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BEFORE THE
POSTAL REGULATORY COMMISSION

Periodic Reporting	:	**Docket No. RM2020-9**
(UPS Proposal One)	:	

PETITION OF UNITED PARCEL SERVICE, INC. FOR THE INITIATION OF PROCEEDINGS TO MAKE CHANGES TO POSTAL SERVICE COSTING METHODOLOGIES

(May 29, 2020)

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Pursuant to 39 C.F.R. § 3050.11, United Parcel Service, Inc. ("UPS") respectfully petitions the Commission to initiate rulemaking proceedings to change how the United States Postal Service determines incremental costs, and in particular how it accounts for peak-season costs, in its periodic reports. Pursuant to 39 U.S.C. § 3652(a), these periodic reports apply the Postal Service's costing methodologies to determine, among other things, whether the Postal Service's "costs, revenues, rates, and quality of service" comply with Title 39, including 39 U.S.C. § 3633, which applies to competitive products.

OVERVIEW

It is well known that package-delivery companies experience large volume—and cost—increases every December, as holiday commercial activity drives major increases in package shipments by U.S. businesses and consumers. This petition concerns the failure of costing models approved by the Commission to fully account for these increased peak-season costs.

For most of its long history, the Postal Service was focused almost exclusively on delivering letters. As a result, costing models developed over many years for purposes of rate regulation were oriented around letter delivery. When the Postal Service began adding a significant volume of packages to its product mix in the mid-2000s, those packages were treated as add-ons to the existing costing models. The Commission did not require the existing costing models to be rethought and rebuilt to address the distinctive features of packages—*i.e*., that packages are bigger, bulkier, and heavier than envelopes. Just as significant, package shipments take on sharply different seasonal patterns than letters, including a dramatic peak in December.

The disconnect between the legacy costing models and the distinctive features of package delivery has grown over time as the Postal Service's package revenues have increased and its letter revenues have declined—in both cases, dramatically. That growing disconnect has led to the present circumstance, where the Commission must now address whether the Postal Service's package delivery services are profitable at all. UPS submits that it will be impossible to answer that question in a rigorous way, as 39 U.S.C. § 3633 requires, until this disconnect between costing models and package delivery is addressed.

This petition focuses on peak-season costs. These costs are caused by competitive products but largely overlooked by existing costing methodologies. Postal Service data shows that, to meet peak-season demand, the Postal Service incurs hundreds of millions of dollars of additional costs every December that it would not incur but for its package delivery business. These costs arise because, to meet the December spike in demand for package delivery services, the Postal Service hires tens of thousands of temporary workers, opens temporary delivery annexes, incurs additional overtime wages, and sends carriers out on a host of additional runs to deliver packages.

These increased costs are a clear example of costs that should be attributed to competitive products under the principle of incremental-cost attribution adopted by this Commission. In Order No. 3506, the Commission directed "the Postal Service to use incremental costs as the basis for class-level and product-level attributable costs."[1] The

[1] Order Concerning United Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies, Dkt. No. RM2016-2 (Sept. 9, 2016) ("Order No. 3506"), at 125.

Commission thus recognized that, at a minimum, the Postal Service should ensure competitive products pay for all of the costs that are reliably caused by those products—which includes all of the costs that could be eliminated if the Postal Service stopped delivering packages. Peak-season costs plainly qualify as incremental costs of the package delivery business under this standard. Such costs *would not exist* if the Postal Service did not deliver packages.

As shown below, however, the current costing models approved by the Commission fail to account for peak-season cost increases, effectively ignoring them under 39 U.S.C. § 3633(a). Many of the Postal Service's existing costing models, for example, are based on special studies conducted during *off-peak months* (such as April), which are then erroneously generalized to cover all months, including December, the peak month for package delivery. As shown below, because of such issues, the current costing models fail to explain and attribute on average some *$500 million* of the additional peak-season costs incurred by the Postal Service on an annual basis.

Peak-season costs represent merely one aspect of the inability of current costing models to identify and attribute all costs caused by package deliveries. The Postal Service has made some limited changes to its cost attribution practices in order to address the Commission's directive that it begin attributing all incremental costs to competitive products. But a significant amount of costs caused by competitive products still are not being attributed to such products, both individually and as a group. The Commission has not yet evaluated the full set of costs the Postal Service could eliminate through an efficient reorganization of its delivery network and other aspects of its operations, if it ceased delivering competitive products. This analysis, which is

essential given the prominent focus given to package delivery today, would reveal large volumes of costs that could be eliminated in such a scenario, but which are not paid for by competitive products today. Such costs are, as an economic matter, "incremental costs" of competitive products, and thus should be paid for by competitive products.

Preliminary data from the recent impact of COVID-19 on the Postal Service appears to provide further evidence that current costing methodologies are not capturing the full costs of package delivery. While COVID-19 has created many challenges for the Postal Service, as well as for private delivery companies, it also has dramatically increased the Postal Service's package-related revenue, along with the share of total revenue represented by packages as compared to letters.[2] According to the publicly available data, this increase in package deliveries, however, has not resulted in greater profits, but rather in greater losses.[3]

Indeed, as UPS has shown in other filings, the Postal Service's own financial disclosures suggest that package deliveries are likely contributing to the Postal Service's growing *losses*.[4] If that is the case, the Postal Service's expansion of its

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[2] Jacob Bogage and Josh Dawsey, *Postal Service to review package delivery fees as Trump influence grows*, WASH. POST (May 14, 2020), *available at* https://www.washingtonpost.com/business/2020/05/14/trump-postal-service-package-rates/.

[3] *Id.* Cost and revenue data relating to March, April, and May of this year are likely to provide further evidence that legacy cost models are missing millions of dollars in costs incremental to competitive products.

[4] *See* Comments of United Parcel Service, Inc. on Revised Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, Dkt. No. RM2017-1 (Sept. 12, 2018), at 4, 15, 24; *see also* U.S. Postal Serv., Quarterly Report (Form 10-Q) (Aug. 8, 2018) ("USPS 10-Q Aug. 2018") at 19-20 (noting that the Postal Service experienced a $1.1 billion increase in "controllable losses" in the nine months ending June 30, 2018, in part "due to additional hours incurred to support growth in the labor-intensive package business").

competitive products business may be harming, rather than helping, the Postal Service itself.

In sum, the public cannot know with certainty whether the Postal Service's package delivery business is actually profitable until all costs associated with that business are taken into account, as Congress required in 39 U.S.C. § 3633. This petition therefore seeks to modify the analytical principles for determining incremental costs under 39 U.S.C. § 3633(a)(1) and 39 U.S.C. § 3633(a)(2) to address the failure of the existing costing models to consider and attribute the increased costs resulting from the Postal Service's seasonal spike in operations.[5]

[5] Because these peak-season costs are "uniquely or disproportionately associated with competitive products," they must also be identified and considered in deciding the "appropriate share" of institutional costs that competitive products must cover under 39 U.S.C. § 3633(a)(3). *See United Parcel Serv., Inc. v. Postal Regulatory Comm'n*, 955 F.3d 1038, 1051 (D.C. Cir. 2020). UPS will address this particular issue in greater detail in comments pertaining to the remand from the D.C. Circuit regarding the appropriate share requirement.

ARGUMENT

I. POSTAL SERVICE COSTS SPIKE DURING THE HOLIDAY SEASON

Package delivery companies experience large volume and cost increases during the winter holiday season.[6] The Postal Service is no different. In late 2019, for example, press reports indicated that the Postal Service was bracing for its "busiest time of the season . . . two weeks before Christmas," with the Postal Service alone projected to deliver about "800 million packages between Thanksgiving and New Year's Day."[7] This is roughly consistent with official statistics indicating the Postal Service delivered at least 700 million parcels between Thanksgiving and the end of 2019.[8]

The Postal Service ramps up its operations every year to handle this greater volume of packages. Correspondingly, Postal Service data shows that its costs are markedly higher in December relative to other non-peak months across several of the largest Postal Service cost segments—Clerks and Mailhandlers, City Delivery Carriers, Rural Carriers, and Transportation. The same pattern is repeated out across the remaining Postal Service cost segments. As Figure 1 demonstrates, monthly costs in

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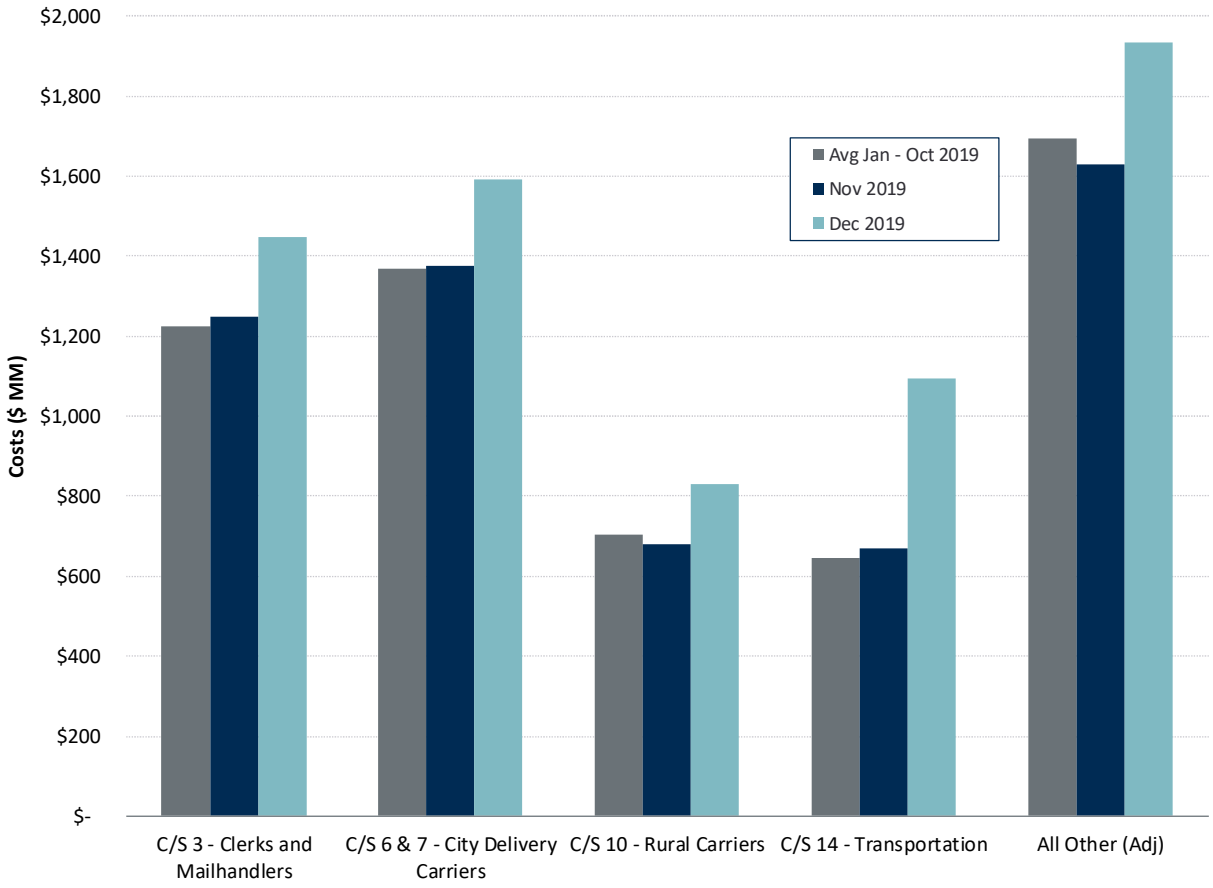
[6] *See* Paul Ziobro, *Delivery Companies Brace for the Pre-Christmas Crush*, WALL ST. J. (Dec. 17, 2017), *available at* https://www.wsj.com/articles/delivery-companies-brace-for-the-pre-christmas-crush-1513515610.

[7] United States Postal Service, *Hundreds of Millions of Holiday Packages Expected Between Thanksgiving and New Year's Day*, NATIONAL NEWS (Nov. 7, 2019), *available* at https://about.usps.com/newsroom/national-releases/2019/1107-20-million-packages-to-be-delivered-daily-this-holiday-season.htm.

[8] This estimate is based on figures reported in the Postal Service's monthly Preliminary Financial Information reports. November and December volume for Total Shipping and Package Services were 451 million pieces and 664 million pieces, respectively. In 2019, two delivery days in November occurred after Thanksgiving. (2/24*451) + 664 > 700 million pieces.

2019 were markedly higher in the largest cost segments in December 2019 as compared to previous months.

Figure 1: Monthly Costs, Selected Segments, Calendar Year 2019[9]



City carrier compensation drives a large portion of this cost increase. As shown in Table 1 below, city carrier compensation paid by the Postal Service increased by $218 million from November to December 2019. This table shows that overtime pay for

[9] National Trial Balance Reports, January - December 2019. "All Other (Adj)" excludes Civil Service Retirement Supplemental Liability (C/S 18.3.3), Workers Compensation (C/S 18.3.4), Annuitant Health Benefits (C/S 18.3.6), and FERS Supplemental Liability (C/S 18.3.7) costs from the "National Trial Balance Reports."

city carriers—a temporary measure to handle short-term spikes in volume—makes up a large portion of the cost increase seen in the above figure.

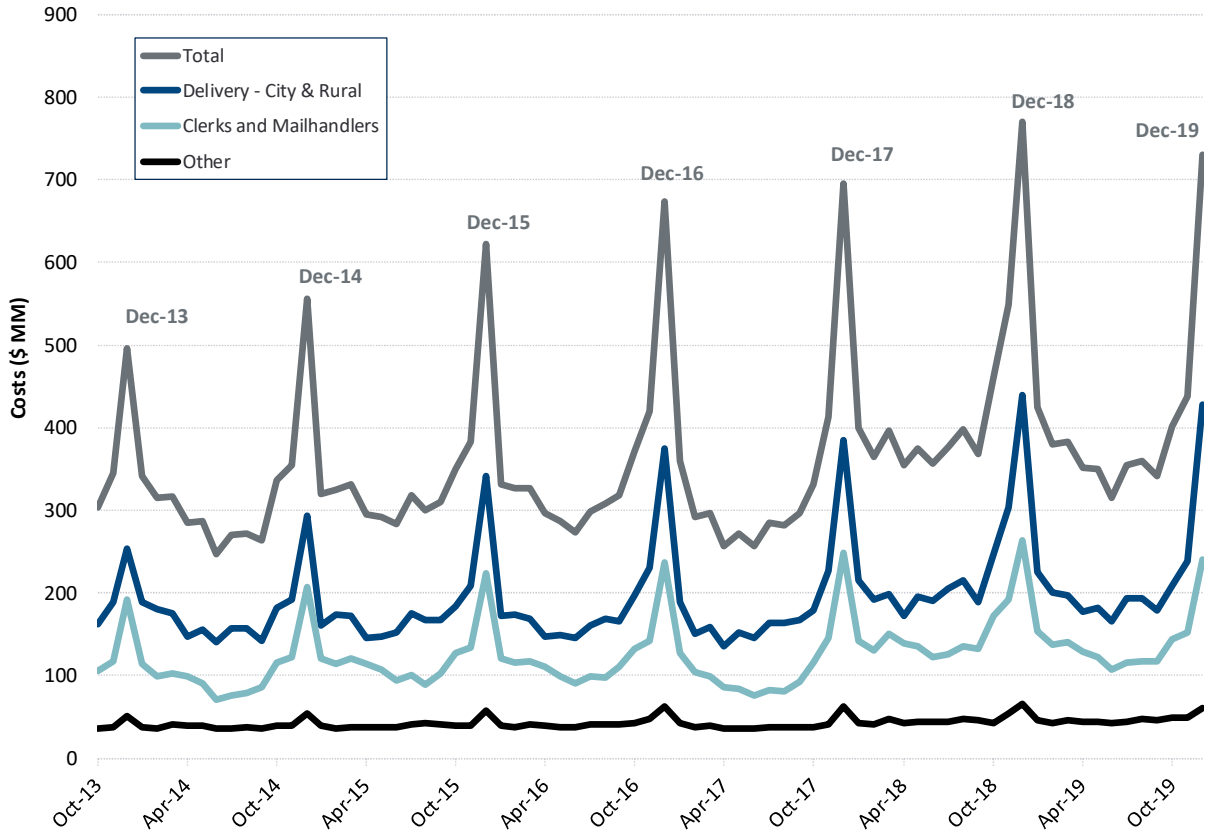
Table 1: December City Carrier Compensation Spike, Calendar Year 2019[10]

	Nov to Dec Increase	% of Total
Overtime Pay	163.3	75%
Regular Pay to FT Employees	49.5	23%
Regular Pay to PT Employees	9.0	4%
Other	-3.8	-2%
Total	218.0	100%

The Postal Service also substantially increases overtime compensation paid to its employees across the entire organization—and the size of the ramp-up has generally increased over the last several years. Figure 2 shows that between 2013 and 2019, there was a marked spike every December for delivery (city and rural) carriers, clerks and mailhandlers, and other costs.

[10] *Id.*

Figure 2: Overtime Costs, October 2013 – December 2019[11]



Seasonal workers constitute another major source of temporary costs during peak season. Only some seasonal workers do not work as city carriers *per se*, and thus are only partially reflected in Table 1. In addition to serving as city carrier assistants, seasonal workers serve as mailhandlers, retail associates, tractor drivers, and city carrier assistants.[12] Every year, the Postal Service hires tens of thousands of seasonal

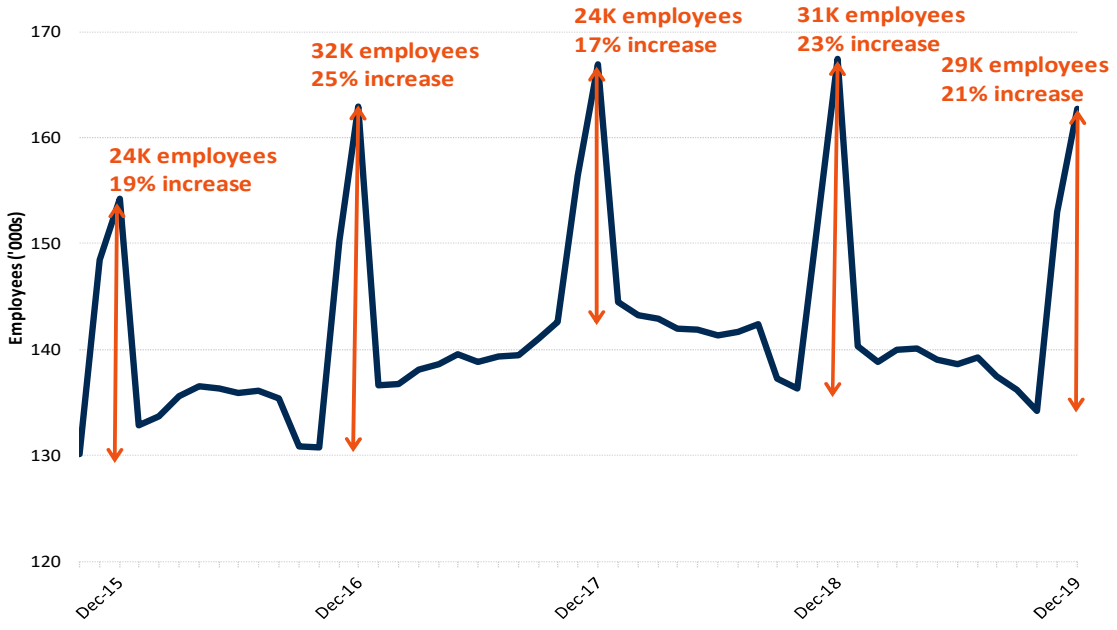
[11] National Trial Balance Reports. Other Overtime Costs is Total Overtime costs less the Overtime costs for Delivery - City, Delivery - Rural, and Clerks and Mailhandlers.

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

employees to accommodate holiday-season volumes. For instance, the Postal Service announced that it hired 29,000 seasonal workers in 2015 and indicated it would hire up to 40,000 seasonal workers in 2016 (similar aggregated figures were not available for more recent years).[13]

Figure 3 shows that between 2015 and 2019, there was a significant spike in non-career employees hired by the Postal Service every December, which was about 17% to 25% higher than in the preceding non-December months.

Figure 3: Non-Career Employees by Month, October 2015 – December 2019[14]



Other delivery-related metrics similarly show an annual spike in Postal Service operations (and costs) in December. Comparing December 2019 to April 2019, for

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[13] *Id.*

[14] USPS Preliminary Financial Information (Unaudited). Note that this and other analyses using USPS Preliminary Financial Information (Unaudited) use SPLY values

example, while the volume of market dominant products was very similar (11.3 billion pieces v. 11.4 billion pieces), December involved higher city delivery work hours (40.4 million v. 35.9 million), higher city delivery salaries ($1.76 billion v. $1.53 billion), and higher shipping and package volumes (664 million pieces v. 444 million pieces).[15]

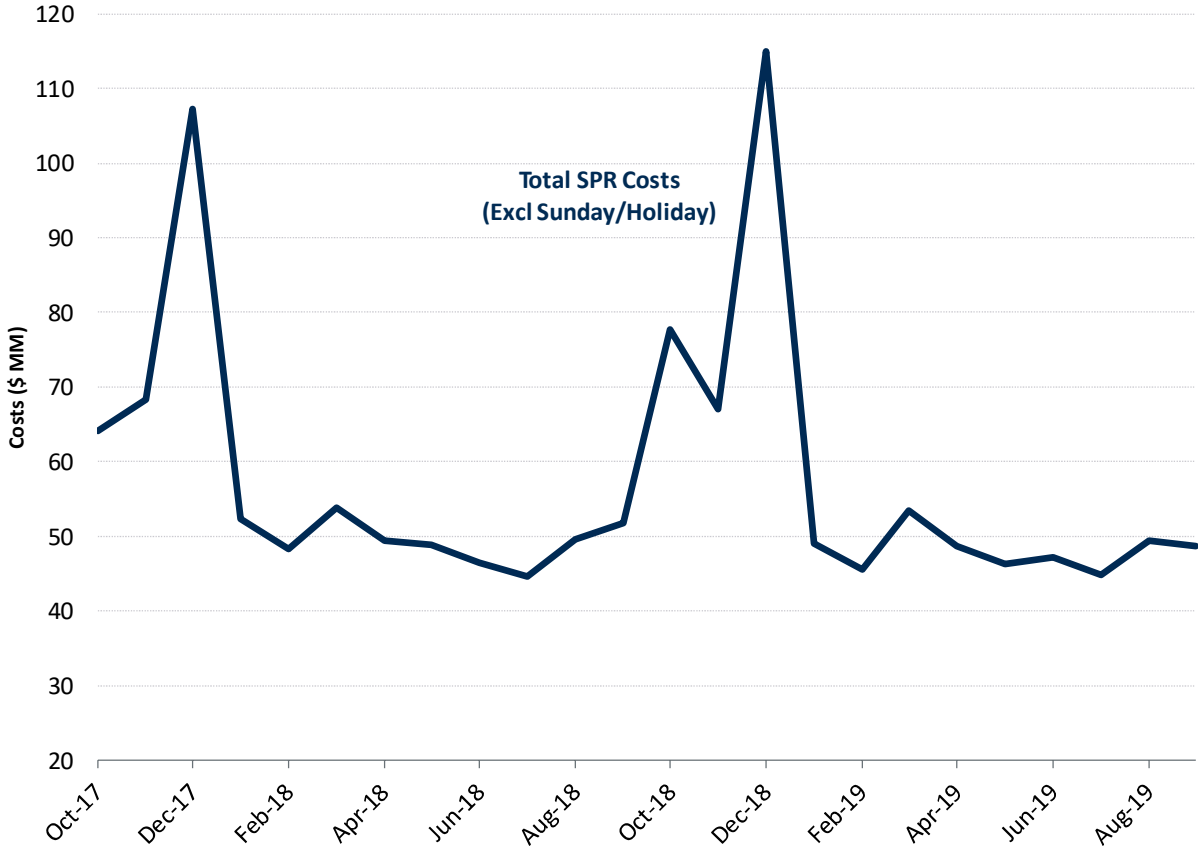
The Postal Service also increases the use of special purpose routes (SPRs) every December in order to deliver the large volume of packages.[16] Figure 4, for example, shows an increase in the use of SPRs during December—although this figure likely understates the extent of the shift in city carrier operations that occurs in December because SPR costs do not capture all parcel-driven second run costs.

when possible. The orange arrows and text compare October and December totals within each calendar year.

[15] *Compare* USPS Preliminary Financial Information for December 2019 (Feb. 6, 2020), at 1-4, *with* USPS Preliminary Financial Information for April 2019 (May 24, 2019), at 1-4.

[16] For example, parcels accounted for a disproportionate share of the increase in volume that occurs between the fourth quarter of fiscal year 2015 and the first quarter of fiscal year 2016. *See* Second Motion of United Parcel Service, Inc. for Issuance of Information Request to the United States Postal Service, Dkt. No. ACR2016 (Jan. 26, 2017), at 3. On a weight basis, competitive products accounted for 60 percent of the total increase in volume that occurred between the fourth quarter of fiscal year 2015 and the first quarter of fiscal year 2016. *Id*.. Parcel Select alone accounted for 43 percent of the total increase. *Id*.

Figure 4: Special Purpose Route Costs by Month, FY18-19[17]



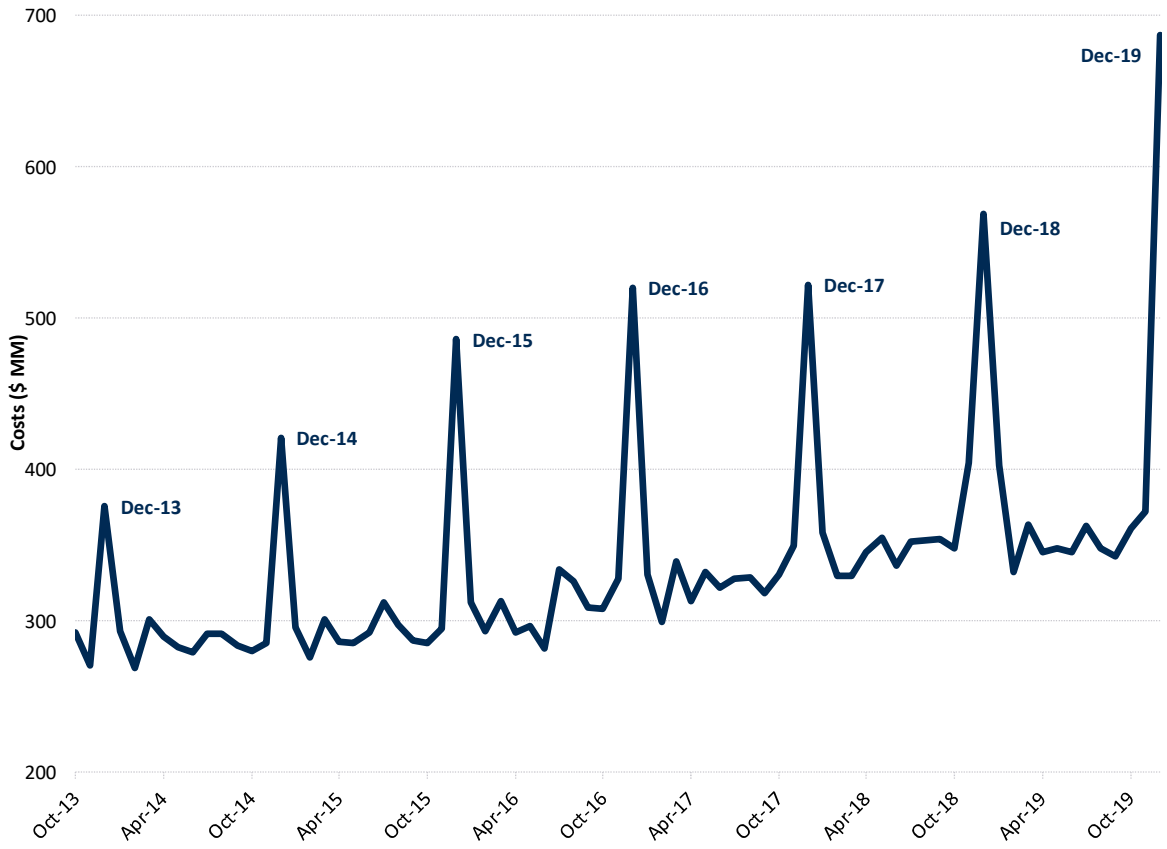
The Postal Service also experiences a substantial spike in highway transportation costs, where peak costs have exceeded non-peak costs by as much as 60% in recent years.[18] Figure 5 shows that every year from 2013 to 2019, there has been a spike in highway transportation costs every December compared to other

[17] Calculations based on IOCS tallies contained in USPS-FY18-37 and USPS-FY19-37. Figure does not include over $360 million in Sunday/Holiday SPR costs ($160 million in FY18 and $200 million in FY19) since Sunday/Holiday data are not available with timestamps in USPS-FY18-37 or USPS-FY19-37.

[18] *See, e.g.*, Order on Analytical Principles Used In Periodic Reporting (Proposal Four), Dkt. No. RM2016-12 (June 22, 2017), at 19 (Commission notes that "extra highway transportation capacity purchased for emergency and Christmas routes is intended to accommodate increases in mail volume.").

months—and that in 2019, December costs were on average about $330 million greater than the non-December months that year.

Figure 5: Highway Transportation Costs, October 2013 – December 2019[19]



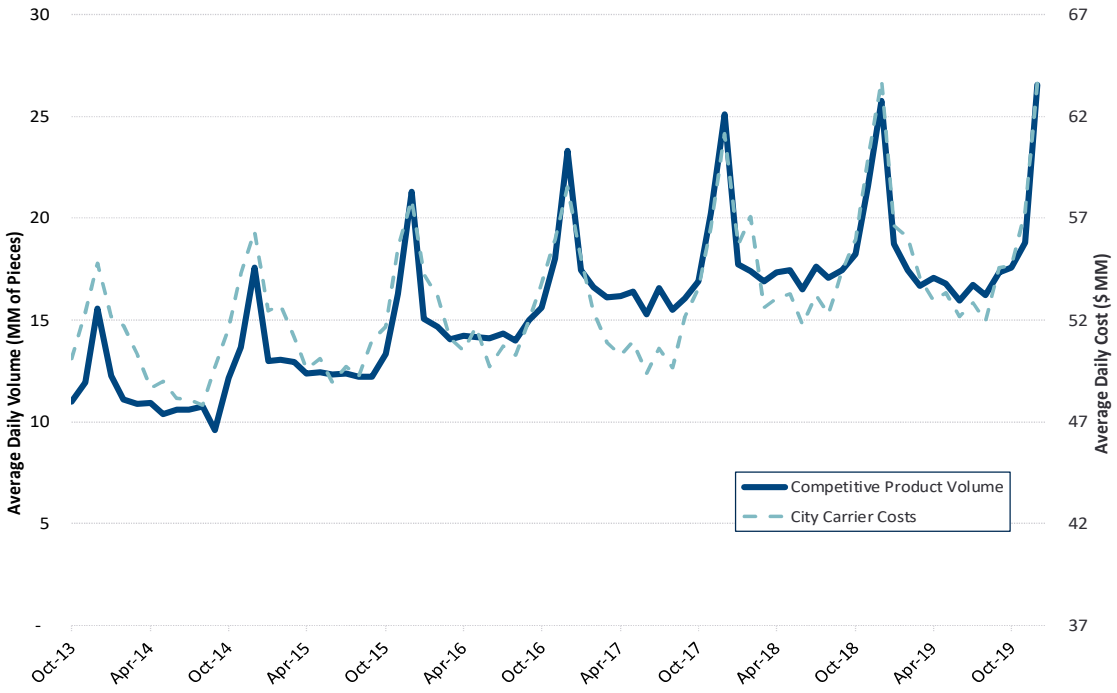
The data demonstrates that the Postal Service experiences a significant cost spike every year during the peak season for package deliveries. And the size of this cost spike is growing over time as the Postal Service's package delivery business continues to grow, even as its letter mail volumes continue to shrink.

[19] National Trial Balance Reports. Figure depicts sum of costs for accounts that map to component 143 (Purchased Highway Transportation) in the FY2013-2019 Financial Reconciliation Sheets from USPS-FY-5.

II. THE SEASONAL COST SPIKE IS CAUSED BY COMPETITIVE PRODUCTS

It is also clear that this seasonal cost spike is caused largely, if not exclusively, by *package deliveries*. For example, as shown below, competitive product volumes are closely correlated with city carrier costs over time—as competitive products volume peaks, so do city carrier costs. Figure 6 shows that from 2013 to 2019, monthly city carrier costs and competitive product volumes spiked in a closely correlated manner every December compared to other months.

Figure 6: Monthly City Carrier Cost and Competitive Product Volume[20]



The Commission has observed that demand for market dominant products also increases during peak season, citing elasticity regression estimates indicating that

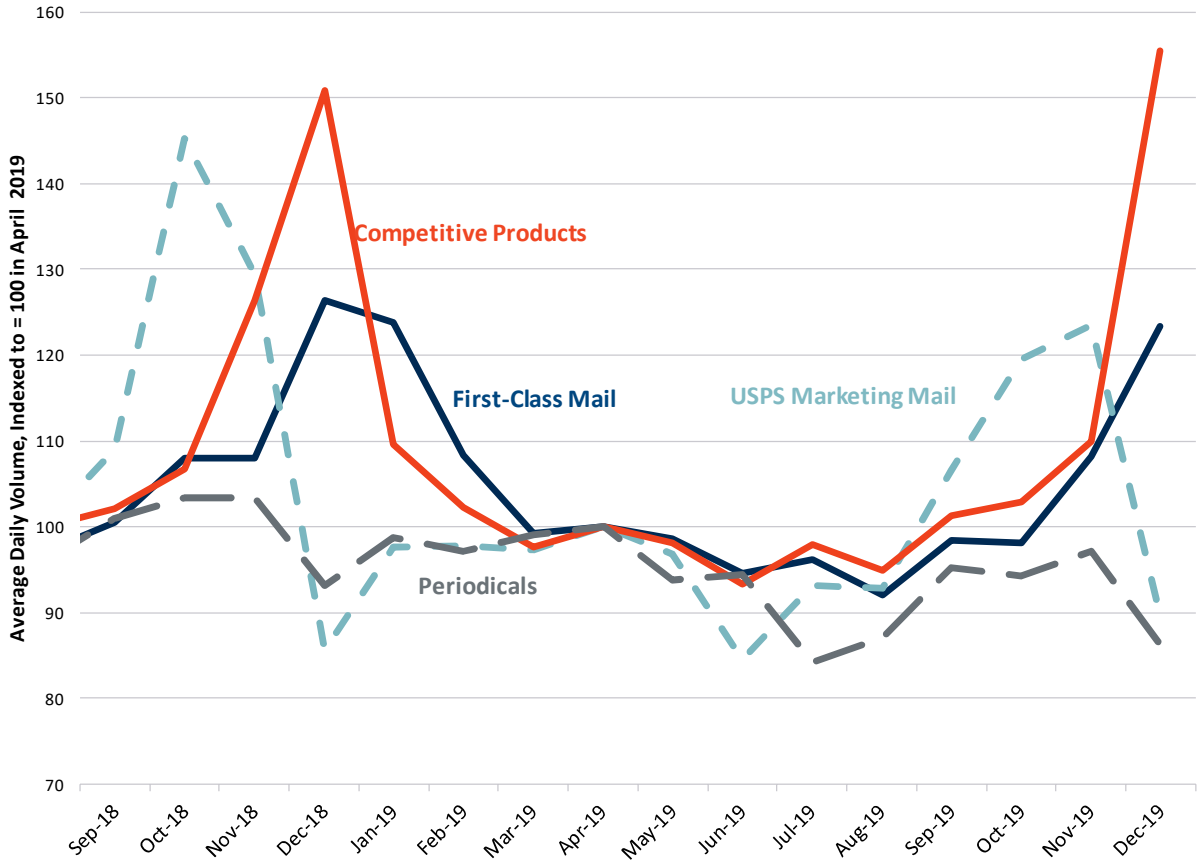
[20] National Trial Balance Reports, USPS Preliminary Financial Information (Unaudited) Reports. Average daily volumes and costs equal monthly volume and cost totals, respectively, divided by delivery days in the month.

demand for some market dominant mail products increases in the first quarter of the Postal Service's fiscal year (October to December).[21] But Postal Service data refutes the notion that market dominant mail is responsible for the December cost spike. Comparing the volume trends over the course of the year across product types shows that competitive products experience the greatest peak in December while other mail classes experience smaller peaks, often at other times of the year.

Figure 7 demonstrates that, from September 2018 to December 2019, average daily volumes of competitive products showed a drastic increase in both December 2018 and December 2019 compared to other months. In contrast, average daily volumes of market-dominant products like First-Class Mail, Periodicals, and USPS Marketing Mail either demonstrate only a modest increase or even decrease during those December time periods.

[21] 2018 Annual Compliance Determination at 123, citing the Postal Service's elasticity estimates for market dominant products.

Figure 7: Average Daily Volume by Mail Class, September 2018 – December 2019[22]



Competitive product daily volume was about 55% higher in December 2019 relative to competitive product daily volume in April 2019,[23] while First-Class Mail

[22] USPS Preliminary Financial Information (Unaudited) Reports, September 2018 - December 2019. Average daily volumes equal monthly volume totals, divided by delivery days in the month, then indexed to 100 in April 2019.

[23] Comparing December 2019 to April 2019, the total volume for shipping and package services (largely comprised of competitive services) was about 664 million pieces and 444 million pieces respectively, or about a 49% increase. *Compare* USPS Preliminary Financial Information for December 2019 (Feb. 6, 2020), at 2, *with* USPS Preliminary Financial Information for April 2019 (May 24, 2019), at 2.

volumes were only about 23% higher during the same time period.[24] Marketing Mail and Periodicals also have a seasonal spike, but their volumes often peak in October or November—volumes of those mail classes actually decrease in December.[25]

When the mail volumes relating to Marketing Mail and First-Class Mail are aggregated, there is virtually no uptick in December volume for these products.[26] Instead, when these products are aggregated, their combined volume actually peaks in October—*before* the December spike.[27] Figure 8 shows that while average daily volumes for competitive products spiked by about 50% in December 2018 and December 2019 (using April 2018 as a benchmark), December is a decidedly average month in terms of letter mail volumes.

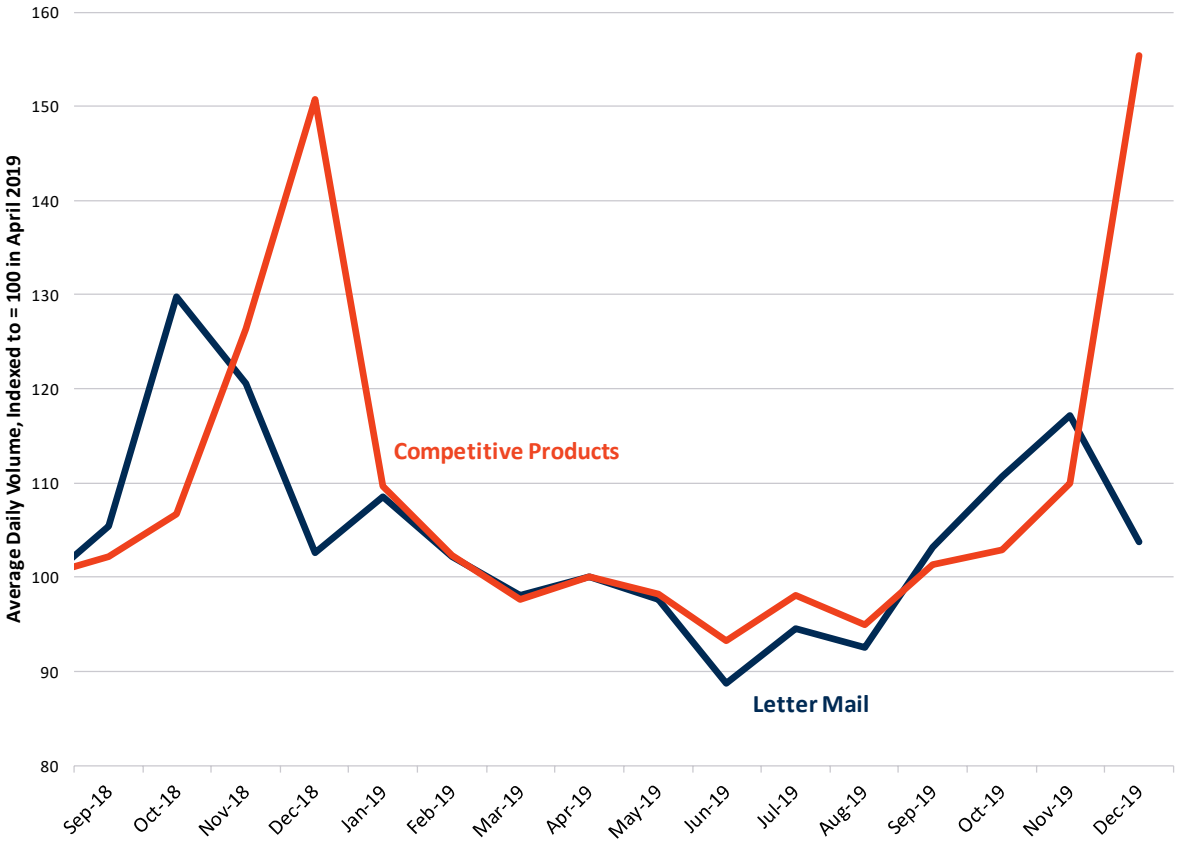
[24] *Compare* USPS Preliminary Financial Information for December 2019 (Feb. 6, 2020), at 2, *with* USPS Preliminary Financial Information for April 2019 (May 24, 2019), at 2.

[25] Comparing December 2019 to April 2019, the total volume for market dominant products (largely comprised of first-class mail and standard mail) was about 11.3 billion pieces and 11.4 billion pieces respectively. *Compare* USPS Preliminary Financial Information for December 2019 (Feb. 6, 2020), at 2, *with* USPS Preliminary Financial Information for April 2019 (May 24, 2019), at 2.

[26] Information taken from USPS Preliminary Financial Information (from April 2019 to March 2020).

[27] *Id*.

Figure 8: Average Daily Volume of Letter Mail and Competitive Products, September 2018 – December 2019[28]



Moreover, while First-Class Mail increases in December along with competitive products, the magnitude of that increase has been declining over the years—in stark contrast to the ever-increasing spike in competitive product volumes. Figure 9 shows that from 2009 to 2019, monthly First-Class Mail volumes have generally been decreasing from year to year, and that the volume spikes every December have been declining. Yet while the December spike in First-Class Mail volume has decreased, the December cost increase has grown.

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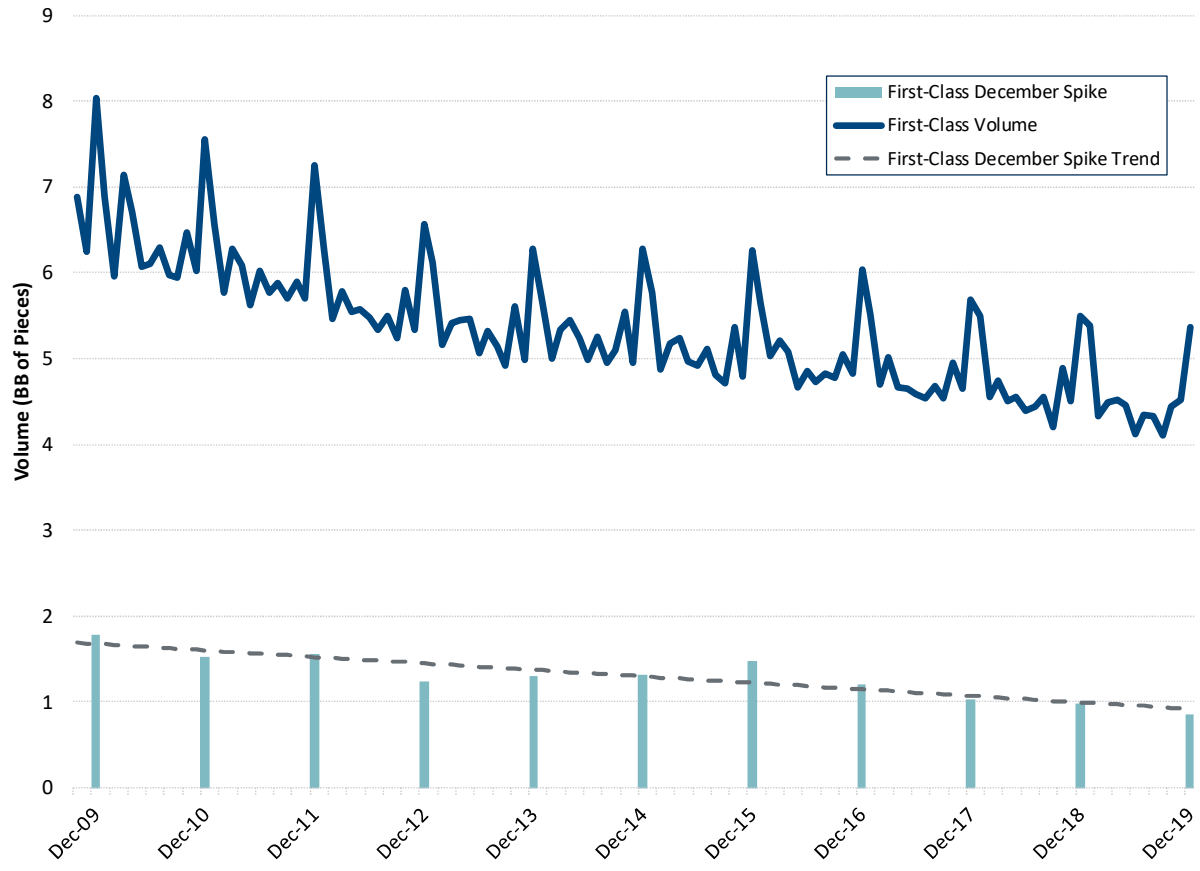
[28] USPS Preliminary Financial Information (Unaudited) Reports, September 2018 - December 2019. Average daily volumes equal monthly volume totals, divided by delivery days in the month, then indexed to 100 in April 2019. For the purpose of this figure, Letter Mail is defined as the sum of First-Class Mail and Standard Mail.

Figure 9: Monthly First-Class Mail Volume, October 2009 – December 2019[29]



The data, therefore, demonstrates that package volumes are responsible for the additional costs incurred by the Postal Service during peak season. Differences in dimensions and required handling between competitive products and market dominant products, and the resulting need for dedicated competitive product resources, equipment and facilities, amplify the effects of this large spike in competitive volumes. This fact should have a significant influence on cost attribution, because the

[29] USPS Preliminary Financial Information (Unaudited) Reports. "First-Class December Spike" represents the increase in First-Class mail volume from November to December of the corresponding year.

Commission has recognized that costs caused by packages should be attributed to packages.[30] If the Postal Service stopped delivering packages, this annual December cost spike would likely all but disappear. Accordingly, the additional costs experienced by the Postal Service in peak season must be understood as caused by, and thus *incremental* to, competitive products. The Commission should, therefore, insist that these costs be attributed to competitive products both on a class-wide and product-level basis.[31]

Such attribution is not occurring today. As shown below, the Postal Service fails to attribute *roughly half* of its annual peak-season cost spike to *any* products, and instead classifies these costs as institutional. In turn, under the Commission's current approach to institutional costs, competitive products are required to cover only a negligible percentage of such costs. By shifting these peak-season costs to the "institutional" side of the ledger, the Postal Service is able to overstate the profitability of competitive products, when in fact such products may not be profitable at all.

III. POSTAL SERVICE COST MODELS FAIL TO ACCOUNT FOR HUNDREDS OF MILLIONS OF DOLLARS IN UNEXPLAINED "PEAK SEASON" COSTS

Using publicly available information drawn from the Postal Service's costing models and monthly reports, UPS, through its outside consultants, has modeled the effects of volume changes on peak-season costs. To conduct this analysis, UPS consultants:

1. Using Cost Segment and Components ("CSC") report for FY 2019 and annual volume totals, estimated the average volume variable cost per

[30] *See* Order No. 3506 at 125 ("The Commission directs the Postal Service to use incremental costs as the basis for class-level and product-level attributable costs.").

[31] *Id.*

piece for each mail class and each of four cost categories (clerks, delivery, transportation, and other);

2. Analyzed the USPS Preliminary Financial Information to calculate the change in volume from November to December for each mail class;[32]

3. Calculated an expected change in volume variable cost for each cost category and mail class by multiplying the results of steps [1] and [2];

4. Calculated the total expected cost increases within each cost category by summing the figures calculated in step [3] for market dominant and competitive product categories;[33] and

5. Compared the total expected cost increases within each cost category to the actual monthly cost increases.

The results of this analysis are striking. While Postal Service costs increased by over $600 million from November to December 2018 (FY19), applying results from Postal Service costing models explains less than half of this increase. The reduction in market dominant volumes should cause costs to decrease by $61 million, while the

[32] While these monthly class-level volumes are derived from reports that are labeled preliminary and unaudited, when summing them within a quarter they are generally very consistent with totals reported in the quarterly Revenue Pieces and Weight reports.

Similarly, summing major categories of costs (clerks, delivery, transportation, and "Other") using the monthly trial balance reports generally generates totals that are consistent with cost totals that are provided in the Cost Segments and Components reports.

[33] These calculations are robust, but do not perfectly replicate the full costing models on a monthly basis because the Postal Service does not provide the underlying data. For instance, the Commission would need at least the following data to accurately reconstruct the complexity of the city carrier model on a monthly level: (i) Monthly volumes of specific products and monthly mailstream ("shape") volumes (DPS, FSS, in-receptacle parcels, etc.), broken down by letter route and SPR; (ii) Microdata from the CCCS and the CCCS-SPR, which are the datasets used to construct the distribution keys that distribute the mailstream-level attributable costs to products; and (iii) Monthly SPR and Letter Route costs.

increase in competitive product volumes would predict only a $300 million increase in costs.

This leaves nearly $380 million of increased costs that the Postal Service's costing models cannot explain. As noted, the Postal Service treats many of these costs as "institutional," and today competitive products revenues must cover only the small portion of such costs that the Commission deems the "appropriate share" for Competitive Products.[34] At a minimum, these increased costs during peak season are "uniquely or disproportionately associated with competitive products," such that they must be considered in deciding the appropriate share on remand from the D.C. Circuit's decision in *United Parcel Serv., Inc. v. Postal Regulatory Comm'n*, 955 F.3d 1038, 1051 (D.C. Cir. 2020). However, they should also be considered under the incremental cost test of section 3633(a)(1) and attributed to products under section 3633(a)(2), given that these increased costs are caused by competitive products.

The results shown below in Table 2 illustrate the serious shortcomings of current Postal Service models in accounting for (and attributing) major costs from the annual seasonal spike.

[34] *See* Initial Comments of United Parcel Service, Inc. on Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, Dkt. No. RM2017-1 (Apr. 16, 2018), at 3, 14 (noting that certain seasonal peak costs are improperly treated as institutional).

Table 2: Analysis of FY2019 December Cost Increase (in Millions of $)[35]

	Actual Nov-to-Dec Cost Increase [1]	Cost Increase Implied by Market Dominant Volume Increases [2]	Cost Increase Implied by Competitive Product Volume [3]	Total Cost Increase Implied by Current Costing Models [4]	Unexplained Cost Increase [5]
Clerks (C/S 3)	$ 186	$ (3)	$ 92	$ 89	$ 96
Delivery (C/S 6, 7, 10)	$ 285	$ (76)	$ 55	$ (21)	$ 306
Transportation (C/S 14)	$ 221	$ 34	$ 83	$ 117	$ 105
Other	$ (74)	$ (16)	$ 70	$ 54	$ (128)
Total	**$ 618**	**$ (61)**	**$ 300**	**$ 239**	**$ 379**

Table 3 below repeats the analysis described above for each of the past five fiscal years; it estimates that the Postal Service's current costing models account for only a fraction of peak seasonal actual cost increases implied by volume changes in market-dominant and competitive products. This table shows that, on average, *more than $500 million* in peak-season costs are unaccounted for every year.

[35] National Trial Balance Reports, USPS Preliminary Financial Information (Unaudited) Reports, FY2019 Cost Segments and Components Report. "Other" excludes Civil Service Retirement Supplemental Liability (C/S 18.3.3), Workers Compensation (C/S 18.3.4), Annuitant Health Benefits & Earned CSRS Pensions (C/S 18.3.6), and FERS Supplemental Liability (C/S 18.3.7).

[1]: Difference between November and December FY2019 monthly trial balance totals.

[2], [3]: Calculated by multiplying the estimated November-to-December change in volume for a given mail class by that class's annual average attributable cost per piece, and then summing across all products. For competitive products, only public information was used.

[4]: [2] + [3].

[5]: [1] - [4].

Table 3: Unexplained November-to-December Cost Increases, FY16-FY20[36]

Fiscal Year	Actual Nov-to-Dec Cost Increase [1]	Cost Increase Implied by Market Dominant Volume Increases [2]	Cost Increase Implied by Competitive Product Volume Increases [3]	Total Cost Increase Implied by Current Costing Models [4]	Unexplained Cost Increase [5]
2016	$ 1,116	$ 190	$ 401	$ 592	$ 524
2017	$ 1,020	$ 64	$ 374	$ 438	$ 582
2018	$ 836	$ (22)	$ 329	$ 307	$ 529
2019	$ 618	$ (61)	$ 300	$ 239	$ 379
2020 (Preliminary)	$ 1,297	$ (11)	$ 520	$ 509	$ 788
Average	**$ 977**	**$ 32**	**$ 385**	**$ 417**	**$ 560**

Without competitive products, these unexplained seasonal costs would not exist. Accordingly, they must be classified as *incremental* to competitive products as that term is defined by the Commission and accepted by the D.C. Circuit, *i.e.*, "'the difference between the [Postal Service's] total costs ... and the total costs without [that] product.'" *United Parcel Serv., Inc. v. Postal Regulatory Comm'n*, 890 F.3d 1053, 1059 (D.C. Cir. 2018) (quoting PRC Order No. 3506 at 58). Assigning such costs to the institutional side of the ledger only obscures the true costs of competitive products and does not

[36] Monthly Trial Balances (2016-2020), USPS Preliminary Financial Information reports (2016-2020), Cost Segments and Components Reports (2016-2020). Costs exclude Annuitant Health Benefits & Earned CSRS Pensions (C/S 18.3.6), Workers Compensation (C/S 18.3.4), and FERS Supplemental liability (C/S 18.3.7), and Civil Service Retirement Supplemental Liability (C/S 18.3.3).

[1]: Difference between November and December monthly trial balance totals.

[2], [3]: Calculated by multiplying the estimated November-to-December change in volume for a given product by that product's average volume variable cost per piece, and then summing across all products. For FY2020, FY2019 attributable cost per piece is used after applying an assumed rate of inflation of 2.2% based on expected hourly compensation from USPS's FY2020 Integrated Financial Plans.

[4]: [2] + [3].

[5]: [1] - [4].

allow the Commission, or the public, to determine with confidence whether competitive products are profitable or not.[37]

While these points are relevant to cost attribution under 39 U.S.C. § 3633(a)(2), they are also relevant to the test for subsidization the Commission has adopted under 39 U.S.C. § 3633(a)(1). In applying section 3633(a)(1), the Commission uses the same test of incremental costs.[38] The only difference is that section 3633(a)(1) looks at incremental costs of competitive products as a whole, whereas section 3633(a)(2) looks at incremental costs of competitive products individually.[39] But in practice, the Postal Service does does not adopt meaningfully different methodologies to determine incremental costs under section 3633(a)(1) that are not captured under section 3633(a)(2).[40]

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[37] As UPS has noted previously, the Postal Service's 10-Q for August 2018 indicates that the Postal Service's delivery of greater volumes of competitive products actually causes the Postal Service to suffer greater and greater losses. The Postal Service experienced a $1.1 billion increase in what it deems "controllable" losses for just the nine months ended June 30, 2018, compared to the same period last year, and its explanation reveals that competitive products are largely responsible for these growing losses. *See* Comments of United Parcel Service, Inc. on Revised Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, Dkt. No. RM2017-1 (Sept. 12, 2018) at 15-17.

[38] Order No. 3506 at 13 (explaining that the Commission uses the incremental costs to test for cross-subsidy of competitive products under 39 U.S.C. § 3633(a)(1)).

[39] *Id.* at 61-62 (attributable costs were redefined to include "those inframarginal costs" that are "calculated as part of a product's incremental costs").

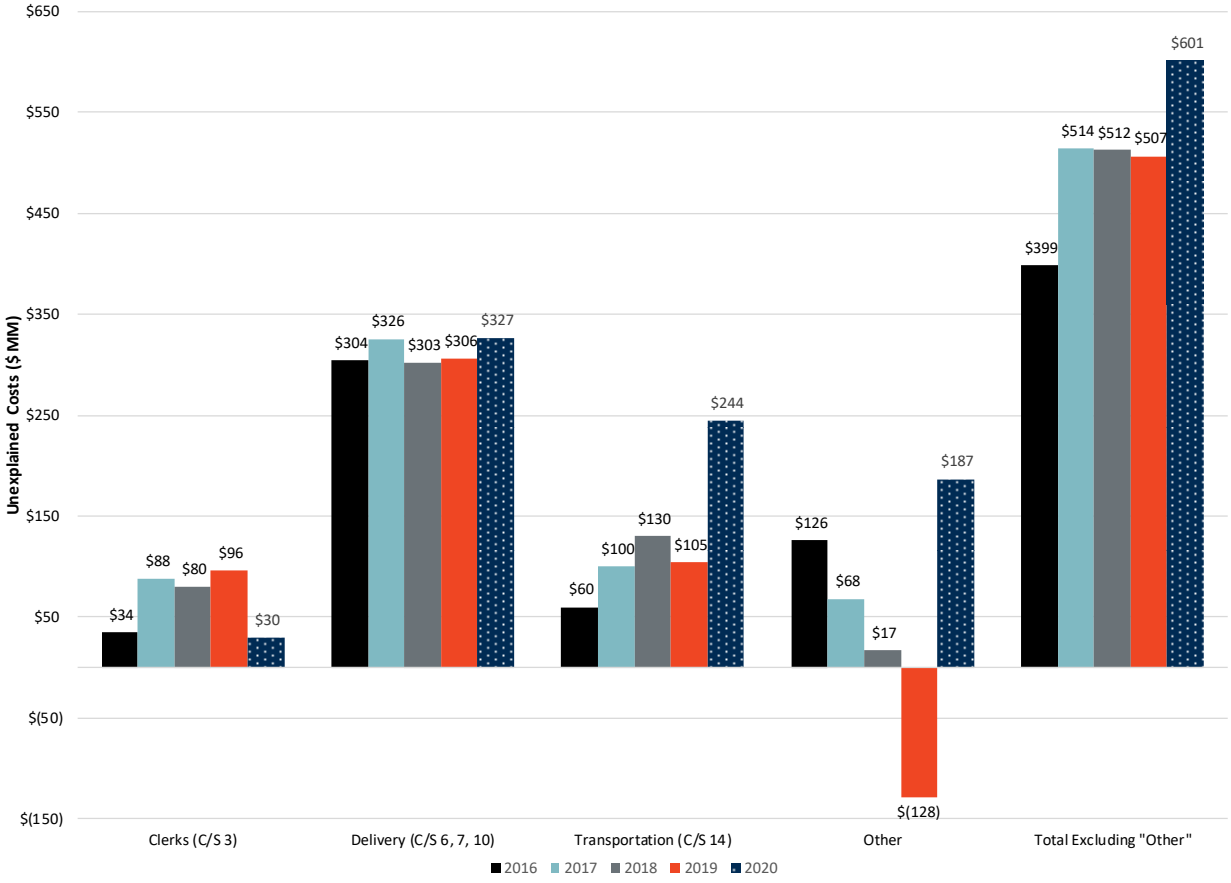
[40] The sum of the product-level attributable costs for competitive products in 2019 was $15.669 billion while total competitive incremental costs, as a group, are $15.960 billion. *See* FY2019 Public Cost and Revenue Analysis, at 3; *see also* PRC-LR-ACR2019-1\FY19 Summary LR-1.xlsx. Thus total competitive incremental costs exceed product-level attributable costs by less than 2%.

IV. SEVERAL OF THE POSTAL SERVICE'S MAJOR COSTING MODELS FAIL TO ADEQUATELY ACCOUNT FOR SEASONAL VARIATION

The existence of large volumes of peak-season costs that are missed by current costing models demonstrates that those costing models are not working properly. Existing costing models fail to attribute peak-season costs in a manner that reflects the actual incremental costs of competitive products. These flaws undermine the ability to calculate costs accurately, especially during peak season, but very likely also throughout the rest of the year.

When these costs are broken down by cost segment, more detailed analysis reveals additional year-to-year fluctuations in cost spikes that the costing models do not fully explain, as shown in Figure 10. The magnitude of the unexplained December costs vary from year to year, likely in part due to fluctuations in the timing of Thanksgiving and in part due to changes in "Other" costs that are ancillary to the core operational areas (processing, transportation, and delivery). Nevertheless, Table 3 above indicates that the presence of unexplainable cost increases is a consistent and recurring issue. Furthermore, as displayed in Figure 10, the unexplained December cost increase averages more than $500 million per year even after "Other" costs are excluded from the analysis.

Figure 10: Unexplained Cost Spikes by Cost Category, FY16-FY20[41]



In other settings, the Commission has argued that the "conclusion by UPS that seasonal trends are not reflected is incorrect,"[42] relying on the existence of quarterly distribution keys. However, for several reasons, the existence of quarterly distribution keys is insufficient to address the concerns raised here.

[41] National Trial Balance Reports (FY16-FY20), USPS Preliminary Financial Information reports (FY16-FY20), Cost Segments and Components Reports (FY16-FY20). Spikes are between November and December. The "Other" section excludes Cost Segments 18.3.3, 18.3.4, 18.3.6, and 18.3.7. FY20 unexplained spikes are based on preliminary analysis described above.

[42] Annual Compliance Determination Report, Dkt. No. ACR2018 (Apr. 12, 2019), at 123.

First, as demonstrated above, there is significant volume variation *within* quarters, and in particular within the fourth calendar quarter, which is most relevant to the current discussion.

Second, quarterly distribution keys are inadequate to address seasonal variation in costs if the volume variability of costs changes over the course of the year. Under such circumstances, products whose relative importance increases in the periods where volume variability is the highest will be under-costed. The general lack of seasonal variability estimates is therefore problematic. In a recent docket involving SPRs, the Postal Service estimated different variabilities for different times of the year, finding that the variability in the last five weeks of the year was as much as 24 percentage points higher than at other times of the year.[43] This large change underlines significant problems with other existing models, which largely rely on a single variability, as discussed in additional detail below.

Third, even this approach of estimating different variabilities for different times of the year is incomplete, as it captures variability only *within* those five weeks, and not the general phenomenon that seasonal volume surges—which are increasingly dominated by competitive products—cause operational changes that add hundreds of millions of dollars in costs every year. In other words, differences in the volume and composition of the mail across these time periods drive differences in the magnitude and structure of costs.

[43] *See* "A New Study of Special Purpose Route Carrier Costs" by Prof. Michael D. Bradley ("Bradley Report"), Docket No. RM2019-6 (June 21, 2019), at 39. The SPR regular delivery variability estimated by Professor Bradley is 80.9% during the peak season, but ranges from 56.9% to 65.7% during the other times of the year. *Id*.

Some specific flaws that are potentially responsible for the failure for current Postal Service costing models to accurately account for seasonal costs are discussed below. These are only examples, however, and the analytical principles that need to be changed go beyond these specific examples to the entire system for allocating costs. The fundamental design of that system was established decades ago in the context of delivering letters, and it is insufficient to determine and properly attribute the incremental costs of delivering packages today.

A. City Carrier Street Time

The costing model for city carrier street time, last updated in 2015 as part of Docket No. RM2015-7,[44] *assumes* that the operations of the Postal Service are uniform throughout the year, and does not account for any seasonal variations in operations or costs.[45] This assumption could only be valid if the Postal Service used a dataset fully representative of its yearly operations. But it does not do so. On the contrary, the Postal Service's city carrier cost model relies on a special study covering *just 12 days* in the *spring* of 2013 (for collection mail) and *13 days* in the *spring* of 2014 (for packages and accountables) using only 300 ZIP codes.[46]

These brief time periods are not a representative sample of delivery days for the year. Indeed, the Public Representative warned that this sample "did not capture

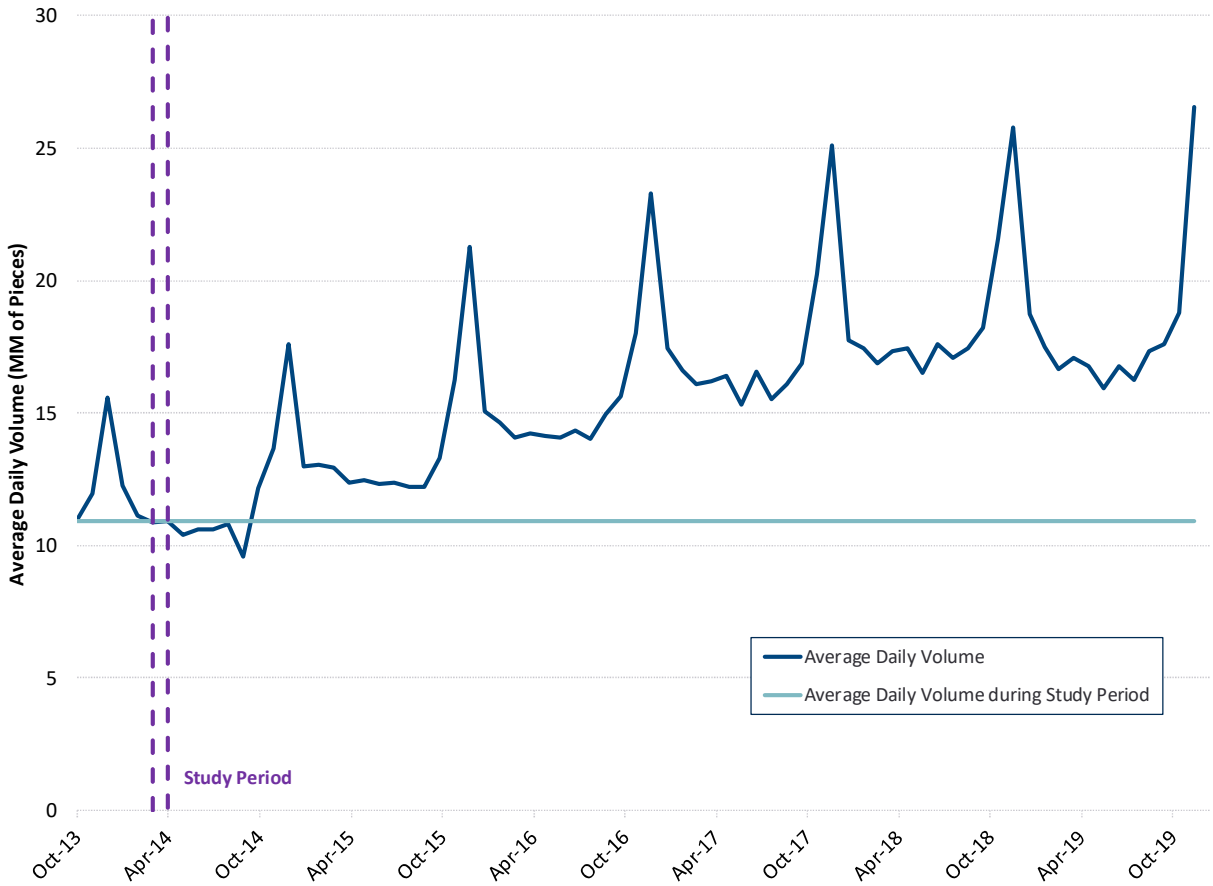
[44] Order Approving Analytical Principles Used in Periodic Reporting (Proposal Thirteen), Dkt. No. RM2015-7 (Oct. 29, 2015) ("Order No. 2792"), at 66.

[45] United Parcel Service Comments on Postal Service Proposal Thirteen Regarding City Carrier Street Time Costs, Dkt. No. RM2015-7 (Mar. 18, 2015), at 19.

[46] Report on the City Carrier Street Time Study, Dkt. No. RM2015-7 (Dec. 11, 2014), at 32, 93.

variation in parcel volume over the entire year,"[47] but this warning has not been heeded. There can be no doubt that this data collection period is not representative of the Postal Service's yearly operations because it misses the peak season with its extraordinary volumes and unique operations. As Figure 11 demonstrates, from 2013 to 2019, average daily total shipping and package service volumes have spiked every December. This means that a sampling process that relies only on a subset of spring days cannot capture this seasonal variation in package volume.

Figure 11: Average Daily Total Shipping and Package Service Volume, Millions of Pieces[48]



47 Order No. 2792 at 18.

48 USPS Preliminary Financial Information (Unaudited) Reports.

In Order No. 2792, the Commission noted that the short sample period was inadequate, stating that the Commission "supports the development of reliable operational data for each ZIP Code-day which would allow all days within a year to be used to estimate volume variabilities."[49] But the Commission accepted the short sample period as a practical necessity, noting that "more comprehensive data are not available."[50] The City Carrier Street Time costing model is plainly inaccurate, and that inaccuracy likely causes, at least in part, the hundreds of millions in unexplained costs per year UPS has identified in the Postal Service's cost models for delivery.[51]

City carrier costing also relies upon the separation of letter route costs into various cost pools, based on "Form 3999" route evaluations. Although the Postal Service conducts these evaluations throughout the year, they are exceedingly rare in December and instead are disproportionately concentrated during quieter times of the year, when city carriers spend a relatively smaller share of their time delivering parcels.

As shown in Table 4 below, the "package and accountable" share of gross street time is highest in December, yet less than 1% of route evaluations are conducted during December. Meanwhile, many of the months with the lowest package and accountable share (such as April, May, and June) are over-represented in the Form 3999 dataset.[52]

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[49] Order No. 2792 at 59.

[50] *Id*.

[51] *See supra* Figure 10: Unexplained Cost Spikes by Cost Category, FY16-FY20 (showing over $300 million in unexplained costs for Delivery (C/S 6,7, and 10).

[52] The Commission has defended this approach, stating that "because the Postal Service diverts packages from letter routes to SPRs during peak season to accommodate increased letter and package volume, it is unclear that any potential seasonal bias in sampling letter routes will under attribute costs to Competitive products." 2018 Annual Compliance Determination, at 124, citing Order No. 4259 from

Table 4: Deviation Parcel Share by Month[53]

Month [1]	Package / Accountable Delivery as a Share of Gross Street Time [2]	Share of Route Evaluations in Form 3999 [3]	Estimated Share of FY19 IOCS LTR Street Costs [4]
January	5.9%	3.5%	8.3%
February	5.6%	4.2%	7.8%
March	5.8%	7.5%	8.5%
April	5.5%	11.3%	8.4%
May	5.4%	12.4%	8.6%
June	5.1%	11.2%	8.1%
July	5.2%	10.2%	8.2%
August	5.5%	14.4%	8.9%
September	5.5%	16.4%	8.0%
October	5.5%	6.0%	8.7%
November	6.2%	2.4%	8.1%
December	8.5%	0.4%	8.3%

UPS has proposed solutions to these problems, including a modeling approach based on actual operational data. For instance, in the RM2015-7 docket, UPS proposed an alternative to Proposal Thirteen involving a model that would rely on Form

Docket Number RM2017-8. But this is nonsensical. While SPRs are more heavily used during the peak season, Postal Service operational data clearly indicate that letter route costs are substantial in December. And while the Form 3999 data are relatively scarce in December, they are still sufficient to demonstrate that letter route carriers spend a greater share of their December days delivering parcels than they do in any other month.

[53] Adj City LR Street Time Proportions_F3999.xlsx; USPS FY19 IOCS Data.

[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 shipping hours in month [1]).

[3]: Count of route evaluations in month [1] as a share of total route evaluations in "Adj City LR Street Time Proportions_F3999.xlsx" dataset.

[4]: FY19 IOCS LTR Street Costs in month [1] as a share of total FY19 IOCS LTR Street Costs.

3999 data to estimate city carrier costs.[54] The Postal Service defended the status quo, however, by claiming that UPS's proposals are not feasible in light of limitations in how the Postal Service collects data.[55] While the Commission has prodded the Postal Service to generate year-round datasets that would allow for an exploration of modeling approaches that capture many key elements of UPS's proposed solutions, the models used by the Postal Service remain flawed.[56] As a result, the Postal Service continues to use a model for city carrier cost attribution that virtually ignores peak-season costs. The Commission must now require that this error be corrected.

B. Special Purpose Routes

As noted, the Postal Service engages in a number of extraordinary activities to accommodate peak-season volumes, including sending its carriers on second and third pass city carrier delivery runs, and other "special" routes. The city carrier street time model for SPRs, however, suffers from flaws that assume away seasonal variations in operations and costs.

In Docket No. RM2019-6, the Postal Service revamped its Special Purpose Route model. As part of that process, the Postal Service did ensure that its new model

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[54] United Parcel Service Comments on Postal Service Proposal Thirteen Regarding City Carrier Street Time Costs, Dkt. No. RM2015-7 (Mar. 18, 2015), at 23-28.

[55] *See* Report on Research into the Ability of a Top-Down Model to Accurately Estimate City Carrier Street Time Variables, Dkt. No. PI2017-1 (Aug. 18, 2017), at 2-3 (noting that various types of data needed to update city-carrier street time methodologies do not exist).

[56] *See* Interim Order, Dkt. No. PI2017-1 (Nov. 2, 2018), at 17 (ordering the Postal Service to provide an expanded dataset of city carrier delivery data). More than seven years have elapsed since the Postal Service initiated the special study that forms the basis for allocating City Carrier costs. As this petition demonstrates, the Postal Service has changed immensely in the intervening time.

attributes a greater share of that cost pool during the peak season.[57] However, nothing in that docket addressed an issue that UPS has long raised: that the line between letter routes and special purpose routes remains blurred.[58]

As a result, a body of costs of unknown but likely significant size that is driven in large part by parcels is assigned to city carrier letter routes. Only a small portion of these costs are assigned to the parcel cost pool within the larger letter cost pool. The remainder are subject to low and irrelevant variabilities (for "regular" delivery based on seven-year-old data) and are distributed to products using distribution keys for shapes that consist primarily of letter mail for the entire quarter.

C. Highway Transportation

The Postal Service's highway transportation cost models also fail to account for changes in the mail mix during the peak season. The Postal Service uses short-term "Christmas Route" contracts when and as needed, primarily in its first fiscal quarter ("Q1"), which includes the month of December because the Postal Service's fiscal year runs from October 1 to September 30.[59] In Q1 of FY2019, costs on Christmas Routes

[57] Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal One), Dkt. No. RM2019-6 (Jun. 21, 2019) at 2 ("the growth in package volume has intensified the implications of the seasonal peak in package delivery, to the point that it is now essential that seasonality be examined and accounted for in an SPR cost analysis").

[58] Responses of the United States Postal Service to Questions 1-12 of Chairman's Information Request No. 5, Dkt. No. ACR2018 (Feb. 5, 2019), at 21.

[59] USPS-FY19-32/CS14-Public-FY19.xlsx, (accounts described as "CHRISTMAS" or "XMAS" as provided on worksheet <WS14.3>).

amounted to over $250 million.[60] While some Christmas Route costs appear in other quarters, the vast majority of them fall in Q1. But the Postal Service does not include trips provided under emergency contracts or Christmas contracts in its Transportation Cost System ("TRACS") system, which is the basis for the development of the quarterly distribution keys used to attribute volume variable transportation costs to products.[61] Accordingly, the mix of mail transported on Christmas Routes is not accurately estimated.[62] In light of the seasonal nature of Christmas Routes and the observable changes to the mail mix that occurs even within Q1, application of regular Q1 distribution keys to Christmas Routes likely contributes to under-attribution of costs to competitive products.[63]

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[60] *Id.* (adding the Q1 adjusted accrued cost totals for the 13 highway transportation account descriptions containing the words "CHRISTMAS" or "XMAS" as provided on worksheet <WS14.3>).

[61] Response of the United States Postal Service to Chairman's Information Request No.3, Dkt. No. RM2016-12 (Oct. 5, 2016), at 10; *see also* Order on Analytical Principles Used in Periodic Reporting (Proposal Four), Dkt. No. RM2016-12 (June 22, 2017) ("Order No. 3973"), at 17 ("Thus, neither Christmas nor emergency contracts are accounted for in the TRACS database.").

[62] *See* Order No. 3973 at 17-18, refuting the Postal Service's assertion that the "spikes in volume . . . being transported on Christmas routes…are appropriately captured by the quarterly distribution factors from TRACS," noting that this assertion "is not supported by any data analysis."

[63] Furthermore, while Order No. 3973 instructed the Postal Service to continue to apply the assumption of proportionality between *capacity and volume* (Order No. 3973 at 19), the variabilities used by the Postal Service as applied to the relationship between *cost and capacity* on Christmas contracts are still the same as those applied to regular contracts, ranging from 38% to 95%. In light of the Postal Service's acknowledgement of "some validity to the notion that seasonal contracts . . . are likely to be more directly related to changes in volume . . . than are regular contracts[,]" and that "the costs of such contracts . . . could perhaps be treated as more or even fully attributable," this issue merits further consideration by the Commission. *See* Reply Comments of the United States Postal Service, Dkt. No. RM2016-12 (Nov. 14, 2016) at 6.

V. ADDITIONAL DATA AND ANALYSIS ARE REQUIRED TO ADDRESS THE FACTORS DRIVING THESE UNEXPLAINED SEASONAL COST INCREASES

There are a number of different factors driving these unexplained cost increases. One possibility is that variable costs per piece are simply higher in the peak season than at other times of the year. Such increases could easily arise if, for example, it is necessary during this period for employees to incur more overtime and earn more overtime pay. Costing models like the current city carrier model that are based entirely on off-peak times of the year, or that underrepresent the peak season, almost certainly fail to capture or account properly for these higher costs.

It is also possible that the extraordinarily high volumes that occur during the peak season force the Postal Service to take special actions and set up temporary operations to accommodate the peak. Such actions could include establishing extra "Christmas" trucking routes to accommodate extra volumes, or setting up special purpose routes in locations that do not normally require them. When actions such as this occur, any start-up costs and/or fixed costs associated with these temporary operations should be attributed to the products experiencing the volume increases that make these temporary operations necessary. This is not currently done.[64]

A third possibility is that the unexplained cost increases that occur in the peak season evidence a more general under-attribution of competitive product costs. UPS

[64] We note that while in its recent update of its Special Purpose Routes costing model the Postal Service focused separately on the volume variability of December costs, it limited its analysis to locations with SPRs, implicitly ignoring the non-variable costs associated with the presence of an SPR. *See* Bradley Report at 32, note 10, discussing "the impact the volume peak has on the number of SPR locations": "the total number of finance numbers reporting SPR hours rises as locations that don't use SPR hours during the rest of the year add them in December."

has long argued that current Postal Service costing procedures fail to capture the full costs associated with its package business. Any such general under-costing of competitive products could be expected to lead to exactly the sort of unexplained peak-season cost increases that we have documented above. It could also explain the increases in institutional costs that have occurred in recent years, despite falling market dominant volumes.[65] Unexplained cost increases of the type seen in December could be expected to occur whenever the Postal Service experiences a substantial shift in mail mix towards packages, such as that caused by the COVID-19 pandemic. To address the reality that packages are now beginning to dominate a network created for letter mail, it is likely necessary for the Postal Service to undertake a complete revamp of its costing methodologies to ensure they accurately model the new normal. The more than $500 million in peak season costs that are unaccounted for every year are only one example of the serious deficiencies present in current costing models.

Some might argue that the unexplained seasonal cost increases documented here are the result simply of inclement winter weather. The facts do not support such a conclusion. If winter weather were the explanation, one would see similar unexplained cost spikes in January and February. But such spikes do not occur.

Determining which of these possible explanations—or what combination of them—accounts for the increase in costs observed during the peak season will require additional analysis and additional data. In particular, UPS urges the Commission to direct the Postal Service to produce supplemental data regarding its peak-season

[65] Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Dkt. No. ACR2019 (May 7, 2020), at 74-87.

operations. UPS has presented an analysis of peak-season trends in this filing based on publicly available cost and volume data. Supplemental data would allow UPS and other interested parties to conduct an even more refined analysis.[66] To that end, UPS requests the Commission order the Postal Service to produce the following data:

- Monthly product-level volumes, including a disaggregation of those volumes by delivery by city carriers on letter routes, by city carriers on SPRs, and by rural carriers;
- Monthly mailstream ("shape") volumes (DPS, FSS, in-receptacle parcels, etc.), broken down by city carrier letter routes, city carrier SPRs, and rural carrier routes;
- Microdata from the CCCS, the CCCS-SPR, the RCCS, IOCS, MODS, and TRACS, with product-level detail and time stamps intact;
- Monthly estimates of SPR and Letter Route costs;
- Product-level revenue and cost data in quarterly 10-Q reports; and
- Additional data relating to changes in operations by month.

VI. UPS PROPOSAL

In this petition, UPS has shown the following:

First, the Postal Service ramps up its operations every year to cope with peak-season demand for package deliveries, requiring it to incur extraordinary overtime costs, hire seasonal workers, and incur various other increased costs.

[66] Such data would permit consideration of issues, such as inframarginal costs and changes to the product-level mix within mail classes, which are not, to UPS' knowledge, possible with public data.

Second, the Postal Service's holiday deliveries of competitive products cause this ramp-up: the Postal Service would not incur sharp increases in peak season costs in the absence of competitive products.

Third, contrary to Order No. 3506 (and the similar incremental-cost test applied under 39 U.S.C. § 3633(a)(1)),[67] Postal Service models fail to capture this causal relationship and leave hundreds of millions of dollars in costs erroneously unattributed under 39 U.S.C. § 3633(a)(2) and unaccounted for under 39 U.S.C. § 3633(a)(1).

Fourth, the failure to properly attribute the spike in peak-season costs evidences a systemic failure of the existing costing methodologies in determining incremental costs.

Fifth, as a result, the Postal Service's competitive products are not held responsible for the full costs they impose on the enterprise during the peak season. Instead, current models systematically shift these costs into institutional costs, which are predominantly covered with market-dominant revenues.

UPS respectfully requests that the Commission direct the Postal Service to attribute unexplained peak-season costs to competitive products as a group under the incremental cost test utilized for 39 U.S.C. § 3633(a)(1), the provision that is meant to prevent subsidization of competitive products.

To do so, the Postal Service should first compute the predicted total change in cost from November to December using its current cost methodologies, as UPS has

[67] *See* Order No. 3506 at 125 ("The Commission directs the Postal Service to use incremental costs as the basis for class-level and product-level attributable costs.").

done in this petition to the extent permitted by publicly available data.[68] The Postal Service should then calculate the unexplained change in cost from November to December. This would be straightforward—the Postal Service need only subtract the total expected cost increase across all products from the total actual change in cost between November and December. As a last step in this methodology, the Postal Service should attribute this unexplained increase in costs from November to December to competitive products as a group by adding it to the incremental costs calculated under the Postal Service's pre-existing methodology used for 39 U.S.C. § 3633(a)(1).

With respect to 39 U.S.C. § 3633(a)(2), the above analysis demonstrates that existing cost attribution models are missing, at a minimum, hundreds of millions of dollars in competitive costs. The Postal Service should closely analyze the seasonality effects ignored by many of its cost segment models, including but not limited to its models for City Carrier Street Time and Highway Transportation. As soon as practicable, the Postal Service should revise these cost models to account accurately for seasonality effects. As an interim measure, however, the Postal Service should attribute the incremental costs identified for competitive products as a group to individual competitive products on a pro-rata basis by weighted volume. Pro-rata attribution of those overlooked costs is plainly superior to not attributing them at all, and this change alone would be a significant step towards compliance with Order No. 3506.

The Commission should also direct the Postal Service to take two additional steps that would lead to an improved cost methodology going forward. *First*, the Postal

[68] This is similar to the calculation underlying Table 2 above. However, due to data limitations, UPS calculated Table 2 using only class-level data.

Service should produce supplemental data regarding its peak season operations, consistent with the description in the previous section.

Second, as referenced above, the Commission should require the Postal Service to develop a new modeling approach for 39 U.S.C. § 3633(a)(1) and (a)(2) that addresses peak-season costs and the deficiencies in allocating incremental costs more generally. Given the magnitude of the issues raised here—which implicate the profitability of package delivery as increased volume demands additional resources—UPS believes that a comprehensive technical conference would be an appropriate next step towards this goal—and the Commission should consider whether it is necessary to undertake this process on an annual basis given the rapidly changing mail mix carried by the Postal Service.[69]

CONCLUSION

The Commission should adopt the proposals set forth above, requiring the Postal Service to: (1) attribute unexplained peak-season costs to competitive products as a group under the incremental cost test utilized for 39 U.S.C. § 3633(a)(1); (2) attribute the incremental costs identified for competitive products as a group to individual competitive products on a pro-rata basis by weighted volume, as an interim measure; and (3) produce the additional data requested in Section V of this petition. As noted, UPS would also welcome a technical conference, or other steps, to begin development of a methodology that properly determines incremental costs at both the class-level and

[69] A technical conference might also reveal additional datasets that are needed to explore the issues raised here.

product-level, for both the peak season and more generally for all costs throughout the year.

Respectfully submitted,

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