

**BEFORE THE
POSTAL RATE COMMISSION**

POSTAL RATE AND FEE CHANGES, 2006

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**RESPONSE OF UNITED PARCEL SERVICE TO
NOTICES OF INQUIRY NOS. 2 AND 3
(August 17, 2006)**

United Parcel Service (“UPS”) hereby responds to the Commission’s Notices of Inquiry Nos. 2 and 3 regarding the design of workshare discounts. Although the notices of inquiry do not focus on the classes of mail in which UPS is directly interested (i.e., Priority Mail, Express Mail, and Parcel Post), the principles underlying the design of workshare discounts affect all classes of mail, including, in particular, Parcel Post.

The Commission has long adhered to the principle of Efficient Component Pricing (“ECP”). UPS agrees with that approach. When applied to worksharing, ECP requires that the rate difference between two otherwise identical pieces of mail, one of which is workshared and one of which is not, should reflect only the costs avoided by the Postal Service due to worksharing. If the rate difference reflects more than the avoided cost, mailers will have an incentive to workshare even when the Postal Service could provide the worksharing services more efficiently, violating the economic principle that a service should be provided by the party that can do so at the lowest cost. That result would undermine the “primary purpose” of worksharing discounts -- the

“maximiz[ation of] productive efficiency within postal markets.” PRC Opinion and Recommended Decision, Docket No. MC95-1, ¶ 4210 (January 26, 1996).

Taking into account costs caused by a mailpiece characteristic that does not arise out of worksharing when deriving workshare rate differences is contrary to ECP. For example, worksharerediscounts that are developed consistently with ECP should not include any cost differences that are caused by the shape of the mailpiece. Instead, cost differences due to shape should be separately reflected in the rate structure.

Shape is a fundamental, intrinsic characteristic of a mailpiece that the mailer typically cannot change with additional preparation. For example, a mailer cannot convert a parcel into a letter simply by packaging it differently.¹ Thus, the rates for workshared letters should be compared to those for non-workshared letters, the rates for workshared flats should be compared to those for non-workshared flats, and workshared parcel rates should be compared to the rates for non-workshared parcels.

Unfortunately, the major mail classes are not currently defined on the basis of shape (with subclasses for each shape based, e.g., on service level). Mailpieces with fundamentally different processing characteristics and costs (letters, flats, and parcels) are mixed together in several subclasses even though they are handled in separate paths by different machines with different costs. As a result, differently-shaped

1. There are limited instances “at the margins” in which a mailer can change the “shape” of a mailpiece from a letter to a flat or vice versa, e.g., by adding thickness to a letter. But these exceptions exist only at the margins. Moreover, if, as discussed herein, the rates for different shapes of mail are accurately reflected in a sensible rate structure, mailers will not have an artificial incentive to change the shape of a mailpiece at the margins solely to achieve a more favorable rate.

mailpieces incur fundamentally different costs throughout their respective mailstreams, even within the same subclass.²

Based on these principles and given the current classification structure, UPS opposes the “de-linking” of the design of rates for workshared categories from non-workshared categories of the same shape and the setting of distinct revenue targets for workshared and non-workshared mail of the same shape. See NOI 3 at p. 2. De-linking workshared categories from non-workshared categories would make it more difficult for mailers to determine whether they can prepare mailpieces more efficiently than the Postal Service, and would create a large risk that the differences in rates between the workshared and non-workshared subclasses would improperly reflect factors unrelated to worksharing. See PRC Opinion and Recommended Decision, Docket No. MC95-1, ¶ ¶ 4253-60. Mailers would be encouraged to workshare even if it is less economically efficient for them to do so, shifting costs that are no longer recovered from the Postal Service’s workshare rates to the users of the remaining classes of mail.

Finally, because the calculation of the costs avoided by the Postal Service due to worksharing is imprecise, passthroughs of less than 100% of avoided cost estimates should be used in determining the discounts paid by mailers, with the degree to which the passthrough departs from 100% depending mainly on the Commission’s confidence

2. UPS long ago advocated the adoption of a simplified mail classification schedule organized principally by shape. See, e.g., Docket No. MC73-1, Statement of Paul Oberkotter on Behalf of United Parcel Service, UPS-T-1, pp. 13-20, and id., Statement of William R. Hughes, UPS-T-2. See also Docket No. MC76-5, Statement of William R. Hughes, Tr. 11/1049 et seq. That approach would simplify the ratemaking process and avoid or at least minimize rate anomalies.

in the avoided cost estimates. Otherwise, there is a danger that the Postal Service will not recover from workshare rates revenues commensurate with the costs incurred and a fair share of other costs (see, e.g., PRC Opinion and Recommended Decision, Docket No. MC95-1, ¶ 4225), to the detriment of the users of the nonworkshared categories and classes of mail.³

* * *

“Presort trees” are helpful for analyzing rate differentials within subclasses. Because mailpieces cannot readily be converted from one shape to another, presort trees should be organized by shape, with unique benchmarks for each shape, i.e., separate benchmarks for letters, flats, and parcels. The most costly rate category should be used as the benchmark, with workshared discounts (based solely on the costs avoided by the Postal Service) subtracted from the benchmark rate.

For the sake of simplicity, it is generally preferable to use fewer benchmarks and to organize the tree from most costly to least costly (or from least costly to most costly, with surcharges instead of discounts), rather than choosing benchmarks that lie

3. While there may be some loss of efficiency if a discount is not set high enough, a discount that is too low does not penalize mailers who do not (or cannot) take advantage of the discount; the loss of efficiency is not coupled with unfairness to non-worksharing mailers. On the other hand, discounts that are too high are both inefficient and unfair to mailers who cannot workshare.

somewhere between the most costly and least costly, which complicates the calculation of both discounts and surcharges.

Respectfully submitted,

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