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BEFORE THE
POSTAL REGULATORY COMMISSION

REGULATIONS ESTABLISHING SYSTEM OF RATEMAKING	:	DOCKET NO. RM2007-1

COMMENTS OF UNITED PARCEL SERVICE IN RESPONSE TO ADVANCE NOTICE OF PROPOSED RULEMAKING ON REGULATIONS ESTABLISHING A SYSTEM OF RATEMAKING
(April 6, 2007)

Pursuant to Order No. 2 (January 30, 2007), United Parcel Service ("UPS") hereby provides its comments as to how the Postal Regulatory Commission (the "Commission") can best fulfill its responsibilities (1) to establish a system for regulating rates and classes for market-dominant postal products and (2) to promulgate regulations to bound Postal Service discretion in setting rates for competitive postal products, while achieving the purposes of the Postal Accountability and Enhancement Act ("PAEA").

The Commission should ensure that PAEA's ultimate beneficiary is the general public, and especially consumers and smaller mailers. To that end, it is important that the Commission formulate strong, clear, and certain rules to properly implement one of PAEA's most-defining elements -- the separation of competitive from market-dominant products in order to ensure that the Postal Service is able to meet future needs and operate on a level playing field to the

benefit of the general public. While adjustments to procedures and rules should be expected over time as the Commission gains experience operating under the new system, the initial development of regulations is worth a significant investment of time and effort, since, to paraphrase, well-begun is half-done.

UPS believes that the new regime outlined by PAEA can be successful in achieving Congress' stated goal of allowing the Postal Service expanded pricing flexibility while providing greater protection to consumers and Postal Service competitors. As a Postal Service competitor, UPS's interest is ensuring that the Postal Service does not unfairly leverage its network -- which was created primarily with revenues from mailers of market-dominant products -- to compete in other markets.

I. The Commission Should Rigorously Exercise Its New Oversight Authority to Ensure that Market-Dominant Products Do Not Subsidize Competitive Products.

PAEA explicitly requires the Commission to establish regulations that "prohibit the subsidization of competitive products by market-dominant products." 39 U.S.C. § 3633(a)(1). To that end, UPS encourages the Commission to exercise the expanded authority delegated to it by PAEA with rigor. Although the Postal Service has been given increased pricing flexibility, the fact remains that, as Congress recognized, most of its revenue comes from market-dominant products. See S. Rep. No. 318, 108th Cong., 2d. Sess. (August 25, 2004), at 19. Thus, the Commission's comprehensive oversight of all product pricing, both for market-dominant and for competitive products, is crucial to ensure fairness to consumers and competitors.

As economist Alfred Kahn noted, "the single most widely accepted rule for the governance of the regulated industries is regulate them in such a way as to produce the same results as would be produced by effective competition, if it were feasible."[1] To achieve that result, the Commission must ensure not only that each competitive product covers its attributable costs, see 39 U.S.C. § 3633(a)(2), but also that competitive products bear the share of institutional costs that makes the maximum possible contribution to Postal Service overhead. And PAEA explicitly requires in section 3633(a)(1) that the Commission's regulations prohibit subsidization, by revenues or otherwise, in addition to requiring in sections 3633(a)(2) and (3) that competitive products recover attributable costs and an appropriate share of institutional costs. PAEA is "pro-active"; it does not provide only for an after-the-fact determination whether subsidies exist. It also requires that the Commission adopt rules designed to prohibit subsidy *before* the new ratemaking scheme takes effect.

In short, the Commission's regulations should take into account explicitly for the fact that competitive products gain an advantage from using a network built primarily with market-dominant revenues.

II. Each Competitive Product Must Cover Its Attributable Costs.

PAEA requires the Commission's regulations to "ensure that each competitive product covers its costs attributable." 39 U.S.C. § 3633(a)(2). This provision recognizes that an essential prerequisite to guaranteeing that market-

[1] Alfred Kahn, *The Economics of Regulation: Principles and Institutions, Volume I* (John Wiley & Sons, Inc., 1970), at 17.

dominant products do not subsidize competitive products is that the Commission first ensure that competitive products recover *at least* the costs that they cause. The Senate Committee recognized that "[o]ver the history of the Postal Reorganization Act the ability to accurately attribute costs has continually evolved, and the Committee expects that with greater transparency about the Postal Service's operations, this process will continue." S. Rep. No. 318, 108th Cong., 2d. Sess. (August 25, 2004), at 9. The Committee noted that PAEA is intended to improve cost attribution and prevent subsidies:

> "The goal of this process is to prevent the subsidization of competitive products by market-dominant products by better identifying the costs incurred by the Postal Service in providing competitive products. … The Postal Service should be able to attribute a greater percentage of its costs. If they do this, it is likely that a greater share of costs can be attributed to competitive products and, to the extent that they can be, should be reflected in the rates charged for those products."

Id. at 29-30 In short, the status quo is not an option: the transparency and accuracy of postal data must improve, and so too must cost attribution.

PAEA provides the Commission with authority to greatly improve cost attribution. To build and improve upon its past achievements in cost attribution, the Commission should demand more thorough and accurate cost data from the Postal Service, both in the annual reports to be filed under section 3651, but also as part of the Commission's regulations under sections 3622 and 3633 governing the Postal Service's exercise of its rate authority.[2] See Federal Communications Commission (FCC), *In the Matter of Policy and Rules Concerning Rates for*

[2] This is not to say that the section 3622 and 3633 regulations should require the same level of detail as will be required for the section 3651 reports.

Dominant Carriers, Second Report and Order, CC Docket 87-313, released October 4, 1990, at ¶ 303.

One example of a specific way the Commission can improve cost attribution is to attribute prior period retiree and health benefit costs. These labor-related costs should be attributed to the products that have caused them. The Commission now has the authority to obtain the information it needs to be confident that the classes that caused those costs pay them. Otherwise, competitive products would likely be subsidized by market-dominant products.

III. Competitive Products Should Make the Maximum Possible Contribution to Institutional Costs.

PAEA also requires that competitive products collectively bear an "appropriate" share of the Postal Service's institutional costs. 39 U.S.C. § 3633(a)(3). Given the statute's mandate "prohibit[ing] the subsidization of competitive products by market-dominant products," 39 U.S.C. § 3633(a)(1), the Commission should make this determination in a way that best protects Postal Service customers who use market-dominant products.

PAEA recognizes that competition will protect the interests of Postal Service customers who have good competitive alternatives from unduly high prices. Consumers of market-dominant products, however, do not presently enjoy the protection of effective competition. The Commission must provide the missing protection in part by ensuring that customers of market-dominant products are not saddled with an unduly large share of institutional costs.

UPS encourages the Commission to maximize competitive product revenues, and thereby give market-dominant customers the greatest possible benefit from the Postal Service's provision of competitive products. Specifically, the Commission should adopt practical rules that, to the extent possible, require the Postal Service to price competitive products to secure the maximum contribution to institutional costs. Such a requirement will help the Postal Service to fulfill the mandate to price market-dominant classes at or below the rate cap.

A policy that ensures the maximum institutional cost contribution from competitive products will also provide a safety net to ensure that market-dominant products do not subsidize competitive products in any way. To the extent that inaccuracies in cost data lead to attribution below actual attributable costs, the institutional cost contribution can help guarantee that this most pernicious form of subsidy will not exist.

UPS submits that meeting the goal of protecting both users of market-dominant products and private companies that compete with the Postal Service requires the Commission to reduce its reliance on demand elasticities which inevitably impose a larger share of institutional costs on market-dominant products. Otherwise, the Commission would punish customers of market-dominant products because they have no other options and competitors who efficiently provide attractive alternatives for customers. Such a result is not consistent with PAEA.

In sum, ensuring that the Postal Service distributes a fair portion of institutional costs to competitive products is not simply a means of leveling the

playing field to the benefit of Postal Service competitors; it is also critical to the protection of consumers, who should be the ultimate beneficiaries of PAEA.

Respectfully submitted,

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