

**BEFORE THE  
POSTAL REGULATORY COMMISSION**

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**REGULATIONS ESTABLISHING  
SYSTEM OF RATEMAKING**

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**DOCKET NO. RM2007-1**

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**REPLY COMMENTS OF UNITED PARCEL SERVICE  
IN RESPONSE TO SECOND ADVANCE NOTICE OF  
PROPOSED RULEMAKING ON REGULATIONS  
ESTABLISHING A SYSTEM OF RATEMAKING  
(July 3, 2007)**

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Pursuant to Order No. 15 (May 17, 2007), United Parcel Service hereby replies to the initial comments of other parties.

**QUESTION 4**

We agree with the Postal Service's definitions of "expedited mail" and "priority mail." We also agree generally with the Postal Service's definitions of "bulk parcel post" and "bulk international mail." However, "bulk parcel post" should include *all* multiple-piece Parcel Post shipments entered by commercial mailers, including undiscounted shipments now entered by commercial mailers as Intra-BMC and Inter-BMC pieces. It should not be limited to pieces that currently receive a workshare, prebarcode, or other discount. Multi-piece commercial Parcel Post mailings of Intra-BMC and Inter-BMC parcels should not be classified as "single-piece parcel post" merely because the current mail classification schedule and postal data systems do not yet distinguish them from "true" single-piece parcels.

Our approach is consistent with the Postal Service’s view that “bulk international mail” includes all “multi-item mailings tendered by a single mailer.” Postal Service Comments at 13.

Finally, we agree with those parties (including the Postal Service) who have suggested that “bulk parcel post” includes all mail entered under the Parcel Select Return Service categories (DMCS §§ 521.27 and 521.28). See, e.g., Postal Service Comments (June 18, 2007) at 12. These pieces are also not “single-piece parcel post.”

### **QUESTION 5**

For several reasons, we disagree that the information in the Postal Service’s annual report should always be sufficient to support later-noticed competitive product rate changes. See, e.g., ADVO Comments (June 18, 2007) at 10.

First, the annual report may not contain all of the information necessary to support a noticed rate change. At least the statute does not require it to contain volume and billing determinants, which are important for determining the propriety of rate changes.

But even if this information were in the annual report, PAEA expressly requires the Commission to (1) “prohibit” subsidy of competitive products; (2) “ensure” that each competitive product covers its attributable costs; and (3) “ensure” that competitive products as a whole cover an appropriate share of institutional costs. 39 U.S.C. § 3633(a). Contrary to those who argue that the Commission does not have the authority to review proposed competitive rate changes, see, e.g., ADVO Comments at 10, PAEA has specifically charged the Commission with the responsibility of determining how best to ensure or “make certain” that these requirements are met. See

Merriam Webster's Collegiate Dictionary (10th ed. 1997) at 386. The Commission cannot guarantee that they are met unless it conducts at least some limited pre-implementation review, based on readily available historical data likely reviewed by the Postal Service in formulating the proposed rates.<sup>1</sup>

By explicitly requiring a written “statement of explanation and justification” for all competitive rate changes, PAEA clearly contemplates some form of Commission review before new rates are implemented. 39 U.S.C. § 3632(b)(1). What is the purpose of a written “justification” if no one is to review it? While PAEA gives the Postal Service increased competitive pricing flexibility above the mandated cost floor, reading sections 3632 and 3633 together demonstrates that Congress envisioned some prior Commission assessment of proposed rates. The Commission should require at least a prima face showing that the proposed rates comply with section 3633. That is especially so since the assessment must be completed so quickly.

Relying solely on the last annual report will not always ensure proper rates because the information in that report could well be too dated. For example, were the Postal Service to decide to change competitive rates of general applicability on January 15 each year, the data contained in the last annual report would likely be almost 15 months old when the new rates are noticed and more than 15 months old when they take effect. If circumstances such as costs or volumes have changed significantly since the last report, the Commission would not have any way of knowing whether the new rates comply with section 3633. That is especially problematic if rate decreases are proposed.

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1. We do not suggest that the Postal Service should be required to file “test year” projections, or any future estimates.

If, as we propose, the Commission requires volumes, revenues, billing determinants, and attributable cost information to be included in the annual report, then the data contained in that report may be sufficient to support later-noticed rate changes if the new rates go into effect no later than, say, three months after the annual report is submitted. Perhaps the Commission's rules could require updated data when new rates are to be implemented more than three months after the last annual report was filed.

Requiring updated historical data with a notice of a rate change will also reduce the likelihood that parties will file complaints, some of which could turn out to be groundless when the data is later supplied in the complaint case.

While we are sensitive to concerns regarding the disclosure of confidential information, none of the information in question -- attributable costs, revenues, volumes, and billing determinants -- has ever been insulated from public disclosure during the 35 year history of the Postal Reorganization Act when new rates were proposed. Certainly, PAEA has not cloaked competitive product ratemaking in a veil of secrecy, and there is nothing in PAEA which suggests that information which has always been disclosed prior to PAEA's adoption has suddenly become more confidential than it had previously been. To the contrary, PAEA's goal is to increase -- not decrease -- transparency. See H. Rep. No. 66, Part I, 109th Cong., 1st Sess. (April 28, 2005), p. 43. Moreover, Congress has given the Commission the tools necessary to make sure that truly confidential information will be protected from widespread disclosure and used only for appropriate purposes. 39 U.S.C. § 504(g).

Because section 3633's requirements apply to "competitive products as a whole," compliance with that section can only be ensured if relevant information on all

competitive rate changes, including those not of general applicability, is provided. That will be even more essential if customized contract rates come to represent an increasingly larger share of competitive product revenues.<sup>2</sup>

### **QUESTION 6**

We agree with the Postal Service that “PAEA has altered the taxonomy of postal costs.” Postal Service Comments at 20. The Postal Service interprets section 3633 to require that competitive products as a whole must cover (1) the sum of each competitive product’s attributable costs; (2) the costs that are specific to competitive products as a whole (what it aptly calls “group-specific” costs); and (3) an appropriate share of institutional costs. Postal Service Comments at 23. In large part, we agree.

We believe that long-run incremental costing is the appropriate basic measure of each competitive product’s attributable costs. As the Postal Service states, competitive products as a whole must also cover “group-specific” costs to avoid subsidy. Again, long-run incremental costing for product groupings is the appropriate method for measuring group-specific costs. We also agree with the Postal Service that competitive products’ “appropriate share” of institutional costs is part of the “cost floor.” Postal Service Comments at 17. While the Postal Service stops there, PAEA also makes assumed federal taxes a competitive products cost, 39 U.S.C. § 2011(h), and the statute indicates that competitive products as a whole should cover an amount equal to whatever net economic benefit the Postal Service realizes due to any preferential

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2. In contrast, the Postal Service need not file updated cost, revenue, and billing determinant information for market-dominant rate changes because there the price cap is what determines the legality of the changes. See 39 U.S.C. § 3622(d).

treatment it receives under federal and state laws, if the FTC and the Commission determine there is such a benefit. P.L. 109-435, § 703.

Again, we agree that the “appropriate share” of institutional costs for competitive products “is best calculated as a mark-up on the sum of the competitive products’ attributable cost.” Postal Service Comments at 23. We suggest that, initially, the Commission use the collective competitive products markup in the very recently concluded rate case, Docket No. R2006-1, until there is some experience with how the new statute is working in practice.

The Docket No. R2006-1 markups represent the Commission’s current in-depth consideration of the appropriate share of institutional costs that should be recovered from competitive products. They were not arbitrarily chosen, but rather were developed on the basis of factors germane to PAEA’s mandate that the Commission “consider all relevant circumstances, including the prevailing competitive conditions in the market. . . .” 39 U.S.C. § 3633(b). Those factors are virtually identical to the factors in section 3622(c) of PAEA. Because the PAEA framework is new and untested, it makes sense initially to use markups that have only recently been adopted after thorough consideration by the Commission.

As we have said, the Commission’s combined cost coverages for competitive products have fallen almost 15 percentage points since Docket No. R87-1. UPS Comments (June 18, 2007) at 10. Thus, the R2006-1 competitive product markup already reflects dramatic reductions in the institutional costs paid by competitive products. To lower it still further in the absence of any meaningful experience under PAEA would be arbitrary.

Of course, the R2006-1 competitive product markup will be reevaluated when the Commission performs the 5-year review of minimum contribution required by section 3633(b).

#### **QUESTION 7**

Having reviewed the comments of other parties, we agree that the Postal Service's assumed income tax liability is a "group-specific cost," as that term is defined by the Postal Service, and should not be attributed to each individual product. See Postal Service Comments at 21.

The Postal Service is concerned that a markup should not be applied to the tax liability, because that would lead to a payment greater than the Postal Service would face if it were a private corporation. Postal Service Comments at 27-28. We understand the Postal Service's point, and we agree that it would be inappropriate to mark up a non-operating item such as the assumed tax liability. Thus, the tax should be added to group-specific costs *after* any markup is applied.

#### **QUESTION 8**

We agree with the Postal Service that costs currently classified as "institutional" should be analyzed to determine the extent to which competitive products cause them. Postal Service Comments at 28 n. 30. To ensure that market-dominant products do not subsidize competitive products, the revenues from competitive products must recover these "group-specific" costs.

We also agree with NAA that city carrier cost attribution must improve. NAA Comments (June 18, 2007) at 12-14. As NAA has indicated (p. 13), there is a substantial risk of subsidy when the amount of city carrier costs that are deemed

“institutional” -- currently, \$7.5 billion -- exceeds the entire amount of costs attributed to Priority Mail, Express Mail, and Parcel Post collectively. As a starting point, at least those city carrier costs that are incurred only in competitive product operations should be attributed to competitive products as “group-specific” costs. Id.

We also agree that the Commission should initiate separate costing proceedings to resolve this, and other, costing issues. Id. at 11-12. Perhaps the Commission could begin with a proceeding dealing solely with city carrier costs because that is the least attributed of the major operational cost segments, with later proceedings dealing with other costs.

#### **QUESTION 9**

PAEA defines “product” as “a postal service with a distinct cost or market characteristic for which a rate or rates are, or may reasonably be, applied.” 39 U.S.C. § 102(6). Most competitive customized rate agreements are likely to be based on the distinct cost or market characteristics of the customer’s mail. Therefore, they are likely “products” for purposes of the Commission’s regulation of competitive rates. See, e.g., GCA Comments (June 18, 2007) at 10.

Interpreting “products” to apply to contract rates should not impose an undue burden on the Postal Service. For market-dominant products, none of the requirements of sections 3621 and 3622 applies at the product level. Sections 3652(a) and 3691(b) require measures of market-dominant service performance at the product level, but if all similar contracts (i.e., all First Class mail contracts) are grouped within the same class, measuring service performance at the class level would be sufficient because the results would apply equally to all products within the class.

For competitive products, the requirement that each product must cover at least the costs attributable to it should be applied to contracts which provide for special rates, to prevent undue preferences. See 39 U.S.C. § 403(c). Indeed, it would be surprising if the Postal Service did not monitor whether it is covering attributable costs on each of its contracts with special rates.

However, having reviewed the comments of other parties, we can conceive of situations where customized contracts may not be “products.” For example, contracts that specify specialized entry requirements or mail preparation features which do not have unique rates or significant cost implications may not fall within the statute’s definition of a “product.” Thus, we agree with the suggestion that the Commission should not decide this issue now, in a vacuum, but should instead decide it on a case-by-case basis until the appropriate governing principles emerge. See, e.g., NAA Comments at 16.

Regardless of whether or not the Commission defines competitive customized rate agreements as “products,” the Commission should require that all competitive customized contract rates cover attributable costs. Otherwise, contract mailers will be granted an undue preference, and the non-favored users of other competitive products will subsidize the rates given to these “preferred” shippers. See 39 U.S.C. § 403(c) (prohibiting “undue or unreasonable discrimination among users of the mails” and “undue or unreasonable preferences to any such user.”)

The likelihood of unduly or unreasonably discriminatory contract rates will increase as customized agreements account for a greater share of competitive product revenues. If an increasingly larger share of competitive rates are not covering

attributable costs, the users of the non-contract rates will be unfairly burdened with recovering them.

### **CONCLUSION**

The Commission's task of interpreting and implementing PAEA is complex. To the extent possible, the Commission should interpret PAEA in a way that recognizes the value of administrative simplicity and practicality, and that minimizes the Postal Service's burden, while remaining consistent with the statutory requirements.

Respectfully submitted,

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