

BEFORE THE
POSTAL REGULATORY COMMISSION

Annual Compliance Report, 2013	:	DOCKET NO. ACR2013
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**INITIAL COMMENTS OF UNITED PARCEL SERVICE ON
POSTAL SERVICE'S FY2013 ANNUAL COMPLIANCE REPORT
(January 31, 2014)**

In response to Commission Order No. 1935 (December 30, 2013), United Parcel Service ("UPS") hereby comments on the United States Postal Service's FY2013 Annual Compliance Report (December 27, 2013).

We recognize that the issues currently before the Commission are limited (primarily, whether the rates in effect in FY2013 complied with the statute) and that the Commission must complete its review within a short, 90-day timeframe. As a result, while we raise several matters that are "relevant to the Commission's review," Order No. 1935 at 5, we urge the Commission to consider those matters in future proceedings, where they can be examined in greater detail.

Some of those matters -- the decreased level of overall attribution and other Competitive Product costing and accounting trends -- lead us to question whether the Postal Service's Competitive Products are shouldering a fair and equitable share of total postal costs, as required by the statute. See 39 U.S.C. § 3633(a). However, another issue must be resolved before the public and

interested parties can have confidence that total postal costs are being properly allocated.

The Postal Service has improperly withheld the vast majority of Competitive Product cost and other data from public view. As a result, neither we nor other interested members of the general public can know with any degree of certainty whether Competitive Products are shouldering an equitable share of total postal costs. That undermines public credibility in the fairness of the process and, we submit, deprives the Commission of valuable input, input of the type expected by Congress, that would aid the Commission in fulfilling its statutory responsibilities.

I. Given Available Data, There Is a Serious Question Whether Enough Total Postal Costs Are Being Allocated to Competitive Products.

A bedrock principle of postal regulation requires that Competitive Products cover their attributable costs (individually and collectively) plus an appropriate share of the Postal Service's institutional costs. 39 U.S.C. § 3633(a). Because of a lack of public transparency, the available portions of the Postal Service's FY2013 Annual Compliance Report ("ACR") and other available information are insufficient to allow the public and interested parties to reach a conclusion on that question. We address this threshold public transparency issue below. But the information that is publicly available reveals disturbing trends.

1. Falling Attributable Costs: Total attributable costs have fallen sharply -- by nearly 11 percentage points -- from 65.1% of total postal costs in Docket No. R97-1 to 54.2% in FY2013. Compare Docket No. R97-1, Opinion

and Recommended Decision, Vol. 2 (May 11, 1998), Appendix E at 4, to FY2013 ACR, LR-USPS-FY13-1, Public Cost and Revenue Analysis Report (“Public CRA”) at 3. As a result, almost \$8 billion of total postal costs have been converted -- improperly, we believe -- from attributable costs to institutional costs. As discussed below, those costs are allocated disproportionately to Market-Dominant Products, even though Competitive Products cause many of them. Even if one excludes the FY2013 Retiree Health Benefits Fund payment of \$5.6 billion from the calculation, the Postal Service attributes only 58.7% of its total costs, significantly less than in Docket No. R97-1.¹

This decline in attribution is directly contrary to Congress' expectation that cost attribution would **increase**, not decrease, under PAEA. See, e.g., S. Rep. No. 318, 108th Cong., 2d Sess. (August 25, 2004) (“Senate Report”) at 29-30 (noting a high level of institutional costs which are disproportionately imposed on First-Class Mail and stating that “the Committee believes the Postal Service can improve on its 60 percent attribution rate . . .”). Even in the face of this low level of attribution, the Postal Service acknowledges in the ACR (at 48) that a major

¹ The Retiree Health Benefit Fund cost is treated as fully institutional. See ACR at 50, n. 31. However, those costs are essentially labor costs as they are part of the compensation paid to postal employees. These costs should be attributed to the same extent that overall labor costs are attributed. See Docket No. R2005-1, Opinion and Recommended Decision (November 1, 2005) at ¶ 4027 (noting that if Congress required funds to be escrowed for Retiree Health Premium costs, those costs “would be attributable to all mail according to the weighted average attributable cost of all labor.”)

competitive product, "non-NSA" Parcel Select, did not cover its attributable cost in FY2013.²

The Competitive Products rate floor of attributable costs plus an appropriate share of institutional costs -- established to ensure that Market Dominant Products do not subsidize Competitive Products -- depends in large part on the accurate attribution of costs. See Senate Report at 29-30 (PAEA has a goal of "prevent[ing] the subsidization of competitive products by market-dominant products by **better identifying** the costs incurred . . . in providing competitive products.") (emphasis added). PAEA also requires that each Competitive Product cover the costs attributable to it. 39 U.S.C. § 3633(a)(2). A large pool of institutional costs creates the opportunity for the Postal Service to avoid fiscal responsibility, to the detriment of itself, Market-Dominant mailers and Competitive Product mailers, and competition, and is contrary to PAEA. See Senate Report at 29-30 ("The Postal Service should be able to attribute a greater percentage of its costs. If they do this, it is likely that a greater share of costs can be attributed to competitive products and, to the extent that they can be, should be reflected in the rates charged for those products.")

² The Postal Service intimates that the below-cost rates for this significant Competitive Product will be addressed by a 9.2% rate increase. ACR at 48. That may be. However, the public -- mailers and competitors -- cannot know whether or not that is the case because the volume, cost, and revenue numbers for non-NSA Parcel Select are not publicly available. A number of Market-Dominant package services were also below cost in FY2013. See ACR at 10 (First-Class Mail parcels), 17 (Standard Mail parcels), and 34 (Parcel Post and Media Mail/Library Mail). These package services are currently in the Market-Dominant Product list presumably because they face limited competition, likely due to artificially low postal rates.

In addition to the decline in overall attribution, the Postal Service has recently made a number of statements that raise questions about the adequacy of current attribution methods. In Docket No. PI2013-1, for example, the Postal Service indicated that **none** of the \$3 billion capital commitments and expenditures made over the past 3 years were attributed; instead, all were treated as institutional costs. Docket No. PI2013-1, Response of the United States Postal Service to Commission Information Request No. 1 (August 2, 2013), Question No. 4(a-b) (“To the extent that [the capital expenditures] benefit competitive products, such benefit is paid for through the institutional cost contribution requirement.”). In its FY2014 Integrated Financial Plan (November 25, 2013, at 6), the Postal Service states that its FY2014 capital commitment plan includes, e.g., “enhancements to mail scanning and tracking systems.” Since scanning and tracking are commonly associated with package products, it would appear that the costs of these “enhancements” should be attributed, at least in part, to Competitive Products.

Similarly, in a recent discussion of the Commission’s decision limiting the Market-Dominant exigent rate increase, the Deputy Postmaster General of the Postal Service said the Postal Service would likely appeal that decision because the Postal Service “need[s] to make investments in **package sorting equipment**, new vehicles, state of the art scanning equipment, and more” Postcom Bulletin No. 03-14 (January 17, 2014) (“Postcom Bulletin”) at 4 (emphasis added). We question why an investment in package sorting equipment would be recouped entirely from Market-Dominant mailers through the

exigent rate increase. Either the classification of all of these costs as institutional is incorrect, or Market-Dominant Products are bearing too great a share of institutional costs given substantial new investments in equipment that benefits Competitive Products, or both.

We strongly encourage the Commission to accelerate its current efforts to improve cost attribution (see Docket No. RM2011-3) and to find other ways to improve attributable costing as a whole, across all cost segments and components, in light of the changes that have taken place since the adoption of PAEA, including substantial changes to the Competitive/Market-Dominant product mix (e.g., the transfer of substantial volumes of services from the Market-Dominant Products List to the Competitive Products List). For example, a longer-run approach should be taken in city delivery carrier costing; the current, short-run “microscopic” approach is likely not sustainable for the Postal Service in the long term. See also Postal Service Office of Inspector General, Risk Analysis Research Center, “A Primer on Postal Costing Issues,” Report No. RARC-WP-12-008 (March 20, 2012) at 11 (“The Postal Service should carefully study and consider potential improvements to its cost system. . . . the drive for efficiency gains and for more finely disaggregated product development requires an enhanced cost system.”).

2. Inequitable Institutional Cost Allocation: As discussed in our comments in the exigent rate case (Docket No. R2013-11), we believe that the current allocation of institutional costs between Market-Dominant Products and Competitive Products is in substantial need of revision. Among other reasons,

significant additions to the Competitive Products List and a significant increase in Competitive Products' relative share of total revenue necessitate reconsideration before the next 5-year review in 2017. The attribution issues discussed above exacerbate the problems created by the inequitable allocation of institutional costs; as the percentage of attributable costs declines, a larger pool of institutional costs must be divided between Market-Dominant Products and Competitive Products. While Competitive Products are required to pay only 5.5% of institutional costs, they pay almost 25% of the costs that are attributed. Public CRA at 3.

The Postal Service raised Market-Dominant Product rates 5.9% on average this year, including an increase in excess of the statutory rate cap, because those products were unable to cover the approximately 94% of institutional costs allocated to them. See Docket No. R2013-11, Postal Service Request (September 26, 2013) at 7. This is in stark contrast to the Competitive Product average rate increase, which was only 2.4%, including no rate increase at all for Competitive Products' largest product, Priority Mail. See Postal Service Press Release No. 13-086 (November 13, 2013); 78 Fed. Reg. 69554 (November 20, 2013) ("Overall, Priority Mail prices will average a net zero percent price increase.")

At the same time the Postal Service is implementing significant rate increases for Market Dominant Products, it is reducing services for such products. Examples include its request in Docket No. N2012-1 to reduce Market-Dominant Product service standards and its recent request to implement a "load

leveling” plan for Standard Mail. See Docket No. N2014-1, Postal Service Request for Advisory Opinion (December 27, 2013) at 4-5. In contrast, the Postal Service is minimizing rate increases for Competitive Products while expanding service parameters, such as day-definite delivery and insurance at no additional charge for Priority Mail (see Docket No. R2013-7), and Sunday delivery for at least one parcel customer. See Docket Nos. MC2014-1/CP2014-1.

In short, it appears that Market-Dominant mailers, who have little or no alternative to the Postal Service, are being asked to foot a larger share of the bill than is equitable or appropriate.

II. The Postal Service’s Practice of Withholding Almost All Competitive Product Data from the Public Is Improper and Has Stymied Public Participation, to the Detriment of the Credibility of the Process and of Its Results.

In the case of the inadequate allocation of institutional costs, the cause of the problem and the solution are relatively clear: a dramatically changing product mix requires a change from the current, static 5.5% allocation to Competitive Products to a method that better reflects the current dynamics of the postal marketplace and the substantial revenue transfers from the Market-Dominant Products List to the Competitive Products List. See Docket No. RM2007-1, Order No. 26 (August 15, 2007) at ¶ 3061 (“The Commission anticipates that [the] need [to revise the appropriate share] may arise for any number of reasons, e.g., additions or deletions to the competitive product lists and market conditions.”) In the case of declining attribution, the causes and solutions are less clear because of a dramatic decline in public transparency since PAEA was

adopted. This decline is based on the false premise that PAEA was intended to allow the Postal Service to shield more of the critical information about Competitive Products from the public, when the opposite -- an increase in public transparency -- was Congress' actual intent.

A primary pillar of PAEA is transparency. After all, PAEA stands for the "Postal **Accountability** and Enhancement Act." Pub. L. No. 109-435 (December 20, 2006) at § 1(a) (emphasis added). PAEA is intended to "[e]nsure that important factual information on the Postal Service's product costs and performance is accurately measured and **made available to the public** in a timely manner." H.R. Rep. No. 66, 109th Cong., 1st Sess. (April 28, 2005) ("House Report") at 43 (emphasis added). Transparency was to increase for both Market-Dominant Products and Competitive Products. See Senate Report at 30 ("Treasury, the Postal Service and the Postal Regulatory Commission should partner with private sector accounting experts and postal stakeholders in **an open, transparent and continuous process** to improve cost accounting and cost attribution at the Postal Service, **especially as it applies to competitive products.**") (emphasis added).

Despite Congress' clear intent, the Postal Service has taken the position that almost all information concerning Competitive Products' costs should be withheld from the public. See ACR, Attachment Two, Postal Service Application for Nonpublic Treatment of Materials ("Application for Nonpublic Treatment") at 1-2. The important data that the Postal Service now files under seal include all information on individual Competitive Products' costs and cost coverages and the

data underlying those figures, and all information on the attribution of costs to Competitive Products except for a single line item for all “Domestic Competitive Products” on the Cost Segments & Components report. The Postal Service’s improper actions have so far gone largely unchallenged. But see Docket Nos. MC2014-1/CP2014-1, Motion of Mark Jamison Requesting Access to Non-Public Materials (November 21, 2013) and related materials.³

To justify its approach, the Postal Service relies on the argument that no “commercial enterprise would voluntarily publish information pertaining to the costs, volumes, revenues, and markets for its competitive products.” See Application for Nonpublic Treatment at 2. But the Postal Service is not just any “commercial enterprise.” Although the Postal Service was given freedom to operate more “like” a commercial enterprise under PAEA through flexibility in pricing, it remains a government entity that earns the majority of its revenues from monopoly (and de facto monopoly) products. See House Report at 44 (“Under the legislation, the Postal Service will compete on a level playing field, under **many** of the same terms and conditions as faced by its private sector competitors, **albeit with stronger controls, oversight, and limitations in**

³ There is also no transparency into the statutorily mandated Competitive Products Fund, where the Postal Service has made questionable transfers. See Docket No. PI2013-1. The public has no information about why and for what actual purpose the entire balance of that Fund has been withdrawn and deposited into the Postal Service Fund, or about whether and on what that money has since been spent. If that money had been left in the Competitive Products Fund, the Postal Service might still have it available to make the investments in package sorting equipment which, according to the Deputy Postmaster General, are motivating the Postal Service to appeal the Commission’s decision in the exigent rate case. See Postcom Bulletin, *supra* at 5.

recognition of its governmental status.”) (emphasis added). In fact, the increased pricing flexibility granted to the Postal Service by PAEA mandates increased, not decreased, public scrutiny. See Senate Report at 19 (“In establishing the postal regulatory structure in the bill, the Committee has attempted to balance the Postal Service’s need for additional flexibility with **the public and mailing community’s need for increased financial transparency** and established safeguards to protect against unreasonable use of the Postal Service’s statutorily-granted monopoly.”) (emphasis added).

Nothing in PAEA changes the public disclosure standards that long existed before PAEA was adopted. Rather, new Section 504(g) incorporates pre-PAEA law on what may be withheld from public view and merely establishes a process for resolving Postal Service claims of confidentiality. See 39 U.S.C. § 504(g)(1), incorporating the public disclosure provisions from pre-existing law, i.e., 39 U.S.C. § 410(c) and 5 U.S.C. § 552(b).

We submit that the lack of transparency into Competitive Products data is largely responsible for the noticeable decline in public participation on Competitive Products costing issues: the public has no access to the information needed to analyze and determine whether or not substantive participation in a proceeding is warranted. See Docket Nos. MC2014-1/CP2014-1, Response of Mark Jamison to Postal Service and Amazon Responses Opposing Access to Materials Filed Under Seal (November 29, 2013) at 3 (“The very opacity of the initial docket prevents one from making any specific claims as to what may be problematic with the docket. . . . These sorts of dockets . . . are presented in a

sufficiently generic and opaque manner so that the ability to raise specific questions in advance is essentially impossible.”)

The deadlines set by PAEA are so short that there is hardly enough time in any proceeding for a potentially interested party to file a motion seeking access to Competitive Product materials and have that motion resolved by the Commission, much less to obtain, review, and analyze the materials and then make a decision on whether it has anything to offer the Commission that would warrant the party’s participation on substantive issues. In order to develop enough information to file substantive comments in any given docket, an interested party must have regular, ongoing access to the relevant postal data. Parties are simply unable, on a case-by-case basis, to develop the facts and perform the relevant analyses necessary to contribute meaningfully without regular access to the relevant data via periodic public reporting.

In short, there has been a dramatic decline in the amount of data that was freely and regularly available before PAEA (with no claim of commercial harm by the Postal Service) to the paucity of data now available. This has effectively denied the public (which includes competitors) the statutory right to participate in Commission proceedings relevant to Competitive Products.⁴ For example, given the scant information available to the public in this proceeding, how could UPS or

⁴ In order to ensure that Market-Dominant Products are not subsidizing Competitive Products -- the most essential aspect of PAEA to both Market-Dominant mailers and competitors of the Postal Service -- the public needs open and ongoing access to information on both product groups.

any other party contribute to the Commission's analysis of whether the Postal Service's rates and fees for Competitive Products are in compliance with Section 3633, except to assert "hunches" based on fragmented and incomplete information? Under the status quo, the public must accept the information supplied by the Postal Service at face value.

The Commission has historically relied heavily on contributions from the interested public, including Postal Service competitors like UPS, to assist it in refining data collection and attribution methodologies. See, e.g., Docket No. R2006-1, Opinion and Recommended Decision, Vol. 1 (February 26, 2007) at 21-54 (relying on the testimony of, e.g., Valpak witness Haldi, OCA witness Roberts, and UPS witness Neels to conclude that most mail processing labor costs are 100% volume variable). It has also regularly adopted proposals to improve costing that were independently developed and advanced by members of the public, including UPS. See, e.g., id. at 77-79 (accepting UPS' proposal to treat 100 percent of non-fuel air transportation contract costs as attributable since "[t]he cause [of those costs] is not reasonably open to debate"). Given the tight deadlines within which the Commission must act under PAEA, these types of contributions from the public would likely be more valuable to the Commission than ever.

This issue has been raised a number of occasions since the implementation of PAEA, see, e.g., Docket No. ACR2008, Public Representative's Motion to Make Core Cost, Volume, and Revenue Materials Public (January 27, 2009) and UPS' Answer to Public Representative's Motion

(February 3, 2009), but it has never been resolved by the Commission. The Commission has stated its intent to open one or more separate rulemaking proceedings to determine what information and materials the Postal Service must file publicly. See Docket No. ACR2008-1, Order No. 196 (March 25, 2009) at 3. We urge the Commission to initiate those proceedings promptly.

CONCLUSION

We recognize that the Annual Compliance Review takes place under a short timeframe with limited opportunity for the Commission to consider the relevant but broad issues discussed above. We do not ask the Commission to make rulings on these complex issues in this proceeding. Instead, we urge the Commission to undertake detailed reviews of these areas of concern in separate proceedings in which these issues can be thoroughly and openly considered by the Commission, the Postal Service, and the public.

In particular, we encourage the Commission to:

- accelerate and expand its efforts to improve attributable costing;
- reallocate institutional costs between Market-Dominant Products and Competitive Products on a more equitable basis; and

- initiate a public proceeding to address the serious issue of the dramatic decline in the public availability of cost and other data relating to Competitive Products.

Respectfully submitted,

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