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BEFORE THE
POSTAL REGULATORY COMMISSION

Annual Compliance Report 2018	:	**Docket No. ACR2018**

INITIAL COMMENTS OF UNITED PARCEL SERVICE, INC. ON UNITED STATES POSTAL SERVICE'S ANNUAL COMPLIANCE REPORT FOR FISCAL YEAR 2018
(February 19, 2019)

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") 2018.[1]

The 2018 ACR confirms the profound 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" while "[c]ompetitive product volumes and revenues continue[] to grow[.]"[2] As mail volumes continue to decline year after year, 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 dedicated to delivering parcels in competitive markets. Over the past three years, the Postal Service has continued to invest heavily in package-sorting equipment, new vehicles, and handheld scanners—all

[1] In Order No. 4998, the Commission extended the deadline for UPS and the Association for Postal Commerce to file their initial comments to February 19, 2019. Order Granting Motions for Access, Dkt. No. ACR2018 (February 8, 2018) at 29 ("Order 4998").

[2] United States Postal Service FY 2018 Annual Compliance Report, Dkt. No. ACR2018 (Dec. 28, 2018) ("FY2018 ACR"), at 1.

specifically intended for use in processing, delivering, and tracking packages. Indeed, the Postal Service expects its revenue growth in FY2019 to be "driven primarily by package volume growth, coupled with strategic price increases on packages."[3] It has invested in an "Enhanced Package Processing System" from Lockheed Martin to address its growing parcel volume.[4] It has increased its use of both "special purpose routes" and under-documented, poorly-understood "second runs" to deliver parcels.[5] And it has stated that it deploys special "package carriers" to delivery points around Manhattan.[6]

The cost methodologies that underlie the Postal Service's ACR for FY2018, however, do not reflect this dramatic shift in the Postal Service's focus. Instead, for cost attribution purposes, 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 is today a primary driver of the enterprise's overall operations. In FY2018, as in years past, UPS has identified numerous, specific deficiencies in the

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[3] Integrated Financial Plan, United States Parcel Service (FY2019) at 1, *available at* https://about.usps.com/who-we-are/financials/integrated-financial-plans/fy2019.pdf.

[4] *See* Lockheed Books $215M Postal Service Sorting Tech Contract, Washington Technology (Nov. 7, 2017), *available at* https://washingtontechnology.com/articles/2017/11/07/lockheed-postal-contract.aspx.

[5] Library Reference USPS-FY18-9, Dkt. No. ACR2018 (Dec. 28, 2018), at 118 (stating that SPR carriers "primarily deliver parcels and perform collection runs in large metropolitan areas").

[6] *See* NYC Postal Carriers Locked Our of Buildings, Unable to Deliver Packages, NBC New York (Nov. 17, 2017), *available at* https://www.nbcnewyork.com/news/local/USPS-Cant-Deliver-Packages-Pile-Up-Post-Offices-NYC-No-Building-Access-458310763.html.

Postal Service's costing methodologies,[7] which the Postal Service has consistently defended as the best it can do in light of purported limitations in the data it collects.

The resulting levels of cost attribution do not hold up. Although Postal Service executives have repeatedly acknowledged that delivering competitive products is a top priority for the organization, and although these products now make up ***45%*** of what the Postal Service delivers in volume by weight,[8] the Postal Service continues to attribute a very low level of its costs to competitive products. In FY2018, for example, the Postal Service attributed just ***18%*** of its costs to competitive products.[9] As reported in the ACR, the Postal Service identified only $4.1 million in competitive products property and equipment assets that related to the "competitive products enterprise,"[10] out of about ***$15 billion*** in total property and equipment assets, a mere 0.09%.[11] Similarly, ACR data indicates the Postal Service is attributing to competitive products ***only 8%*** of the depreciation costs associated with its new handheld scanners, even though these

[7] *See, e.g.,* Comments of United Parcel Service, Inc., Dkt. No. RM2018-6 (June 29, 2018) (regarding the way the Postal Service calculates incremental costs for competitive products); Comments of United Parcel Service, Inc., Dkt. No. IM2018-1 (July 3, 2018) (regarding the Universal Postal Union's Terminal Dues system); Comments of United Parcel Service, Inc., Dkt. No. RM2018-8 (August 29, 2018) (regarding irregularities in the costing of inbound letter post products).

[8] *See* Library Reference USPS-FY18-42, Dkt. No. ACR2018 (Dec. 28, 2018) (competitive weight (in pounds) as a percent of total fiscal year 2018 weight).

[9] *See* Library Reference USPS-FY18-2, Dkt. No. ACR2018 (Dec. 28, 2018) (calculating domestic competitive attributable costs as a percent of total fiscal year costs).

[10] *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 ACR2017 CHIR No. 8"), at Response No. 5(b) (citing USPS-FY17-39); *see also* Library Reference USPS-FY18-39, Dkt. No. ACR2018 (spreadsheet titled "FY18-CP03.xlsx").

[11] 2018 USPS Form 10-K at 16.

scanners were purchased for the very purpose of tracking package deliveries.[12] Illogical disconnects like these can be found in many of the Postal Service's cost pools.

The conclusion is unavoidable that many costs driven by competitive products are simply 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 "appropriate share" of institutional costs that must be covered by competitive revenues was recently adjusted, but remains untethered to the growing prominence of the competitive products business. According to the Commission's recently finalized formula, the Appropriate Share for FY2018 would be 8.6%.[13] As a result, the Appropriate Share requirement remains so low as to be effectively meaningless. At the same time, the Postal Service has asked 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.

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[12] *See infra* at 14-15; UNITED STATES POSTAL SERVICE OFFICE OF INSPECTOR GENERAL, PACKAGE DELIVERY SCANNING - NATIONWIDE, AUDIT REPORT (REPORT NO. DR-AR-18-001) 1 (Oct. 27, 2017).

[13] *See* Order Adopting Final Rules Relating To The Institutional Cost Contribution Requirement For Competitive Products, Dkt. No. RM2017-1 (Jan. 3, 2019) ("Order No. 4963) at 28.

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. Nonetheless, only a small fraction of these seasonal package costs are attributed to competitive products.

Comparing December 2017 to April 2018, December involved higher city delivery work hours (40 million v. 35 million), higher city delivery salaries ($1.7 billion v. $1.5 billion), higher shipping and package volumes (692 million pieces v. 479 million pieces)—but flat mail volumes (11.706 billion pieces v. 11.326 billion pieces).[14] On February 8, 2019, the Postal Service reported that it had delivered "955 million packages between Thanksgiving and New Year's Day" this holiday season.[15] The Postal Service has confirmed that it hired "43,684" peak season workers in FY2018, and "54,366 Additional Supplemental Workforce Hires . . . as part of peak preparation in FY2019."[16] The Postal Service has also stated that "to accommodate the surge in volume and to avoid service

[14] *Compare* USPS Preliminary Financial Information for December 2017 (Feb. 9, 2018), at 1-4, *with* USPS Preliminary Financial Information for April 2018 (May 24, 2018), 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.).

[15] Remarks of Postmaster General Brennan, United States Postal Service Board of Governors Open Session (February 8, 2019) at timestamp 12:50, *available at* https://about.usps.com/who/leadership/board-governors/briefings?video=bgs190208.

[16] Responses of the United States Postal Service to Questions 1-12 of Chairman's Information Request No. 5, Dkt. No. ACR2018 (February 5, 2019) ("Responses to ACR2018 CHIR No. 5") at Response No. 5(d), (e).

disruptions during the holiday season" it increases the use of "Sunday delivery service."[17]

During peak season, the Postal Service also makes use of "peak annexes," which the Postal Service describes as "short-term leased facilities used to sort and stage increased season volume."[18] The Postal Service operated 67 such annexes in FY2018.[19] It remains unclear how the costs associated with these peak annexes are attributed, but the Postal Service has stated that only one-third of the costs associated with these peak annexes are attributed to competitive products.[20] Such a low level of attribution to competitive products is plainly irrational given that—as highlighted above—it is only seasonal *package* volume that required the Postal Service to set up these peak annexes.

The large number of packages the Postal Service delivers during its peak season, combined with the fact that letter mail volumes remain flat during this period, indicates that most 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.[21] Indeed, many Postal Service costing

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[17] *See* 2017 USPS Form 10-K at 20; *see also* Postal Service is Ready to Deliver Nearly 16 Billion Pieces of Cheer This Holiday Season, U.S. Postal Serv. (Nov. 13, 2018), *available at* https://about.usps.com/news/national-releases/2018/pr18_092.htm ("[T]he Postal Service is expanding its Sunday delivery operations to locations with high package volumes beginning Nov. 25. The Postal Service already delivers packages on Sundays in most major cities, and anticipates delivering more than 8 million packages on Sundays this December.").

[18] Responses to ACR2018 CHIR No. 5 at Response No. 4(a).

[19] *Id.* at Response No. 4(b).

[20] *Id.* at Response No. 4(d) - (f).

[21] For example, regarding peak season workforce costs, the Postal Service has stated only that "[t]he labor costs associated with supplemental workforce hires for the purpose of peak preparation are captured in the general ledger and are attributed and distributed to products in

models are based on studies that were conducted during non-peak season periods, with their results extrapolated to draw conclusions about peak season periods.

A principal problem that prevents peak season costing from being addressed adequately is the lack of transparency. Postal Service data is often produced only on an annual or quarterly basis, making it difficult to evaluate how much seasonal variation in cost occurs, or how it 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, and should be expanded to report additional information. UPS believes that product-level volume data should also be produced 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.) contain date and time stamp information that will support the calculation of monthly distribution keys.[22]

Even given the limited seasonal costing data available, it is clear that market dominant customers are being burdened with a disproportionate share of peak-season costs. For cost-attribution purposes, it appears that the Postal Service treats peak-

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accordance with the established costing methods." Responses to ACR2018 CHIR No. 5 at Response No. 5(g).

[22] 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.

season costs as though they occurred under ordinary conditions.[23] As long as the Postal Service attributes seasonal costs according to variability assumptions and distribution keys developed during “normal” non-peak season operations, these costs will never be properly attributed. UPS urges the Commission to order the development of peak-season distribution keys to accurately attribute peak season costs to products.

The methodology for allocating SPR vehicle costs now acknowledges that peak season operations partially drive that portion of vehicle costs. UPS applauds the Postal Service for this first step. The Postal Service and the Commission should continue to explore the extent to which peak season operations drive the costs in other vehicle cost pools as well. This fix is only partial, however, as the cost attribution methodologies for special purpose routes are outdated (as will be discussed below), and current methodology does not account for differences in the mail mix during peak season.

B. Vehicle Costing

The Postal Service, in its FY2018 Annual Report to Congress, discussed recent investments made in its delivery fleet, stating that postal delivery vehicle inventories had increased to 208,133 units in FY2018 (from 205,997 units in FY2017 and 189,750 in FY14).[24] The Postal Service stated in its 2018 Form 10-K report that it “purchased approximately 8,000 new vehicles to add to our fleet during the year ended September

[23] *See, e.g.,* Responses to ACR2018 CHIR No. 5 at Response No. 5(g).

[24] United States Postal Service FY 2018 Annual Report to Congress at 12, *available at* https://about.usps.com/who-we-are/financials/annual-reports/fy2018.pdf; United States Postal Service FY 2015 Annual Report to Congress at 49, *available at* https://about.usps.com/who-we-are/financials/annual-reports/fy2015.pdf.

30, 2018."[25] All 8,000 of these new vehicles are Ram Promaster delivery vehicles, which have roughly three times the capacity of the standard delivery vehicle, a feature that is clearly driven by the Postal Service's package business.[26]

Notwithstanding that these new vehicles were purchased to support parcel delivery, the costs associated with these new vehicles are treated like the costs of existing delivery vehicles—vehicles which were purchased during an era in which the Postal Service was focused on delivering letters.[27] In 2018, the existing methodology that attributes very small shares of the relevant costs—8.9% of motor vehicle service ("MVS") personnel costs, 9.0% of MVS supplies and materials costs, and 17.1% of vehicle depreciation costs—to competitive products.[28]

A significant portion of the apparent under-attribution of vehicle costs to competitive products stems from the Commission's decision in RM2016-3, when it

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[25] 2018 USPS Form 10-K at 43. 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 6.6% ($107 million) from FY2017 to FY2018. See USPS-FY17-2 (C/S 12) and USPS-FY18-2 (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.

[26] *See* Responses to ACR2018 CHIR No. 5 at Response No.12(a). The Ram ProMasters that were purchased have a cargo capacity of 353 cubic feet; the cargo capacity of the Grumman vehicles are 121 cubic feet.

[27] *See* Responses to ACR2018 CHIR No. 5 at Response No. 12(b); Responses to ACR2017 CHIR No. 8 at Response No. 4(b).

[28] The numbers presented are the competitive product share of the combined city delivery and rural delivery costs in segments 12.1 (12.1.1 + 12.1.6), 12.2 (12.2.1 + 12.2.3), and 20.2 (20.2.1 + 20.2.3), respectively. The precise attribution for new delivery vehicles may differ slightly from that of the delivery fleet as a whole, depending on whether the new vehicles are used differently than existing vehicles (in terms of the relative distribution across city carrier letter routes, city carrier special purpose routes, and rural carrier routes. However, unlike last year, the Postal Service declined to provide detail on how new vehicle costs were attributed this year. *Compare* Responses to ACR2018 CHIR No. 5 at Response No. 12(b) *with* Responses to ACR2017 CHIR No. 8 at Response No. 4(b).

approved a petition by the Postal Service to treat and attribute the vehicle costs associated with delivery in the same way the recently adopted city carrier model treats and attributes labor costs. This is problematic because while vehicle costs are driven by cubic footage, labor costs are driven by piece counts. The Postal Service has made many statements outside of Commission proceedings that concede that their vehicle investment decisions are being driven by the need to accommodate a higher cube mail stream.[29] These statements are inconsistent with current costing procedures. UPS maintains that the Commission's ruling in RM2016-3 was in error, and the error has only become clearer over time. UPS respectfully urges the Commission to revisit it this fiscal year.

It is difficult to accept any costing methodology that attributes such small shares of the Postal Service's delivery vehicle costs to competitive. Under the Commission's test, 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.[30] Surely, a much higher proportion of the costs of purchasing new, larger, and more expensive vehicles in order to deliver packages is properly viewed, as an

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[29] *See, e.g.,* 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.").

[30] *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").

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. Such action is especially urgent given the Postal Service's imminent investment in larger vehicles designed to facilitate the delivery of packages.[31]

C. <u>Special Purpose Routes and Second Runs</u>

The costing practices associated with special purpose routes ("SPRs") and second runs for regular delivery routes remains opaque and flawed. For example, the mix of special purpose route costs continues to shift towards parcel-only routes.[32] Current costing procedures, however, treat the overwhelming majority of SPR street costs identically—whether they are caused by parcel routes, collection routes, or combination routes—using a 20-year-old methodology.[33] The Postal Service has acknowledged that these routes are managed locally, and that it does not know how

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[31] *See* U.S. Postal Service Projected Capital Spending and Processes for Addressing Uncertainties and Risks, U.S. Government Accountability Office (June 2018) at 11 ("In its latest projection of capital spending, covering fiscal years 2018 through 2028, USPS projects an annual average of roughly $821 million on capital spending for vehicles, primarily driven by a multi-year acquisition of new delivery vehicles starting in fiscal year 2019. . . . USPS is considering taller vehicles that will better allow carriers to handle trays of mail and packages. "), *available at* https://www.gao.gov/assets/700/692859.pdf.

[32] *See* Library Reference USPS-FY18-32, Dkt. No. ACR2018 (Dec. 28, 2018) at CS06&7-Public-FY18.xlsx (In FY18, Parcel Post routes accounted for 28% of total SPR costs (47% including Sunday Delivery costs, which are fully attributable to Parcel Select according to Dkt. No. RM2018-5.), 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 Response No. 5.

[33] *See* Responses of the United States Postal Service to Chairman's Information Request No. 13, Dkt. No. ACR2016 (February 10, 2017), at Response No. 6. Roughly 19% of SPR costs are, for the time being, treated as 100% attributable to Parcel Select. *See* Order Approving In Part Proposal Two, Dkt. No. RM2018-5 (January 8, 2019) ("Order 4972").

many route days they account for.[34] The Postal Service has itself acknowledged a need for improvement in how it treats these routes.[35] This year it has further acknowledged that it does not maintain *any* data regarding the time or costs associated with second runs.[36]

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 example, how its carriers increasingly need to perform "second run[s]" to ensure they are able to deliver all of their assigned "parcel" volumes.[37] 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 lacks a methodology by which to measure them.[38]

To attribute these costs, the Postal Service relies on carriers "clocking" their time to particular codes.[39] 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

[34] *See id*. at Response No. 1b.

[35] Responses of the United States Postal Service to Chairman's Information Request No. 1, Dkt. No. PI2017-1 (June 30, 2017), at Response No. 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").

[36] Responses to ACR2018 CHIR No. 5 at Response No. 8.

[37] *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 Response No.15(a), (b).

[38] Responses to ACR2017 CHIR No. 8 at Response No. 15.

[39] *Id*.

accurately assign costs.[40] Even if carriers were clocking their time perfectly, however, the Postal Service has admitted that the costs of second runs by city carriers to deliver parcels are sometimes “classified as letter route costs.”[41] 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.[42]

There are many open questions about how the Postal Service is modeling these types of runs.[43] 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.[44] MDD are handheld scanners that allow postal employees to track

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

[41] *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 Response No.15(a), (b).

[42] *See* USPS-FY18-32, Dkt. No. ACR2018 (December 28, 2018) at CS06&7-Public-FY18.xlsx.

[43] *See* Responses to ACR2017 CHIR No. 8 at Response No. 15.

[44] *See* Library Reference USPS-FY15-8, Dkt. No. ACR2015 (spreadsheet titled “fy15equip.xls” at Tab PAGE IV-4, which shows “Depreciation Costs” for “MDD” equal to $“23,273,983”); Library Reference USPS-FY16-8, Dkt. No. ACR2016, (spreadsheet titled “fy16equip.xls“ at tab PAGE IV-4, which shows “Depreciation Costs” for “MDD” equal to $“56,695,792”); Library Reference USPS-FY17-8, Dkt. No. ACR2017 (spreadsheet titled “fy17equip.xls” at Tab PAGE IV-4, which shows “Depreciation Costs” for “MDD” equal to $“62,320,510”); Library Reference USPS-FY18-8 (spreadsheet titled “fy18equip.xls” at Tab “Depre. Costs (Equip. Group)”, which shows“ Depreciation Costs” for “MDD” equal to $“63,083,747”). UPS notes that the depreciation costs for the predecessor scanners known as Intelligent Mail Devices (“IMD”) have also increased during the same timeframe.

package delivery.[45] MDD is the successor to IMD. It provides GPS data and allows for real time tracking of packages.[46] Real time tracking is an essential feature of modern package delivery that is offered by all of the Postal Service's competitors and expected by consumers.[47] There is no such consumer expectation that ordinary letter mail will be or will need to 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 more customers."[48] Thus, the depreciation costs for these scanners would be expected to be attributed primarily, if not exclusively, to the packages that the Postal Service ships.

It appears, however, that the depreciation costs for these categories of equipment are attributed roughly in line with city and rural carrier labor costs.[49] As a result, only ***8%*** of IMD depreciation costs and ***9%*** of MDD depreciation costs are attributed to competitive products.[50] The remainder is either attributed to market-dominant products or is classified as institutional costs, which are mostly borne by

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45 United States Postal Service Office of Inspector General, Package Delivery Scanning - Nationwide, Audit Report (Report No. DR-AR-18-001) 1 (Oct. 27, 2017).

46 *See id.*

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

48 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).

49 *See* Library Reference USPS-FY18-31, Dkt. No. ACR2018 (spreadsheet within cost files folder titled "FY18Public.A.xlsx" at Tabs CS06, CS07, CS98.2 at Columns Z and AA, Row 62 (formula for "Carrier Scanners" and "MDD" "Total Domestic Competitive Costs" incorporating distribution keys from "CS6," City Carrier Labor, and "CS10," Rural Carrier Labor).

50 See *id.* The total reported domestic competitive costs for MDD is $2,152,605, which is approximately 9% of the total reported costs for MDD, $23,981,096. *See* Library Reference USPS-FY18-31, Dkt. No. ACR2018 (Dec. 28, 2018) (spreadsheet within cost files folder titled "FY18Public.A.xlsx" at Tab CS98.2 at Column AA, Row 62).

market-dominant products. This low level of competitive product cost attribution does not make sense given the Postal Service's own statements to the effect that these devices were purchased to support parcel delivery.[51] 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.

E. New Enhancements & Offerings

The Postal Service continues to experiment with alternative delivery approaches, including parcel lockers.[52] The Postal Service appears to attribute the labor costs associated with delivering packages to parcel lockers according to its ordinary distribution keys for city and rural carriers.[53] The purchase, installation, and maintenance costs associated with parcel lockers are nonsensically treated as institutional costs, and not attributed to any products.[54] The Commission should immediately require the Postal Service to attribute all costs associated with parcel lockers to competitive products, as these costs are plainly incremental to competitive products.

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

[52] Responses to ACR2018 CHIR No. 5 at Response No. 6 (stating that the Postal Service installed 5,529 parcel lockers in FY2018); Responses of the United States Postal Service to Questions 1-7 of Chairman's Information Request No. 1, PI2017-1 (Jun. 30, 2017), at Response No. 1.

[53] Responses to ACR2018 CHIR No. 5 at Response No. 6(b).

[54] *Id.*

The Postal Service also plans to expand its two-hour delivery service.[55] It is not clear how the Postal Service has handled or will handle the attribution of the costs associated with this alternative service. But since the Postal Service also appears to be developing this service to handle ever-increasing volumes of parcels, all associated costs 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[.]"[56] Yet the Postal Service has only identified a handful of assets as property and equipment assets costing a mere $4.1 million as part of the competitive products enterprise.[57] Moreover, the Postal Service has indicated the total "[n]et [b]ook [v]alue" of these assets is only $1.8 million after "[a]ccumulated [d]epreciation[.]"[58] This statement of property and equipment assets for the entire competitive product enterprise, an enterprise with a revenue of 23.064 billion in FY2018[59] strains credibility.

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[55] *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/.

[56] *See* 39 C.F.R. § 3060.14.

[57] *See* Library Reference USPS-FY18-39, Dkt. No. ACR2018 (Dec. 28, 2018) (spreadsheet titled "FY18-CP03.xlsx").

[58] *Id.*

[59] Library Reference USPS-FY18-39, Dkt. No. ACR2018 (Dec. 28, 2018), USPS-FY18-39.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).

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."[60] 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.[61] Similarly, the Postal Service has purchased 150 dimensional scanning devices to detect short paid parcels.[62] Although these investments are clearly related to parcel handling, under the current approach, these are not considered to be assets of the competitive products enterprise.

While the Postal Service's accounting of assets of the competitive product enterprise has grown substantially from FY17 to FY18, the criticisms above still hold. 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 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

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[60] Responses to ACR2017 CHIR No. 8 at Response No. 5.

[61] FY2017 ACR at 27.

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

Postal Service cost attribution framework, and has similar consequences, which should likewise be investigated.

II. CERTAIN INTERNATIONAL COMPETITIVE DATA SHOULD BE PUBLICALLY DISCLOSED

In Order No. 4836, the Commission ordered the Postal Service to report "revenue, volume, attributable cost, and contribution data by Universal Postal Union country group and by shape for the preceding the fiscal year subject to review and each of the preceding four fiscal years[.]"[63] On its face, the Order does not appear to require the disclosure of any non-public, competitively sensitive information. The Commission did not specify whether the Postal Service would be required to publically disclose this information, but the Postal Service chose to report this data only in the non-public library references provided in this docket.

On February 8, 2019, the Commission granted UPS's outside counsel and consultants access to certain non-public library references related to the Postal Service's international competitive business.[64] Although the library references are complex, it appears that the Postal Service has reported the data ordered disclosed in Order No. 4836 within these materials. There is nothing competitively sensitive about the top-line, aggregated "revenue, volume, attributable cost, and contribution" data for Inbound Letter post. Although certain "country group" data may indirectly disclose data regarding the Postal Service's international partners, such data should be aggregated to the extent there is a legitimate confidentiality concern and then disclosed. If necessary,

[63] Order Amending Rules For Periodic Reporting, Dkt. No. RM2018-2 (September 25, 2018) ("Order No. 4836") at 4, 16-7, 29.

[64] *See* Order No. 4998.

UPS plans to submit a motion for disclosure of this information pursuant to 39 CFR 3007.400.

The Postal Service has long sought to claim all international competitive data as non-public, even where it is a simple matter to aggregate the data to mask any and all competitively sensitive information. UPS respectfully requests that the Commission review the Postal Service's non-public treatment of international competitive data, and order the Postal Service to disclose its international competitive data to the extent it does not meet the Commission's standards for non-public treatment, and to the extent it may be aggregated to mask all competitively sensitive and/or third party information.

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. RM2015-7

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 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."[65] The Commission noted that "even the Postal Service's expert observes UPS's approach has benefits and challenges[.]"[66] The Commission thus

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

[66] *Id*. at 64.

directed the Postal Service to determine whether a single equation city carrier letter route cost model for street time could produce improved variability estimates.[67]

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,"[68] as well as to "review the SPR cost model for street time."[69] 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.[70] 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 insurmountable.[71]

On November 2, 2018, the Commission concurred that "additional data are required to evaluate whether the obstacles . . . identified in this docket can be overcome" and directed the Postal Service to provide an expanded dataset of city carrier delivery data.[72] Further, the Commission instructed the Postal Service to begin sampling no later than mid-January, and that status reports on its progress are due on a

[67] *Id*. at 65.

[68] 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.

[69] *Id*. at 3.

[70] 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.

[71] 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.

[72] *See* Interim Order, Dkt. No. PI2017-1 (November 2, 2018) at 16-17.

quarterly basis.[73] UPS applauds the Commission's ongoing efforts to improve City Carrier costing and requests that the Commission continue to take all appropriate action to ensure that the Postal Service is fully investigating the possibility of a single equation city carrier street time model.

B. <u>RM2017-8</u>

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.[74] The Commission has acknowledged that Form 3999 evaluations are rare in December compared to the spring months.[75] City Carrier time spent on parcels is significantly greater as a proportion of all time in December than the 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

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[73] *Id.* at 17. The Commission specifically said that "Sampling should begin as soon as practicable but no later than 10 weeks following the issuance of this Order." Ten weeks from November 2, 2018 was January 11, 2019.

[74] 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.

[75] 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.

to parcels.[76] Based on UPS calculations using publicly available data, this resulted in under-costing of competitive products by about $21 million in FY18.[77]

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."[78] 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 special purpose routes. UPS further requests that the Commission review the international competitive data required by Order No. 4836 and order its public

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[76] 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.

[77] Using updated Form 3999 data produced in ACR2018, 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-FY18.xlsx," in Library Reference USPS-FY18-32). 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 2018, after taking into account a similar adjustment to the base year (FY14). Calculations are available upon request.

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

disclosure. UPS welcomes any guidance from the Commission on how best to address any of the issues discussed above.

Respectfully submitted,

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