

**BEFORE THE POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268**

Review of Treasury Report

Docket No. PI2008-2

**COMMENTS OF THE PARCEL SHIPPERS ASSOCIATION
ON
TREASURY REPORT**

Pursuant to Postal Regulatory Commission (PRC or Commission) Order No. 56¹ and Commission Rules of Practice, the Parcel Shippers Association (PSA) submits these comments on the Report submitted on December 19, 2007.² The Postal Accountability and Enhancement Act (PAEA)³ requires the Secretary of the Treasury (Treasury) in consultation with the Postal Service and an independent certified public accounting firm to develop recommendations for accounting practices and principles that will govern the operation of the Competitive Products Fund (CPF) and the determination of an assumed Federal income tax to be imposed on competitive products income. See 39 U.S.C. §2011(h). Section 2011(h) requires the Treasury to develop recommendations

¹ Notice and Order Providing an Opportunity to Comment on Treasury Report (Docket No. PI2008-2).

² See *Report of the U.S. Department of the Treasury on Accounting Principles and Practices for the Operation of the United States Postal Service's Competitive Products Fund*, December 19, 2007 (Report). The Report may be accessed from the Commission's website, <http://www.prc.gov>.

³ Pub. Law No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

regarding, among other things, “the accounting practices and principles that should be followed by the Postal Service,” and present those recommendations to the PRC for final disposition. *Id.*; see also Report at 1.

The Parcel Shippers Association (PSA) appreciates this opportunity to express its views on the recommendations contained in the Report. PSA is a voluntary industry association consisting of members that ship packages, largely from businesses to consumers, and companies that support those activities. A list of PSA members is available on the association’s web site at www.parcelshippers.org. PSA’s mission is to promote competition in the package delivery sector. It strives to encourage a competitive environment that results in the best possible service at the lowest possible costs for its members. PSA’s members make extensive use of the Postal Service and other carriers to deliver their products. Our members, collectively, touch the vast majority of the Postal Service’s Parcel Select Shipping Services product and also make substantial use of Priority Mail, Expedited Services, and bulk international mail. Our members also ship, or consolidate for delivery to the Postal Service, hundreds of millions of mail pieces categorized as Mailing Services products. These include First-Class Mail parcels, Standard Mail parcels, Bound Printed Matter, and Media Mail. While not directly subject to the recommendations contained in the Report, costs and prices for these Mailing Services products will undoubtedly be affected by the accounting and costing procedures resulting from this proceeding.

SUMMARY OF PSA POSITION

PSA is pleased the Report generally endorses the existing Postal Service cost and revenue analysis systems as a foundation for going forward. See Report at 7. PSA made a similar endorsement early in the postal reform implementation process. See Docket No. RM2007-1, PSA Comments (April 6, 2007) at 9-11. With respect to the Report's specific recommendations on costing and accounting for revenue:

Recommendation 1: The current USPS economic cost attribution system should be modified so that the currently estimated class and subclass costs are remapped and attributed to the competitive products as defined by the PRC. Once remapped, product cost assignment should then be made consistent with the current USPS attribution rules and processes for marginal and incremental costs.

PSA agrees. There is no reason to abandon a system and methodologies that have generally worked well since postal reorganization in 1970.

Recommendation 2: To enable a practical solution to be developed that could be validated by third parties, a theoretical or "on paper only" enterprise — USPS Competitive — should be analytically created by assigning to it an appropriate share of all USPS costs.

PSA agrees. Not only is it impractical to create a "true stand-alone competitive products entity," Report at 7, as explained below doing so would negatively affect the Postal Service as well as users of both competitive and market-dominant products. Further, creating the "on paper only" enterprise by assigning to it the incremental cost of competitive products plus an appropriate share of institutional costs is consistent with the provisions of the PAEA that address cross subsidization. See section 3633(a).

Recommendation 3: The volume-variable or marginal product costs currently reported by the USPS cost system should be used — after the product definition modification required by PAEA— to ensure that the competitive products cover their attributable costs. The reported incremental costs should be used to ensure that cross-subsidization of the competitive products by the market-dominant products is not occurring.

PSA agrees. Further including “group specific costs” in the incremental costs of competitive products as a whole, as proposed by the Postal Service in Docket No. RM2007-1, will ensure that competitive products are not being cross subsidized by market-dominant products. See United States Postal Service FY 2007 Annual Compliance Report at 2, 27; Docket No. RM2007-1, Postal Service Comments (December 18, 2007) at 20-27.

Recommendation 4: When the costs of the USO have been reliably determined and subjected to third-party validation, then the PRC should make any adjustments it deems necessary to the institutional cost assignment approach described in the following recommendation.

PSA agrees. PSA believes that because USPS competitors are not subject to a USO and thus do not incur any USO costs, it would be inappropriate to charge USO costs to competitive products. Further, charging all USO costs to market-dominant products is consistent with the common practice of other postal operators. See Report at 8.

Recommendation 5: The current USPS cost accounting system should be modified so that all of the costs for USPS’s two lines of business (Market-Dominant and Competitive) can be assigned using cost drivers that capture the causal relationship between the lines of business and their applicable business costs. The remaining unassigned costs should be treated as institutional costs and an appropriate percentage of these institutional costs, which should be defined by the PRC by regulation, should be covered by the theoretical Competitive enterprise.

PSA agrees. Costs that are caused only by competitive products, i.e., competitive product group specific costs, should be paid by competitive products, not shared by all USPS products. Similarly, market dominant group specific costs should be paid only by market dominant products. However, as discussed below, the PRC may also wish to revisit its determination of the “appropriate share” of institutional costs to be borne by competitive products once this and other modifications are made to USPS costing systems

PSA offers no comment at this time on recommendations 6 through 9 except to note:

—as stated in earlier comments, “PSA submits that the assumed Federal income tax is not appropriately considered an attributable cost.” Docket No. RM2007-1 PSA Comments (May 17, 2007) at 8; and

—with respect to the allocation of assets, we agree with Treasury’s belief “that the separation of the assets could be achieved with the same cost drivers currently used for depreciation and other expenses in the USPS postal classes and subclasses costing system.” Report at 26.

DISCUSSION

- 1. As recommended by Treasury, established methods for accounting for Postal Service costs and revenues should be continued. These systems need only be tailored to meet PAEA requirements, not substantially revised.**

PSA strongly supports a foundational conclusion of Treasury’s recommendations regarding accounting systems and principles – existing Postal Service cost and revenue analysis (CRA) systems should provide the foundation

of PAEA systems and be used to analytically create Treasury’s “on paper only” competitive enterprise. *Id.* at 6, 7.⁴ The Report is replete with endorsements of current USPS approaches to costing and accounting for revenue.

Once remapped, product cost assignment should then be made consistent with the current USPS attribution rules and processes for marginal and incremental costs. *Id.* at 6.

The volume-variable or marginal product costs currently reported by the USPS cost system should be used — after the product definition modification required by PAEA — to ensure that the competitive products cover their attributable costs. *Id.* at 7.

This [statutory] definition [of costs attributable] is consistent with the economic costing approach of the current USPS cost system. Consequently, Treasury assumes that compliance with this PAEA definition would require no modification to the current USPS cost system beyond those recommended to accommodate the newly defined competitive products. *Ibid.*

Fortunately, the existing revenue tracking systems at USPS appear to be adequate for this purpose. No further work or system modification appears necessary in this area unless the reclassification of postal classes and subclasses to the newly defined competitive products warrants them. *Id.* at 9.

Refining the product cost object should allow the existing cost system to report competitive products’ marginal and incremental costs. *Id.* at 33.

As the above citations indicate, Treasury believes that existing systems need only be tailored to collect cost and revenue information in the new reporting categories (i.e., products rather than subclasses) and modified to identify fixed costs that are specific to either competitive or market-dominant products (which

⁴ PSA similarly endorsed the use of the Postal Service’s existing costing systems as the basis of PAEA accounting systems in Docket No. RM2007-1. *See, e.g.,* PSA Comments (April 6, 2007) at 9-11. Those comments argued that Section 3622(c)(2) and 3631(b) of the PAEA, which state that attributable costs should be determined using “reliably identified causal relationships,” codify the economic costing approach used by CRA systems. Accordingly, allocating fixed costs based upon non-causal cost drivers would not only be inconsistent with CRA systems, but also the PAEA.

Postal Service has elsewhere referred to as “group-specific costs”).⁵ Once modified, CRA systems will be able to generate the cost and revenue data for the “on paper only” Postal Service competitive product enterprise. *Id.* at 7.⁶

Since the Postal Service has previously stated its intention to make these changes⁷ and Commission Rule 3015.7 anticipates that the Postal Service will do so, the Report also implicitly endorses the approach being taken to develop PAEA accounting systems. No significant adjustments to the approach signaled by the Commission and the Postal Service for modifying existing systems are necessary.

PSA also agrees that the Commission should develop an appropriate approach for attributing costs resulting from the universal service obligation (USO), once those costs are estimated. *Id.* at 8. The primary goal of the PAEA with respect to competitive products is to promote fair competition. Docket No. RM2007-1, PSA Comments (July 3, 2007) at 1, 10. Since Postal Service competitors are not burdened with a USO, Postal Service costing systems should be adjusted to ensure that competitive products are not placed at a disadvantage

⁵ PSA emphasizes that to implement Section 3633(a)(3) of the PAEA as interpreted by Commission Rule 3015.7(c), group-specific costs must be estimated for both competitive and market-dominant products. This is because total institutional cost (which is the denominator of the “share of institutional cost” calculation) “now becomes total cost less the sum of attributable cost for each product and less the group-specific costs causally related to either the group of market-dominant products or to the group of competitive products.” Docket No. RM2007-1, Postal Service Comments (June 18, 2007) at 21-22.

⁶ Specifically, the cost of the enterprise will be the sum of attributable costs for competitive products plus competitive product group-specific costs plus 5.5 percent of institutional costs from the tailored CRA systems. The revenues of the enterprise will be the sum of competitive product revenues from the tailored systems.

⁷ United States Postal Service FY 2007 Annual Compliance Report at 2, 27; Docket No. RM2007-1, Postal Service Comments (December 18, 2007) at 20-27.

by higher costs resulting from the Postal Service's universal service obligation.⁸ Further, we see no reason to deviate from the typical method of funding the USO where "the usual starting point in practice for other postal operators has been that the cost of the USO is borne solely by the market-dominant products." Report at 8.

- 2. The Commission need not and should not alter costing systems in a manner that has the effect of charging competitive products for "implicit subsidies" unless and until Congress eliminates constraints on the Postal Service that, as judged by the Federal Trade Commission (FTC), place the Postal Service at a net disadvantage to its competitors.**

PSA strongly opposes modifying Postal Service CRA systems to account for and thus effectively charge competitive products for the "implicit subsidies" the Postal Service receives due to its governmental status, i.e., Postal Service advantages relative to its competitors, until and unless Congress eliminates the competitive *disadvantages* that the Postal Service also faces. Making changes to costing systems to effectively eliminate Postal Service advantages without addressing its competitive disadvantages would make a bad situation worse, tilting the playing field even further toward the Postal Service's competitors. As

⁸ Such an adjustment would not alter the finding of the Federal Trade Commission's PAEA-mandated report that "[b]ased on the estimates above, the USPS's unique legal status appears to cause it to suffer a net competitive disadvantage relative to its private competitors." FTC Report at 64. According to FTC calculations, the largest portion of the Postal Service economic burden results from the wage premium that Postal Service pays. Further, other than Alaska Bypass Service costs, USO costs were not even included in FTC's estimation of the Postal Service net competitive disadvantage. *Accounting for Laws that Apply Differently to the United States Postal Service and Its Private Competitors; A Report by the Federal Trade Commission* (December 2007) (FTC Report) at 56.

explained by FTC Commissioners Harbour and Leibowitz in their statement concurring in part with the FTC Report, the Postal Service appears to be operating at a net competitive disadvantage to its competitors.

We join in the Commission's finding that the USPS, because it is an agency of the government of the United States, 'enjoys' a net competitive disadvantage versus other firms selling competitive products. The differential application of various federal and state laws to the USPS's sale of competitive products provides more burdens than benefits for the Postal Service.

Statement of Commissioners Pamela Jones Harbour and Jon Leibowitz Concurring in Part. Congressional Postal Study. Commission File No. P071200.

Charging the Postal Service only for implicit subsidies while making no accounting adjustments or statutory changes to account for or eliminate Postal Service disadvantages would allow the Postal Service to "enjoy" an even larger net competitive *disadvantage*, making its position in the competitive parcel market, a market in which it holds only a relatively small share, even more fragile. See, Docket No. RM2007-1, PSA Comments (April 6, 2007) at 3; Postal Service Comments (June 18, 2007) at 25. Such accounting, and the resulting higher Postal Service prices, would produce an inappropriate windfall for the Postal Service's competitors.

Citing "economic efficiency," some have advocated removal of any "implicit subsidies" even if Postal Service competitive disadvantages are not concurrently addressed. See e.g., Docket No. ACR2007, United Parcel Service Reply Comments (February 13, 2008) at 2-3 (citing FTC Report).⁹ Economic

⁹It is worth noting that the portion of the FTC Report cited on this point was the portion with which Commissioners Harbour and Leibowitz did not concur. Statement Concurring in Part at 2.

efficiency, however, should not control here. The overriding purpose of the PAEA in the competitive market was to level the competitive playing field:

Our bill has the primary goal of allowing the Postal Service to continue to fulfill its universal service mission at a reasonable cost. To achieve this goal, the legislation establishes a modern system for regulating rates, gives needed flexibility to the Postal Service, and includes provisions to ensure a level playing field for the Postal Service and its competitors.¹⁰

Accordingly, in Docket No. RM2007-1, the Commission's determination of the appropriate share requirement was based largely and appropriately on its analysis of the impact on competition.

In attempting to quantify an appropriate contribution, the Commission is mindful of the risks of setting it too high, particularly at the outset of the new system of regulation. The market is competitive; the Postal Service's market share is relatively small; and the Postal Service needs some flexibility to compete. On the other hand, the Commission has an obligation to preserve competition by not establishing a markup so low as to give the Postal Service an artificial competitive advantage.

PRC Order No. 26 (Docket No. RM2007-1, August 15, 2007), para. 3058.

Finally, "one-sided" adjustments to address differential application of laws appears to directly contradict the PAEA, which emphasizes taking into account the "net economic effect" of laws that apply differently to the Postal Service and its competitors.

(d) COMPETITIVE PRODUCT REGULATION.—The Postal Regulatory Commission shall take into account the recommendations of the Federal Trade Commission, and subsequent events that affect the continuing validity of the estimate of the *net economic effect*, in promulgating or revising the

¹⁰ *Statement for the Markup of the Postal Accountability and Enhancement Act House Committee on Government Reform by Rep. Henry A. Waxman, available at <http://oversight.house.gov/documents/20040824121851-66621.pdf> (May 12, 2004).*

regulations required under section 3633 of title 39, United States Code.

PAEA, §703(d)(emphasis added).

3. The appropriate share requirement should be reviewed (and potentially adjusted) after the CRA systems are tailored to meet the requirements of the PAEA.

PSA does not anticipate that tailoring CRA systems, as recommended by Treasury to meet the PAEA requirements, will have a significant effect on the eventual measurement of the percentage of institutional costs borne by competitive products. However, given the Postal Service's "razor thin margin of compliance" in 2007 with the existing 5.5 percent appropriate share requirement, even modest changes in accounting methods could inappropriately affect whether competitive products actually produce an appropriate share of institutional costs. See, Docket No. ACR2007, Comments of DMA and PSA (January 30, 2008) at 6.

To ensure that changes in accounting methods do not inappropriately result in estimates suggesting non-compliance, PSA urges the Commission to require the Postal Service to calculate the impact of any accounting changes on the estimated share of institutional costs borne by competitive products. As DMA and PSA recommended in Docket No. ACR2007 (at 7-8), the Commission should then review this calculation and, if necessary, make adjustments to the appropriate share requirement.¹¹

¹¹ We understand that the Commission may initiate proceedings to review other aspects of Postal Service CRA systems (e.g., Carrier Cost System) in the near term. If so, it may be appropriate to

4. A “stand alone” competitive products entity is not practical or appropriate; nor is it necessary to prevent cross subsidization.

Because the Postal Service generally processes market-dominant and competitive parcels together on the same equipment,¹² it is common practice for shippers to prepare market-dominant and competitive parcels in the same containers and transport them in the same trucks to the same postal facilities.¹³ This makes sense for shippers not only to avoid the cost of separating these parcels – when the Postal Service is just going to combine them again for processing – but also to reduce container-handling costs by producing fuller containers, which benefits both the shippers and the Postal Service.

Structurally separating or creating a “stand alone” competitive products entity would effectively preclude parcel shippers and the Postal Service from combining market-dominant and competitive mailings. This would in turn require a larger number of containers, with separate containers for market-dominant and competitive products. And it would require parcel shippers to enter parcels, and the Postal Service to process them, at a larger number of facilities, with separate facilities for market-dominant and competitive products. Thus, in addition to

delay making an adjustment to the appropriate share requirement until those reviews are complete and their impact quantified.

¹² Of course, not all parcels are processed on the same equipment and thus not all parcels can be combined. Machinable and nonmachinable parcels, for example, are only combined in containers when presorted to 5-Digit ZIP Code.

¹³ For example, in Docket No. R2006-1, PSA witness Zwieg testified that FedEx SmartPost enters both Parcel Select and Standard Mail parcels at DDU's throughout the country. Tr. 33/11249-50 (Zwieg). In fact, the Postal Service recently promulgated rules to encourage the efficient practice of combining parcels. September 27, 2007 *Postal Bulletin* at 7.

reducing Postal Service internal economies of scale and scope,¹⁴ structural separation would increase mail preparation and entry costs for parcel shippers.

We expressed similar concerns, i.e., that entering parcels at a larger number of facilities would increase mailer costs, about the expected impact of the Postal Service's Evolutionary Network Development (END) in a previous docket.

[R]equiring parcel shippers to enter parcels at a greater number of destination facilities...will increase private sector costs (e.g., transportation costs, containerization costs, handling for additional sorts, expanded dock areas) and transit times (e.g., by requiring shippers to "hold" parcels longer to generate sufficient volume to fill a container for a particular destination facility). Thus, a network that requires parcel shippers to enter parcels at a larger number of destination facilities would have to substantially reduce USPS costs and improve USPS delivery times just to maintain existing end-to-end cost and service levels.¹⁵

Docket No. PI2007-1, PSA Initial Comments (July 16, 2007), Appendix 3 at 2.

Structural separation would also impede the ability to presort by destination and make dropshipping less cost-effective thereby increasing postage costs to shippers. Requiring competitive and market-dominant parcels to be prepared and entered separately will cause some shippers to lose worksharing discounts because the Postal Service allows shippers to meet presort minimums based upon combined parcel weight and volume. DMM 705.20.3. If a shipper can no longer combine competitive and market-dominant

¹⁴ PSA notes that both competitive and market-dominant products benefit from these economies of scale and scope. Thus, structural separation would not only harm competitive products, but also market-dominant products (the very products that structural separation would be designed to benefit).

¹⁵ As part of PSA's analysis of the impact of END, one of our members estimated that the combined cost of entering parcels on pallets at additional facilities would be the equivalent of a 16-26 percent increase in the rates for its DBMC-entered Parcel Select pieces. Docket No. R2006-1, PSA-T-1 (Finley) at 2-3. While the scenario analyzed is not exactly the same, it is suggestive of the high cost of entering parcels at additional entry points.

parcels, it may no longer be able to meet the minimum volume and weight requirements to qualify for a particular discount. This will not only increase costs for the shipper, but also increase processing costs for Postal Service.

All of this, of course, is unnecessary to guard against cross subsidization. Indeed, the PRC has already put in place sufficient rules – as specified in Commission Rule 3015 – to prevent such an occurrence.

We support the Treasury recommendation for an analytically created, on paper only, competitive products enterprise. See Report at 7.

CONCLUSION

For the foregoing reasons PSA concludes the following:

1. Treasury has endorsed the established systems for determining costs and revenues (CRA). Treasury is correct in finding that these systems need only be adjusted to meet PAEA requirements to accommodate the newly defined competitive products, not substantially revised.
2. As Treasury found is common in other countries, “the cost of the USO [should be] borne solely by the market dominant products.”
3. In making the recommended costing adjustments, the PRC should not impose a charge for “implicit subsidies” (Postal Service Governmental advantages) unless and until Congress eliminates the constraints on Postal Service that caused the FTC to conclude that, actually, Postal Service was at a net disadvantage to its competitors. To do so would further tilt the “playing field” against

the Postal Service in contravention of the PAEA's objective of promoting fair competition.

4. If the modest changes called for in accounting methods affect whether competitive products comply with the "appropriate share requirement", the Commission should review and adjust the requirement.
5. Any separation of postal products should be a purely theoretical exercise which recognizes the economies of scope and scale in the real world. Not to do so would hypothesize a situation where shippers would not engage in the common practice of combining both market-dominant and competitive parcels in the same container, and transporting them in the same trucks to the same postal facilities. It would also lead to a larger number of containers, entered at a larger number of facilities, where there are two separate facilities, increasing mail preparation and entry costs, postal rates, and postal costs.

The Report is a helpful guide to the PRC, which we urge the Commission to heed, as it fashions rules for "accounting practices and principles" as required by section 2011(h).

Respectfully submitted,

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