

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

Competitive Product Prices
International Business Reply Service
Competitive Contract 3 (MC2011-21)
Negotiated Service Agreement

Docket No. CP2011-61

PUBLIC REPRESENTATIVE COMMENTS IN RESPONSE TO
UNITED STATES POSTAL SERVICE FILING OF A
FUNCTIONALLY EQUIVALENT INTERNATIONAL BUSINESS REPLY SERVICE
COMPETITIVE CONTRACT 3 NEGOTIATED SERVICE AGREEMENT

(March 4, 2011)

On February 18, 2011, the United States Postal Service filed a Notice to add an International Business Reply Service (IBRS) competitive contract to the IBRS Competitive Contract 3 product.¹ As requested by Order No. 680 filed on February 24, 2011 by the Postal Regulatory Commission addressing the Notice, the Public Representative submits the following comments for consideration.²

1. Background

The Postal Service's proposed agreement is a successor to the contract with the same customer, addressed in Docket No. CP2010-22 and included in the IBRS Competitive Contract 2 product. The Postal Service states that the new IBRS contract is functionally equivalent with previous IBRS contracts, in general. It also justifies

¹ Notice of the United States Postal Service Filing of a Functionally Equivalent International Business Reply Service Competitive Contract 3 Negotiated Service Agreement, February 18, 2011.

² Notice and Order Concerning Filing of an Additional International Business Reply Competitive Contract 3 Negotiated Service Agreement, February 24, 2011.

inclusion of this contract under IBRS contract 3, proposed in Docket Nos. MC2011-21 and CP2011-59, because the functional terms of the corresponding agreements and benefits to be achieved are the same.

The Postal Service claims that the present agreement is functionally equivalent with the other IBRS contracts because they all share the same, general cost and market characteristics. The IBRS agreements, considered collectively, afford business mailers of lightweight articles to foreign consumers a means to retrieve those articles for refurbishment, recycling or repair at no cost to their customers. Consistent with the concept of functional equivalence, IBRS NSAs can differ in minimum volume or postage requirements based on mailer size or other criteria. Rates can also vary because of differences in these requirements, and because of updated cost information.

The Postal Service filed under seal a cost coverage analysis related to the proposed agreement. Based on this analysis, the Postal Service certifies that revenues to be generated by the proposed agreement would cover attributable costs, thereby complying with all provisions stated in 39 U.S.C Section 3633(a). Based on his own review, the Public Representative concurs with the Postal Service that the proposed contract adds to total competitive product contribution.

2. General Comments

The Public Representative believes that the use of competitive IBRS contracts affords the Postal Service and customers a flexible means for adding value to the original mailing of lightweight articles to foreign customers. The repair or refurbishment of these articles, made possible through reply mailings, is beneficial from the consumer's viewpoint. At the same time, the Postal Service and its business customers can be expected to capture part of that added value through higher revenues and expanded shipping of such merchandise. Recycling of parts from original product sales can also be expected to lower internal business costs and expand shipping through lower rates to final consumers. In either case, end customers, shippers, and the Postal Service come out on the winning side.

Contractual instruments allow the Postal Service to fine tune its service terms to the particular circumstances of its business customers. The Public Representative believes that the notion of functional equivalency is critical in this regard. With the availability of functionally equivalent contracts, all exporting firms are able to access IBRS benefits. In short, functional equivalency allows a “spreading of the wealth” thereby ensuring that no individual firm gains an unfair advantage over rivals.

3. Comments on Cost Attribution and Contribution Estimation Procedures

A. Cost Attribution

For the proposed contract, the Public Representative notes that the Postal Service calculated average unit attributable costs for mail processing, delivery and transportation functions from the FY 2010 ICRA and applied these to expected contract volumes to estimate attributable costs. For transportation costs in particular, the Public Representative was able to verify that average attributable costs per piece for different modes of inbound transportation were summed to arrive at total unit costs for transportation. After adjustment for inflation and contingencies, these unit costs were multiplied by the expected contract volume to estimate total inbound attributable transportation costs. This procedure for calculating transportation costs appears to rely on the assumption that inbound transportation for contract volume would use the same average mix of transportation modes reflected at the system level.

This procedure undoubtedly biases transportation costs in an unknown direction. A more accurate cost estimating method should be found for future contracts which accounts for the particular mix of transportation modes and the average length of haul (distance) per mode that better reflect the realities of particular agreements. Similar refinements might well be in order for mail processing and delivery costs as well.

B. Contribution Estimation

The Public Representative also notes that services provisioned under IBRS contracts represent, effectively, a portion of a two part bundled service offered to business customers. The bundle consists of: a) original shipments of affected articles to foreign consumers, and b) the value added reply service. Consequently, an IBRS contract can add to total contribution from an expansion of the number of outbound mailings, as mentioned above, and the creation of a new inbound mailing flow from the contract itself. Therefore it appears under the current estimation procedure, that the added contribution from the proposed contract is underestimated because the expansion of the outbound mail flow it creates is ignored. In fact, it is possible for a new IBRS to add to total contribution, even if the IBRS contract shows a negative contribution, as estimated under current procedure.

For example, it is easy to envision an IBRS contract priced at unit attributable cost so that it only breaks even. Under the current estimation procedure, a zero contribution from the contract would be estimated. Yet, one would expect some volume expansion from the outbound mail flow, the contract creates, and positive contribution from that source alone. Therefore provision of the service produces a positive contribution on the whole. This means that a slight decrease in the rate would still produce a positive contribution, even though the IBRS contract would show a negative result.

Because of these possibilities, the Public Representative believes that it is important to estimate the contribution from expansion of existing outbound volume that results from new IBRS contracts. Improved estimation methods can lead to more efficient pricing of IBRS contracts as well.

The Public Representative respectfully submits the preceding Comments for the Commission's consideration.

William C. Miller
Public Representative

901 New York Ave., NW Suite 200
Washington DC 20268
(202) 789-6829; Fax (202) 289-6861
email: william.miller@prc.gov