

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Ruth Y. Goldway, Chairman;  
Tony L. Hammond, Vice Chairman;  
Mark Acton  
Dan G. Blair; and  
Nanci E. Langley

Modification of Analytic Principles  
Used in Periodic Reporting  
(Proposals Twenty-Two through Twenty-Five)

Docket No. RM2010-4

Public Representative Comments in Response to Order No. 327  
(Proposal Twenty-Two)

November 30, 2009

On October 29, 2009, the Commission issued Order No. 327 requesting comments on the Postal Service's Proposals Twenty-Two through Twenty-Five to make changes in the analytical methods approved for use in periodic reporting. The Public Representative submits comments on Proposal Twenty-Two at this time.

**Proposal Twenty-Two:** A Postal Service Proposal to Calculate Incremental Cost for the Group of Competitive Products

The Postal Service proposes a methodology for calculating the incremental cost for the competitive group of products for the purposes of providing a more accurate measure of the cost required for testing cross-subsidy. It is stated by the Postal Service that Proposal Twenty-Two is not a change in methodology, as a methodology for estimating the incremental costs of competitive products has not been established at the present time.

The Postal Accountability and Enhancement Act (PAEA) explicitly prohibits "the subsidization of competitive products by market-dominant products." 39 U.S.C 3633(a)(1). The Act specifies that the revenue from each competitive product cover its attributable cost and also the revenues from all competitive products collectively cover their attributable costs. In Order No. 43 Docket No. RM2007-1, the Commission states that, "Incremental Costs will be used to test for cross-subsidies by market dominant products of competitive products. To the extent that incremental cost data are unavailable, the Commission will use competitive product's attributable costs supplemented to include causally related, group-specific costs to test for cross-subsidies." So in

Proposal Twenty-Two the Postal Service proposes to estimate incremental cost using a calculation method presented by Professor Michael Bradley, R2000-1, USPS-T-22 and implemented by Nancy Kay in R2000-1, USPS-T-23. The incremental cost for a product group is calculated by isolating the decrement that would occur in total cost if the product group was all together omitted. Then, the overall incremental cost for the product group (or individual product) is estimated by adding the incremental costs for each of the product cost component drivers.

In Proposal Twenty-Two, the incremental cost estimation for the domestic competitive products uses the cost component structure presented in the CRA. Furthermore, since the cost component structure presented in the ICRA does not divide international products into market dominant and competitive at the cost pool level, attributable costs must be used instead. The ICRA is not as refined and detailed as the CRA at this time. In addition, the ICRA reclassifies most of the product-specific cost as institutional costs which again differs from the CRA.

In the development of an incremental cost test, the focal point is on the construction of a “cost floor” for the competitive products that is compared to product revenue. In the proposed method, the incremental costs for a product group (or individual product) will be greater than the attributable costs for that same product group in any cost component. That is, incremental costs will never be less than and will generally be greater than attributable costs for all cost components in the CRA. The Postal Service maintains that this has two effects: a) incremental cost for a product group will be greater than attributable cost for the same group, and is thus, a better cost floor for a cross-subsidy test, and b) if

the estimation of the incremental cost for a product group is “incomplete” for some cost components, the product group attributable cost is used instead for those cost components, and the resulting “hybrid” measure will be greater than the competitive product group’s overall attributable cost. Thus, the proposed hybrid method is a preferred cost floor in the case of incomplete cost data with some cost components.

The Postal Service presents an illustration of the possible impact using the proposed “hybrid” incremental cost estimation method using FY2008 data. The proposed hybrid method appears to extract and assign more product/group specific costs as incremental cost using cost component level information than the Commission method using attributable cost plus group specific cost. In the illustration the comparison for total competitive product cost is \$6,651,635 (Commission method) vs. \$6,736,625 (Hybrid method).

The Public Representative applauds the Postal Service’s effort to develop a method to estimate incremental costs for competitive products and product groups for a more accurate incremental cost test for the absence of subsidies to competitive products from market-dominant products. The ability of the Postal Service to assign more costs as incremental costs at the cost component level is a movement in the right direction, and the Postal Service has demonstrated its ability to do so to some degree. Hence, the hybrid method is a work in progress. The Public Representative would encourage the Postal Service to explore more deeply the problem of the estimation of incremental cost at the cost component level being “incomplete” and try to remedy it. Also, any effort to refine and

improve detail within the ICRA is an effort to make the proposed hybrid method even more accurate. The Public Representative encourages the Commission to view the proposed hybrid method to calculate incremental cost as a method that is more accurate than what presently exists, and is, therefore, a step in the right direction. It is recommended that the Commission accept Proposal Twenty-Two as an interim step with further refinements to come in the future.

Respectfully Submitted,

Diane K. Monaco  
Public Representative

901 New York Avenue, NW  
Suite 200  
Washington, D.C. 20268-0001  
202-789-6849  
[diane.monaco@prc.gov](mailto:diane.monaco@prc.gov)