

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

Periodic Reporting  
(UPS Proposals One, Two, and Three)

Docket No. RM2016-2

CHAIRMAN'S INFORMATION REQUEST NO. 1

(Issued November 20, 2015)

To assist in the evaluation of its Petition requesting a change in analytical principles,<sup>1</sup> United Parcel Service, Inc. (UPS) is requested to provide written responses to the following questions. Answers should be provided no later than December 3, 2015.

1. UPS states that “[f]rom telecommunications and airports to electrical power and water utilities, public utilities have an economic incentive to leverage their governmentally-conferred monopoly power by expanding into competitive markets.” Petition at 2.
  - a. Please confirm that, unlike a majority of the public utility examples cited above, the Postal Service is not investor-owned;
  - b. If confirmed, please explain whether the incentive to expand into competitive markets applies to the Postal Service;
  - c. If not confirmed, please explain why the Postal Service is similarly situated to the public utilities cited above.

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<sup>1</sup> Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, October 8, 2015 (Petition). To support each of its proposals, UPS also submitted the Report of Dr. Kevin Neels Concerning UPS Proposals One, Two, and Three (Report of Dr. Kevin Neels) with the Petition.

2. UPS states that “[w]hile captive mailers are paying significantly increased prices and experiencing reduced service standards, the Postal Service is slashing prices of its competing products to drive up its market share.” *Id.* at 5.
  - a. Please confirm that the UPS position is that the Postal Service, by “slashing prices” on its competitive products, has been able to increase prices for captive mailers and to reduce service standards;
  - b. If confirmed, please reconcile these statements with the CPI-based price cap for market dominant products;
  - c. If not confirmed, please explain the meaning of the quoted text;
  - d. Please provide all evidence demonstrating that an increase in the Postal Service’s market share in parcel markets, vis-a-vis its competitors, is attributable to the Postal Service lowering prices for competitive products.

### **Proposal One**

3. In its Petition, UPS discusses the basis for its conclusion that Proposal One complies with the requirements of 39 U.S.C. § 3633. *Id.*, Proposal One at 12. UPS also notes that its proposals “necessarily implicate letter mail costs as well.” Petition at 21. Please discuss whether Proposal One complies with the requirements of 39 U.S.C. § 3622, with particular emphasis on whether the proposal complies with the “reliably identified causal relationships” requirement of 39 U.S.C. § 3622(c)(2).
4. UPS states that “[i]nframarginal costs are variable costs that exist in the many areas of operations in which the Postal Service enjoys economies of scale that take the form of a cost structure in which the unit cost of handling additional mail pieces declines as overall mail volumes increase.” *Id.*, Report of Dr. Kevin Neels at 10.

- a. Please confirm that UPS contends that the Postal Service currently has increasing economies of scale and decreasing marginal costs;
  - b. If confirmed, please provide all evidence relied upon to support this conclusion;
  - c. If not confirmed, please explain how UPS was able to reliably calculate inframarginal costs.
5. Please provide a breakdown of the inframarginal costs of market dominant products, akin to the breakdown provided for competitive products, in Table 6 of the Report of Dr. Kevin Neels. *Id.* at 30.
6. Please provide an estimate of the total subsidy received by competitive products from market dominant products, net of the costs associated with the Universal Service Obligation.
7. Please confirm if Dr. Neels (or any other expert for UPS) performed any analysis to assess whether there are any hidden fixed costs within reported attributable or inframarginal costs. If so, please provide all statistical results and all supporting workpapers for such analyses. If not, please explain why no such analyses were performed.

## **Proposal Two**

8. Dr. Neels states that “[t]he measure of work-content-weighted volume I use in this analysis is equal for each year to the summation across all postal products of the number of mail pieces handled in that year by the Postal Service multiplied by the per unit attributable costs in 2014 for that category of mail.” *Id.* at 34.
  - a. Please provide an economic rationale for using “work-content-weighted volume” instead of a different measure of volume (e.g., total volume) in the fixed costs regression analysis;



10. Dr. Neels states that, “[i]n particular, I accept Postal Service costing for components when the regression results in a negative coefficient on weighted volume. Taken on its face, this result would imply that adding mail to the system reduces fixed cost – a result that I find a priori to be implausible.” *Id.* at 43.
  - a. Please confirm that, according to Dr. Neels’ interpretation, a positive coefficient on weighted volume implies that variable costs for a given component are understated, meaning that a portion of “reported fixed cost” is variable. If not confirmed, please explain.
  - b. Please also confirm that, following the same logic, a negative coefficient on weighted volume implies that variable costs for a given component are overstated. If not confirmed, please explain.
11. Please explain the constraints imposed by running a regression between weighted volume and reported fixed costs without a constant for those components with: 1) negative constants and positive significant slopes; or 2) negative constants and negative significant slopes, as described in the Report of Dr. Kevin Neels. *Id.* at 44.
12. Please provide the following costs:
  - a. The costs of each component with a negative and significant slope line, akin to the breakdown for positive slopes in Table 11 of the Report of Dr. Kevin Neels;
  - b. The hidden variable cost for each cost component with a negative slope, using the same methodology as used in Table 14 of the Report of Dr. Kevin Neels;

- c. The hidden variable costs for each market dominant product, akin to the breakdown provided for competitive products in Table 15 of the Report of Dr. Kevin Neels.

By the Acting Chairman.

Robert G. Taub