

BEFORE THE  
POSTAL REGULATORY COMMISSION

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Periodic Reporting (Proposal Seven)

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:  
: Docket No. RM2021-1  
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**INITIAL COMMENTS OF UNITED PARCEL SERVICE, INC.  
ON NOTICE OF PROPOSED RULEMAKING ON  
ANALYTICAL PRINCIPLES USED IN PERIODIC  
REPORTING (PROPOSAL SEVEN)  
(February 26, 2021)**

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United Parcel Service, Inc. (“UPS”) respectfully submits these comments in response to the Commission’s Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Seven), Dkt. No. RM2021-1 (Nov. 18, 2020) (“Order No. 5756”).<sup>1</sup>

**INTRODUCTION**

On November 9, 2020, the Postal Service filed a petition, supported by an accompanying report by Professor Michael D. Bradley, requesting that the Commission initiate a rulemaking proceeding to update the volume variability factors (“variabilities”) for highway transportation contracts (“Proposal Seven”).<sup>2</sup> Specifically, Proposal Seven seeks to modify the current costing methodologies for two types of routes that have become increasingly important in recent years, as the Postal Service delivers more packages: “Christmas” routes and routes that occur under Dynamic Route Optimization

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<sup>1</sup> Notice of Proposed Rulemaking on Analytical Principles Used in Periodic Reporting (Proposal Seven), Dkt. No. RM2021-1 (Nov. 18, 2020) (“Order No. 5756”).

<sup>2</sup> Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Seven) (“Petition”), Dkt. No. RM2021-1 (Nov. 9, 2020), at 1.

(“DRO”) contracts. Proposal Seven aims to update the Postal Service’s cost-to-capacity variability estimates for Christmas routes and DRO routes, based on data from the Transportation Contract Support System (“TCSS”), the same data source that was used to estimate the established cost-to-capacity variabilities for regular highway contracts.<sup>3</sup>

Proposal Seven is a modest step forward and UPS supports its implementation. At the same time, however, this proposal provides another example of how incremental costs of competitive products of the Postal Service are being systematically understated.

The costs in the first category of routes—*Christmas* transportation routes—are primarily costs the Postal Service incurs because of the large amounts of packages it delivers. The Postal Service is increasingly adding these Christmas routes in December, the peak season for packages, because it delivers more packages at that time. UPS has previously demonstrated that the Postal Service experiences large volume and cost increases every December, because holiday commercial activity drives major spikes in package shipments.<sup>4</sup> And as UPS has shown in other filings, if the Postal Service were not delivering packages, its overall volumes would *decrease* in December.<sup>5</sup> This dictates that all or nearly all of the costs of Christmas routes should be attributed to the Postal Service’s package business, since such routes would likely not exist without that business.

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<sup>3</sup> Petition at 2.

<sup>4</sup> See, e.g., Initial Comments of United Parcel Service, Inc. on United States Postal Service’s Annual Compliance Report for Fiscal Year 2020, Dkt. No. ACR2020 (Feb. 1, 2021), at 7.

<sup>5</sup> See, e.g., Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, Dkt. No. RM2020-9 (May 29, 2020), at 2.

But under Proposal Seven, approximately *half* of the costs of Christmas routes will not be attributed to packages. This low level of cost attribution results from flawed economic assumptions embedded in the Postal Service’s costing models—notably here, the assumption that the Postal Service’s operations are fixed. Because the Postal Service’s models assume that its operations are fixed, the models fail to account for the fact that the Postal Service would be able to eliminate all or nearly all Christmas routes if it stopped delivering packages. Those costs that would be eliminated if the Postal Service stopped delivering packages should, as an economic matter, be treated as *incremental* costs of the package delivery business.<sup>6</sup> Today, such costs are *not* included in the Postal Service’s calculation of incremental cost, and this omission causes the Postal Service’s costing models to systematically understate the true incremental costs of competitive products.

The same is true for the peak-season increase in Dynamic Route Optimization (“DRO”) contracts. DROs represent a new initiative where old fixed-price highway contracts are being replaced by new rate-per-mile contracts whose costs vary depending on departure times, lines of travel, mail types, and mail volumes.<sup>7</sup> DRO contracts spike during the peak season for package deliveries, and DROs used to address the seasonal spike in operations caused by competitive products should also be treated as largely incremental to competitive products. But this does not occur either, and Proposal Seven does not address this problem.

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<sup>6</sup> Order Proposing Regulations to Establish a System of Ratemaking (“Order No. 26”), Dkt. No. RM2007-1 (Aug. 15, 2007), at 65.

<sup>7</sup> Office of Inspector General, *Postal Service Dynamic Route Optimization and Cost Savings Initiative*, Report Number NL-AR-19-004 (Sep. 27, 2019), at 1.

In sum, while Proposal Seven is a modest improvement over the status quo, it highlights that Postal Service costing, in segment after segment, yields implausible results because it relies too heavily on the application of a costing framework that uses untenable assumptions. The Postal Service's costing framework takes the existence and magnitude of a cost as given, calculates a variability, and then allocates those costs to products using distribution keys. The cost framework does not, however, go to why those costs exist in the first place, or why they have grown so robustly over time—or how those costs would change if the Postal Service stopped delivering competitive products altogether. It was one thing to overlook those questions in the past, when package deliveries were not a major driver of the Postal Service's business. But today package deliveries are a major driver and are responsible for operational changes across the Postal Service's business.

As explained in the UPS presentation for the technical conference in the seasonality docket (RM2020-9),<sup>8</sup> the correct way to address these issues is to create a new model for the costs of a hypothetical Postal Service that delivers *only market-dominant products*. If the Commission subtracts the costs predicted by that model from total Postal Service costs, it will have a reliable estimate of the incremental costs of competitive products. Slight tweaks in the status quo models are not enough, as the results of this docket demonstrate.

Until the Commission implements that alternative approach, UPS agrees with implementing Proposal Seven as an improvement over the status quo. Even so, however, there are two important changes the Postal Service should make to the

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<sup>8</sup> Technical Conference, Dkt. No. 2020-9 (Sep. 29, 2020).

methodology before proceeding. Under the Postal Service petition, the distribution keys applied to Christmas and DRO routes remain the set of distribution keys derived from *regular* highway transportation accounts. Under Postal Service models, competitive products cause approximately 50% of attributable costs for regular highway transportation routes. The Postal Service proposes to apply that percentage to Christmas routes, even though competitive products likely make up a much larger percentage of volume on them and therefore cause a much larger percentage of costs. The same is true for the peak-season increase in DRO routes.

This is a significant inaccuracy. Applying a 50% proportion derived from regular highway transportation routes to routes where competitive products make up substantially larger shares of the volume yields unreliable results. The Postal Service should propose a way to more accurately apportion attributable costs, and until it does, should conservatively assume that all of the costs for these routes are caused by competitive products.

Separately, as detailed below, the Postal Service imports the capacity-to-volume variability from normal highway transportation routes to DRO routes due to a lack of data. That means only 77% of DRO route costs are considered attributable to products. But as detailed below, economic logic adopted by the Commission in other dockets dictates that 100% of these route costs are attributable. UPS submits that the Postal Service should use a 100% capacity-to-volume variability for DROs as well.

## **ARGUMENT**

### **I. THE COMMISSION SHOULD IMPLEMENT AN ALTERNATIVE ECONOMIC FRAMEWORK FOR EVALUATING THE INCREMENTAL COSTS OF THE COMPETITIVE PRODUCTS BUSINESS**

The Commission has a legal duty to ensure there is no “subsidization of competitive products by market-dominant products.” 39 U.S.C. § 3633(a)(1). The Commission analyzes the incremental costs of competitive products to implement this requirement.<sup>9</sup> Conceptually, this requires an analysis of what would happen in a but-for world in which the Postal Service did not offer competitive products. As the Commission has recognized, “[i]ncremental costs are the variable and fixed costs that would be eliminated if a product (or products) was (were) (hypothetically) discontinued.”<sup>10</sup>

As detailed below, both Christmas contracts and incremental peak-season DRO contracts are clear examples of costs that are largely, if not fully, incremental to competitive products. Yet the Postal Service cost models attribute only about *half* of these costs to competitive products.

#### **A. CHRISTMAS CONTRACTS**

Christmas route costs are primarily incurred during December, the peak season for package (but not mail) volumes. December accounts for 77% of annual Christmas route costs and 92% of Q1 Christmas route costs.<sup>11</sup> Indeed, these figures likely

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<sup>9</sup> Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products (“Order No. 43”), Dkt. No. RM2007-1 (Oct. 29, 2007), at 65.

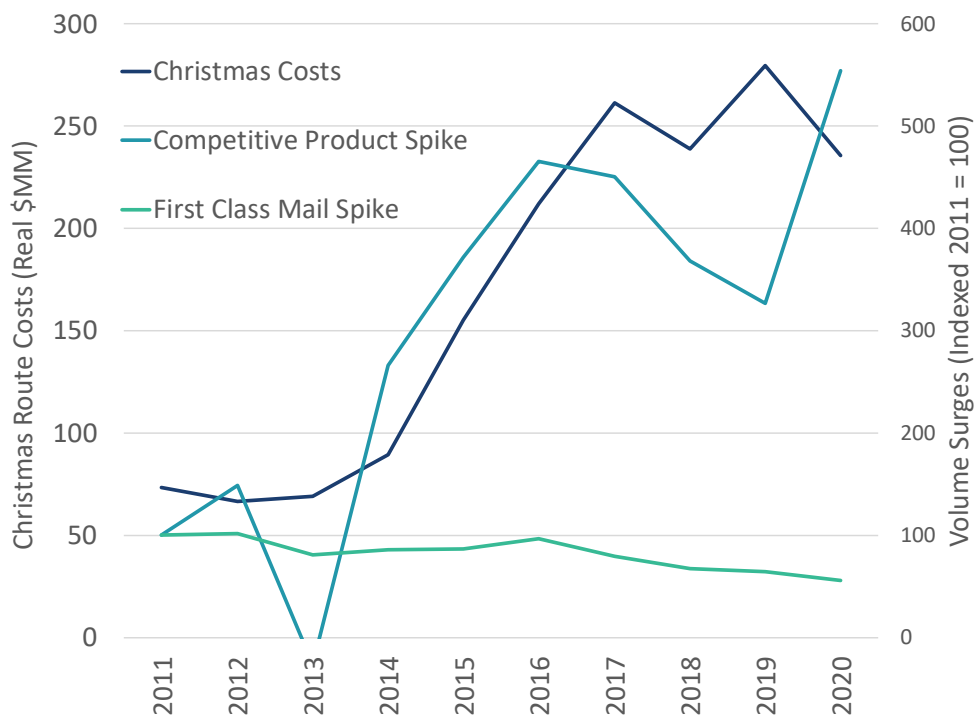
<sup>10</sup> Order Proposing Regulations to Establish a System of Ratemaking (“Order No. 26”), Dkt. No. RM2007-1 (Aug. 15, 2007), at 65.

<sup>11</sup> Total Christmas route costs were \$241 million in FY2020; \$187 million of those costs were incurred in December. See Monthly National Trial Balance Reports (2020).

understate the share of costs that are actually incurred in December, as “suppliers have ninety days to submit requests for late and extra trip costs occurred during the Peak Season.”<sup>12</sup>

The rapid growth in the Postal Service’s Christmas route costs over the past several years coincides with a period in which the peak season surge in competitive product volumes has grown. The size of peak season surge in first class mail has waned over the same period. These trends are depicted in Figure 1 below.

**Figure 1: Christmas Route costs and December volume spikes (FY2011-FY2020)<sup>13</sup>**



<sup>12</sup> See Responses of the United States Postal Service to Questions 1-9 of Chairman’s Information Request No. 1, January 7, 2021, (“Responses to CHIR 1”) at Question 2.

<sup>13</sup> Costs are from the trial balance and are deflated by a truck transportation producer price index from the Federal Reserve Economic Data, available at <https://fred.stlouisfed.org/> (Series PCU484484). Volume spikes for market dominant and competitive products are calculated by

Christmas route costs grew **321%** in real terms between FY2012 and FY2019. Competitive products are the only plausible explanation for this growth. Yet under current costing methodologies, only 43% of those costs are treated as attributable costs of domestic competitive products.

Every year the Postal Service makes a series of decisions to initiate Christmas routes at locations where it anticipates that it will need additional capacity to accommodate expected volume growth. As the Postal Service explains, Christmas route capacity is needed when there is not enough spare capacity on regular contracts to accommodate peak volume changes.<sup>14</sup> As UPS has explained elsewhere, these peak volume changes are driven by seasonal spikes in competitive product volumes.<sup>15</sup> At the conclusion of the annual peak season when competitive product volumes subside to normal levels, the Postal Service terminates these routes.

These facts indicate that Christmas route costs are largely—if not entirely—incremental to competitive products. Yet even after Proposal Seven is deployed, only roughly *half* of Christmas route costs will be treated as attributable costs of domestic competitive products.<sup>16</sup>

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first taking the difference between December volumes and November volumes in each fiscal year. These differences are indexed to 100 in FY2011; the December volume spikes in every year are thus expressed relative to the FY2011 volume peaks. The conclusions from this graph are qualitatively similar if the December volume surge is instead measured as the difference between December volumes and the average monthly volumes across the other 11 months of the fiscal year.

<sup>14</sup> Michael D. Bradley, Research on Updating Purchased Highway Transportation Variabilities to Account for Structural Changes (“Bradley Report”), Dkt. No. RM2021-1 (Nov. 9, 2020), at 2.

<sup>15</sup> Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, Dkt. No. RM2020-9 (May 29, 2020), at 1-2.

<sup>16</sup> FY20-Christmas\_Route\_Impact\_Analysis.xlsx in UPS-RM2021-1/1.



## **B. DRO CONTRACTS**

The other costs at issue in the petition, those associated with DRO contracts, present another example of why the status quo methodology is missing competitive incremental costs.

As noted above, DROs represent a new initiative where old fixed-price highway contracts are being replaced by new rate-per-mile contracts whose costs vary depending on departure times, lines of travel, mail types, and mail volumes.<sup>17</sup> DRO contracts replace standard processing and distribution center (“P&DC”) contracts,<sup>18</sup> and the Postal Service’s rationale for using DRO contracts was to make costs more responsive to demand (and volume).<sup>19</sup>

The Postal Service explains that while these contracts replace traditional processing and distribution center (“P&DC”) contracts, they have “important differences.”<sup>20</sup> These contracts do not have fixed routes. Instead, “[t]he routes travelled and number of stops made by a truck can change, depending upon the dynamics of volume flows.” Furthermore, DRO contracts “do not have fixed annual contract awards, but rather are paid on a per-mile rate. The per-mile rate is the same for all trips within a given contract cost segment.”<sup>21</sup>

As these routes continue to increase in number, it becomes increasingly important to ensure the relevant cost models are reliable and accurate. The Postal

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<sup>17</sup> Office of Inspector General, *Postal Service Dynamic Route Optimization and Cost Savings Initiative*, Report Number NL-AR-19-004 (Sep. 27, 2019), at 1.

<sup>18</sup> Bradley Report at 42.

<sup>19</sup> See, e.g., Responses of the United States Postal Service to Questions 1-7 of Chairman’s Information Request No. 2 (February 17, 2021) (“Responses to CHIR 2”) at Questions 2, 5.

<sup>20</sup> Bradley Report at 29.

<sup>21</sup> Bradley Report at 29.

Service has indicated that it expects DRO costs to continue to grow in coming years.<sup>22</sup>

As illustrated in Table 1 below, DRO costs have grown rapidly over the past several years and now represent more than 11% of the Postal Service's total transportation costs.<sup>23</sup>

**Table 1: Highway Transportation Costs by Type and Fiscal Year (in \$ millions)<sup>24</sup>**

Fiscal Year	Christmas Routes	DROs	Regular Highway Contracts	Total	Christmas + DRO Routes as a Share of Total
	[1]	[2]	[3]	[4]	[5]
2011	62	-	3,281	<b>3,343</b>	<b>1.9%</b>
2012	59	-	3,318	<b>3,377</b>	<b>1.8%</b>
2013	64	-	3,346	<b>3,409</b>	<b>1.9%</b>
2014	83	-	3,440	<b>3,523</b>	<b>2.4%</b>
2015	145	-	3,477	<b>3,622</b>	<b>4.0%</b>
2016	194	-	3,633	<b>3,827</b>	<b>5.1%</b>
2017	241	(0)	3,829	<b>4,070</b>	<b>5.9%</b>
2018	229	140	3,949	<b>4,319</b>	<b>8.6%</b>
2019	286	391	3,839	<b>4,516</b>	<b>15.0%</b>
2020	241	530	3,982	<b>4,753</b>	<b>16.2%</b>

DRO contract costs tend to spike in December compared to other months, implying that their growth in December is also disproportionately driven by and associated with competitive products. December DRO costs were \$151.6 million in FY20, compared to a monthly average of \$34.4 million in the other months.<sup>25</sup> The below chart depicts this trend graphically:

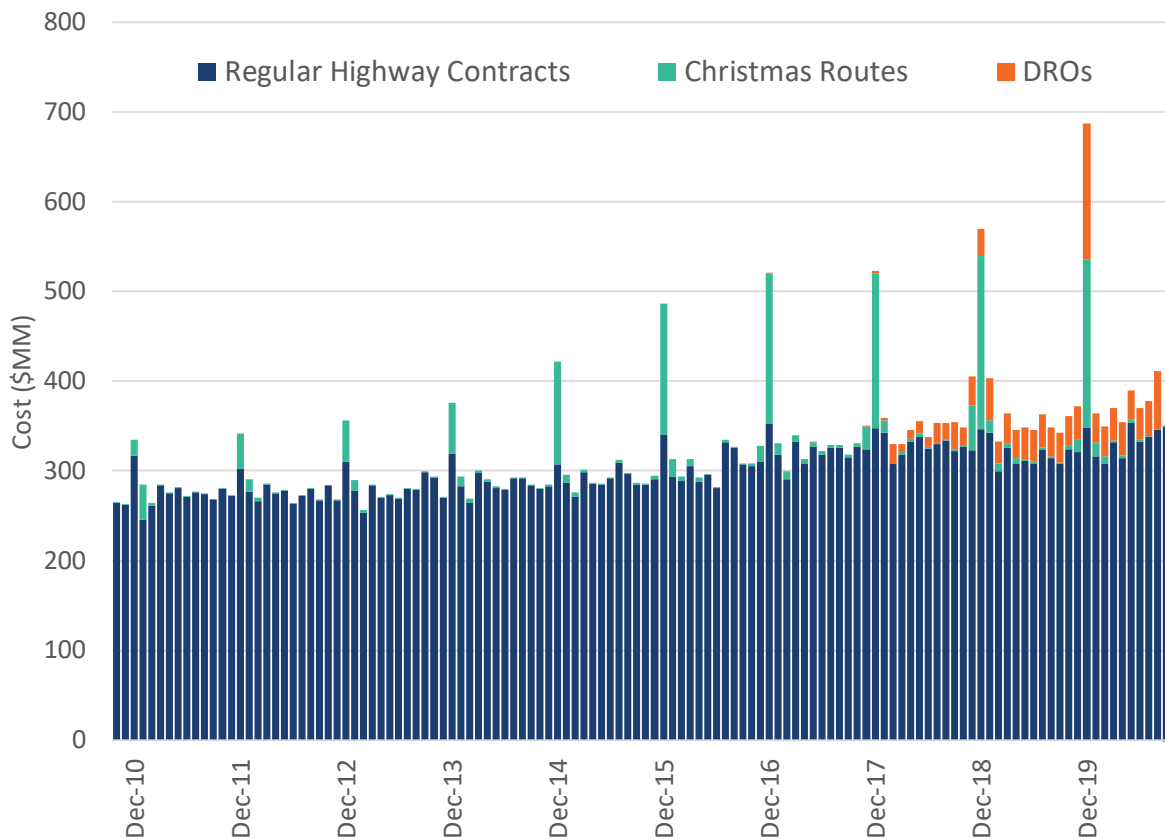
<sup>22</sup> See Responses of the United States Postal Service to Questions 1-7 of Chairman's Information Request No. 2, Dkt. No. RM2021-1 (Feb. 17, 2021), at Question 6.

<sup>23</sup>  $530 / 4,753 \approx 11.1\%$

<sup>24</sup> USPS Monthly Trial Balance Reports to PRC. Categorized using account numbers identified in Descriptive Statistics.sas, as provided in USPS-RM2021-1-1.

<sup>25</sup> USPS Monthly Trial Balance Reports to PRC. Categorized using account numbers identified in Descriptive Statistics.sas, as provided in USPS-RM2021-1-1.

**Figure 2: Highway Transportation Costs by Month and Type (FY2011-FY2020)<sup>26</sup>**



As with Christmas route costs, the peak-season increase in DRO route costs provides another example of costs that are largely caused by competitive products, yet have only a modest percentage of costs assigned to competitive products. Specifically, roughly 26% of FY2020 DRO costs are attributable to competitive products; under Proposal Seven that share rises only to roughly 41%.<sup>27</sup>

As UPS has discussed in more detail in the docket concerning its seasonality petition, to address these issues, the Commission should conduct a study of all the

<sup>26</sup> USPS Monthly Trial Balance Reports to PRC. Categorized using account numbers identified in Descriptive Statistics.sas, as provided in USPS-RM2021-1-1.

<sup>27</sup> See FY20\_DRO\_Variabilities\_Impact\_Analysis.xlsx in UPS-RM2021-1/1.

costs that could be saved if the Postal Service delivered only market-dominant products.<sup>28</sup> Until that is done, the incremental costs caused by competitive products will continue to be under-reported.

**II. THE PROPOSAL CAN BE IMPROVED EVEN UNDER THE STATUS-QUO ECONOMIC FRAMEWORK OF THE POSTAL SERVICE**

As noted, UPS agrees that Proposal Seven should be adopted. But even staying within the status quo economic framework of the Postal Service, there are two ways Proposal Seven should be modified to better ensure Christmas Route and DRO costs are reliably attributed to products.

First, the Postal Service should use a more reliable method for identifying appropriate distribution keys, as the Proposal makes the unwarranted assumption that the product/cost causation patterns for typical highway transportation routes also apply to these admittedly special categories of route transportation costs. Second, the Postal Service should apply a 100% “capacity-to-volume” variability to DRO route costs in addition to the proposed 100% “cost-to-capacity” variability, as the facts and circumstances of DRO Routes indicate the “capacity-to-volume” factor is also 100%. These modifications are detailed below.

**A. A Reliable Method for Estimating Distribution Keys for Christmas and DRO Route Costs is Needed**

Under Proposal Seven, the distribution keys applied to Christmas route and DRO costs are copied from the distribution keys applied to regular highway transportation route costs. Those distribution keys are estimated from TRACS data that does not

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<sup>28</sup> Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, Dkt. No. RM2020-9 (May 29, 2020), at 38-39.

sample Christmas routes, and has only recently begun sampling DRO routes.<sup>29</sup>

Because the Postal Service has not previously collected data on routes in these two categories, the Postal Service assumes that the product mix transported on Christmas and DRO routes is *identical* to the product mix transported on the corresponding regular highway transportation accounts in that quarter.

This assumption is not justified by the data, particularly during the time of year when Christmas routes are operating and when DRO costs peak. Evidence from TRACS data indicates that the mail mix on regular highway contracts in December—the time period when Christmas and DRO contracts are used extensively<sup>30</sup>—is more heavily skewed towards competitive products than in the rest of the quarter. Using TRACS data from FY2020, competitive products' share of cubic foot miles in December is measurably higher than in October and November.<sup>31</sup> This fact indicates that an even larger share of the *incremental* December cubic foot-miles on regular routes is comprised of competitive products. Yet current practice applies distribution keys that are based on a combination of the “baseload” mail volumes and the incremental mail volumes that appear on regular routes. Thus the application of regular route distribution

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<sup>29</sup> See Petition at 41, Responses to CHIR 1 at Question 4. In addition, the Postal Service has indicated that it “is currently investigating the feasibility of separately testing Christmas routes in TRACS.”

<sup>30</sup> December accounts for 77% of annual Christmas route costs and 92% of Q1 Christmas route costs. December accounts for 29% of annual DRO costs and 68% of Q1 DRO costs.

<sup>31</sup> For example, domestic competitive products make up 49% of the cubic foot-miles on Inter-SCF routes when analyzing October and November, but that rises to 56% when analyzing December only. See UPS-RM2021-1-1.

keys to these specialized contracts clearly results in the under-costing of competitive products.<sup>32</sup>

The lack of distribution key data on Christmas and DRO contracts is regrettable. Nonetheless, insisting that these costs be forced into the “regular” costing framework forces the Commission to adopt a proxy distribution key. The Postal Service’s proposed approximation, however, is almost certainly inaccurate, for the reasons outlined above. Simply put, there is no basis to believe that the quarter-long mail mix on regular routes reflects with any accuracy or reliability the incremental product mix that necessitates Christmas routes, or the peak season surge in DRO capacity and costs. Unless and until the Postal Service develops distribution keys that are based on the mail mix actually carried on those routes, the simplest and most accurate solution is for the Commission to require, conservatively, that all Christmas route costs and the peak season increase in DRO costs be attributed to competitive products. Until the Postal Service develops a suitable alternative, it should—consistent with prior practice—assign all of these costs to competitive products.<sup>33</sup>

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<sup>32</sup> Given the differences between Christmas and DRO contracts on one hand and regular highway routes on the other, it is plausible that the mail mix on these “irregular” routes is even more heavily comprised of competitive products than would be suggested by either a December-only distribution key from regular routes or a distribution key based purely on *incremental* December cubic foot-miles.

<sup>33</sup> For Sunday special purpose routes (“SPRs”), the Postal Service temporarily adopted a distribution key that attributed 100% of costs to competitive products, until it found a superior approach. See, e.g., USPS-FY18-32 Preface.pdf: “The treatment of this cost pool is 100 percent volume variable, and is all assigned to competitive products.”

**B. The “Capacity-to-Volume” Variability for DRO Routes is 100%**

Under the Postal Costing framework, the percentage of a cost component that is considered attributable to products is known as the “variability” of the cost component.<sup>34</sup> In the context of highway transportation costs, as explained by Professor Bradley, “[e]ach overall purchased highway transportation variability is the product of two parts: the relevant cost-to-capacity variability and the relevant capacity-to-volume variability.”<sup>35</sup>

The Postal Service petition presents what it calls “Final Estimates of DRO Highway Transportation Variabilities,”<sup>36</sup> but in fact the Postal Service only presents half of the picture—that table *only* presents the **cost-to-capacity** variabilities analyzed in Professor Bradley’s report.<sup>37</sup> To arrive at “final” variabilities for highway transportation, it is necessary to multiply the cost-to-capacity variabilities by the relevant capacity-to-volume variabilities. When this further step is completed, the “final” DRO Highway Transportation Variability is actually 0.773,<sup>38</sup> not the 1.0 number reported by the Postal Service.<sup>39</sup>

This result reveals the problem, as the capacity-to-volume variability should also be 1.0, which would then lead to an *actual* final variability of 1.0 (as 1.0 multiplied by 1.0

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<sup>34</sup> The “variability” percentage, however, does not mean the percentage of costs that are variable. It is equivalent to cost elasticity, or the percentage change in cost with respect to the percentage change in volume. Order re UPS Proposals One and Two (“Order No. 3506”), Dkt. No. RM2016-2 (Sept. 9, 2016), at 7.

<sup>35</sup> Bradley Report at 3.

<sup>36</sup> Petition at 4.

<sup>37</sup> Petition at 4 (reproducing Bradley Report Table 18).

<sup>38</sup> Professor Bradley explains the “best proxy” for capacity-to-volume variability is .773. Bradley Report at 42.

<sup>39</sup> Petition at 4 (while the Postal service accurately describes DRO costs as having a “cost-to-capacity variability equal to 1.0” in the text, it refers to a table that purports to show “Final Estimates of DRO Highway Transportation Variabilities” as a whole).

is 1.0). Professor Bradley argues to the contrary, stating that “there is not yet sufficient data to estimate a separate capacity-to-volume variability equation for DRO transportation.”<sup>40</sup> Instead, he recommends that the Postal Service adopt a “proxy” to estimate that variability, and suggests that the capacity-to-volume variability applied to DRO contracts should be the same as that applied to regular P&DC contracts, because DRO contracts are replacing P&DC contracts and “serve the same type of facilities.”<sup>41</sup>

But P&DC capacity-to-volume variability is **not** an acceptable proxy for DRO contracts. Unlike P&DC contracts, vehicle capacity on DRO routes is more responsive and flexible to volume changes. The Postal Service has indicated that for DRO contracts, “[t]he routes travelled and number of stops made by a truck can change, depending upon the dynamics of volume flows.”<sup>42</sup> Further, the Postal Service’s original rationale for moving from traditional to DRO contracts was precisely to make costs more responsive to volume.<sup>43</sup>

In Docket RM2016-12, the Postal Service relied on operational reasons why capacity might be less than proportional with volume:

For example, when volume rises, the Postal Service is able to take advantage of existing empty space and capacity does not rise as quickly.

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<sup>40</sup> Bradley Report at 41-42.

<sup>41</sup> Bradley Report at 42.

<sup>42</sup> Petition at 3.

<sup>43</sup> Office of Inspector General, *Postal Service Dynamic Route Optimization and Cost Savings Initiative*, Report Number NL-AR-19-004 (Sep. 27, 2019), at 5 (“The initiative allows for morning Highway Contract Routes (HCR) to change from a fixed-price contract with set routes (static), to a rate per mile (RPM) contract with varying departure times, lines of travel, and mail types transported based on mail volume (dynamic) to optimize routes thus reducing mileage and transportation costs.”).



When volume falls, network responsibilities preclude the Postal Service from reducing capacity in direct proportion to volume declines.<sup>44</sup>

The information the Postal Service has provided about DRO contracts is inconsistent with that rationale. Instead, the Postal Service has indicated that DRO contracts are more responsive to demand and can be terminated or added as demand conditions change.<sup>45</sup>

In that docket, the Commission faced a similar issue, where the Postal Service sought to apply the capacity-to-volume variabilities estimated on regular highway contracts to Christmas contracts. There, the Commission concluded that because Christmas routes “are likely to be more directly related to changes in volume . . . than are regular contracts,”<sup>46</sup> it made sense to continue the use of capacity-to-volume variabilities of 100%. The logic for the Commission’s conclusion in that docket regarding the capacity-to-volume variabilities for Christmas routes is perfectly mirrored here, this time with respect to DRO routes. Thus, for DRO contracts, the Commission should order the Postal Service to use a capacity-to-volume variability of 100%—and therefore an overall variability of 100%—for DRO route costs.

### **CONCLUSION**

UPS supports Proposal Seven because it is a step in the right direction and better than the status quo. At the same time, however, this Proposal raises several serious concerns that support UPS’s broader argument that the Commission should

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<sup>44</sup> Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), Dkt. No. RM2016-12 (Aug. 22, 2016), at 2.

<sup>45</sup> See, e.g., Responses of the United States Postal Service to Questions 1-7 of Chairman’s Information Request No. 2 (February 17, 2021) (“Responses to CHIR 2”) at Questions 2, 5.

<sup>46</sup> Order No. 3973 at 19.

alter the approach the Postal Service uses to estimate incremental costs. As discussed above, both Christmas routes and the peak-season increase in DRO contract routes are largely caused by competitive products, and are therefore largely incremental to competitive products. Yet under the proposed methodology, only roughly half of the costs will ultimately be paid for by competitive products. The best approach to handling this issue, as UPS has demonstrated in other dockets, is for the Commission to develop a model for the stand-alone costs of a hypothetical Postal Service delivering only market-dominant products.

Until the Commission implements this alternative approach, UPS supports Proposal Seven as a step forward but urges the Commission to include the two modifications discussed above: The Commission should order the Postal Service to (1) develop and then deploy a reasonable alternative for distribution keys, and as an interim measure attribute all of these costs to competitive products and (2) use a 100% “capacity-to-volume” variability for DRO Route Costs under the Commission’s reasoning in the docket addressing the same issue for Christmas Routes (Order No. 3973 at 17-19).

Respectfully submitted,

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