission on how best to address any of the issued discussed above.

Respectfully submitted,

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