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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 ORDER PROPOSING REGULATIONS
TO ESTABLISH A SYSTEM OF RATEMAKING
(September 24, 2007)

Pursuant to Commission Order No. 26 (August 15, 2007), United Parcel Service comments on the Commission's proposed regulations to administer certain provisions of the Postal Accountability and Enhancement Act ("PAEA"). We comment only on the "appropriate share" of institutional costs to be contributed by competitive products.

Appropriate Share of Institutional Costs

UPS agrees that the Postal Service should be expected to contribute more than 5.5% of the total institutional costs of the Postal Service initially proposed by the Commission. *See* Order No. 26 at 72, ¶ 3056 (expressing "the hope (and expectation) . . . that competitive products will generate contributions in excess of the floor"). While dissatisfied with the proposed level of the minimum contribution, UPS understands the transitional needs of the Postal Service and therefore does not object at this time to a minimum contribution of 5.5%. However, once the PAEA is fully implemented and the

accounting principles and practices mandated by 39 U.S.C. 2011(h) are established, UPS urges the Commission to establish a fixed, rather than a minimum, percentage of total institutional costs as the "appropriate share" to be paid by competitive products, with that percentage reflecting competitive products' historic contribution levels over a period longer than just two years.

A. Once past the implementation phase, the "appropriate share" of competitive products' institutional cost contribution should not be set as a contribution "floor."

After the interim period during which the PAEA is initially implemented, UPS suggests that the Commission set the "appropriate share" at a level that better represents the share of institutional costs competitive products should be expected to contribute, rather than a minimum contribution that should be exceeded.[1] UPS believes that such an approach is more workable and more consistent with the PAEA's partitioning of competitive and market dominant products.

The Commission should then provide the Postal Service with more specific direction on the share of institutional costs that competitive products are expected to pay, so that the Postal Service knows with greater certainty what it must recover from market-dominant products. Eventually, the "appropriate share" should represent the actual contribution that competitive products must make.

As others have argued, the Postal Service provides competitive products in large part to minimize the burden of network costs on its market-dominant products. *See,*

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1. The PAEA's use of the term "share" should be given its common meaning, which is "a portion . . . contributed by an individual or group," not just a lower limit. *Merriam Webster's Collegiate Dictionary* (Tenth Edition 1997), at 1077.

e.g., Reply Comments of ADVO, Inc. in Response to Second Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking (July 3, 2007) at 4. The PAEA recognizes that competition will protect mailers who have competitive alternatives. It requires, as one of its "Objectives," the Commission "[t]o allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products." 39 U.S.C. § 3622(b)(9). If 5.5% of total institutional costs are allocated to competitive products, then 94.5% of such costs will necessarily be allocated to market-dominant products. Prescribing an actual expected contribution from competitive products rather than a "floor" would mitigate the effect that a competitive contribution set at the minimum "floor" would have on market-dominant products, yet would still retain pricing flexibility for the Postal Service both for competitive and for market-dominant products.

B. For the long term, the share of total institutional costs allocated to competitive products should more accurately reflect historic levels.

As the Commission has stated, the proposed competitive product contribution percentage of 5.5% is "influenced by historic results": it is based on the contribution competitive products have actually made in the past two years. Order No. 26 at 73, ¶ 3059.

While the postal regulatory regime is being largely revised, UPS does not object to that rate of contribution as a transitional measure, despite concerns regarding it.

For the longer term, UPS suggests that using only two years as a measure of historic results is too short-sighted. The current circumstances indicate why two years

is too short. The rates in effect in FY2005 and FY2006, which dictated the contribution levels for those years, were set as a result of non-precedential rate case settlements.[2]

The following chart shows our best approximation of actual competitive product contribution percentages from FY1990 to FY2006.[3]

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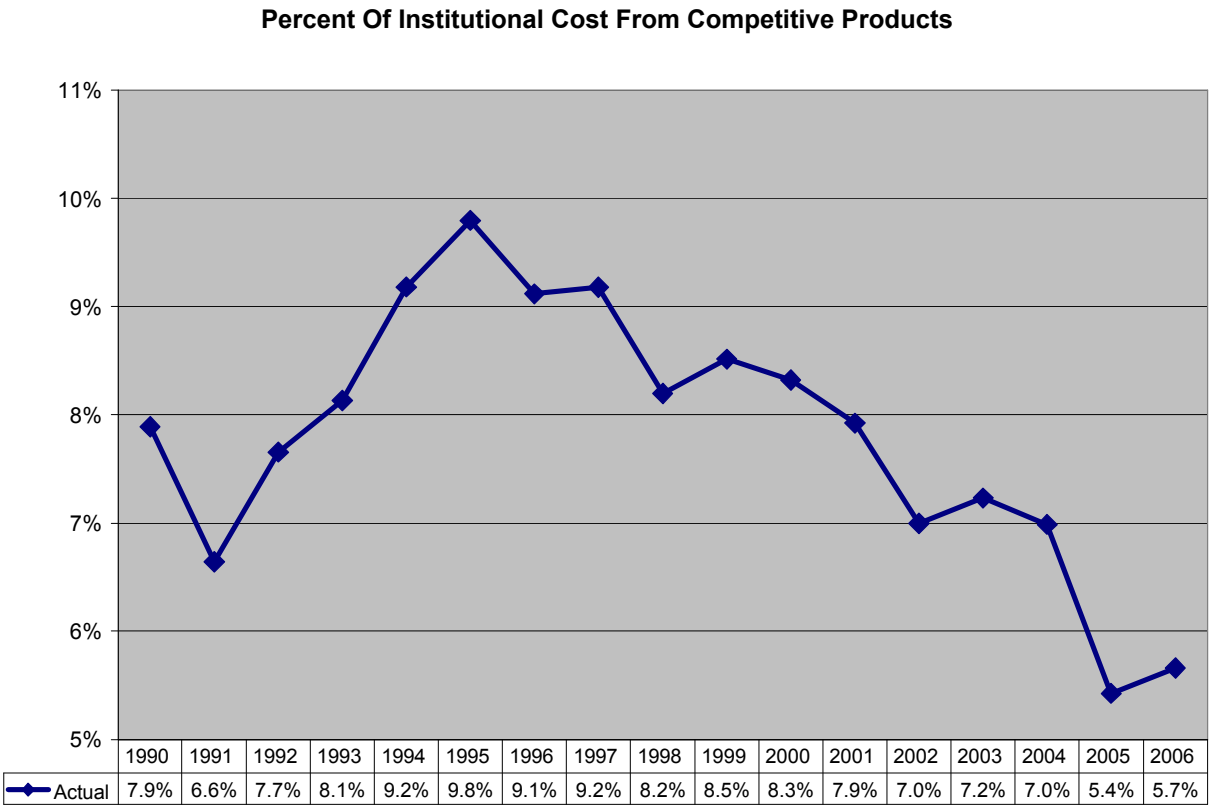
2. The FY2003 through FY2006 rates were not determined independently by the Commission, but rather were the result of the settlement agreements in Docket Nos. R2001-1 and R2005-1. Both settlement agreements explicitly state that they are to have no precedential effect, and the Commission approved the settlement rates largely on that basis. Docket No. R2001-1, Opinion and Recommended Decision Approving Stipulation and Settlement at *i*; Docket No. R2005-1, Opinion and Recommended Decision at 43, ¶ 4002. Consequently, the contribution levels resulting from those settlement rates should not be used as reference points for historic results.

3. We have not been able to fully replicate the Commission's approach in all years. Moreover, because the Postal Service did not file Commission versions of its Cost and Revenue Analysis Report ("CRA") for years before FY1997 (except for FY1991, filed as Exhibit USPS-4L to USPS-T-4 in Docket No. MC93-1) and we do not have data that permits us to recast the results for those years, the chart reflects data from Postal Service CRA versions for FY1990 and FY1992-96. We recognize that, as a result, the contribution levels for FY1990 and FY1992 through FY1996 may unavoidably be somewhat overstated. However, even taking that into account, FY1990-1996 contribution levels far exceed those in FY2005 and 2006.



The chart indicates that the FY2005 and FY2006 contribution levels are both historic anomalies. The average percentage contribution made by competitive products across the past 17 years is approximately 7.8%. Looking only at the more recent years from FY1997 on, in which data using Commission costing methods are available (see footnote 1, *supra*), the average percentage contribution is 7.4% -- an average that is heavily influenced by the contribution levels from FY2003 through FY2006, which resulted from the Docket Nos. R2001-1 and R2005-1 settlement rates. Without those years included, the average contribution of competitive products since FY1990 rises to 8.3%, or to 8.2% based on the more recent years of FY1997 through FY2002.

This example shows why reliance on only two years is dangerous. However, while conditions within any evolving market change over time, the past can still be

instructive for the future. If a historical perspective is to be used in the future for setting contribution levels for competitive products, UPS urges that it ought to be longer than two years.

Conclusion

Once past the initial implementation phases of the PAEA, the Commission should require a specific percentage amount as the "appropriate share" of competitive products' contribution to institutional costs. Such share should more accurately reflect historic contribution levels and should eventually represent competitive products' total contribution to institutional costs.

Respectfully submitted,

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