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BEFORE THE
POSTAL REGULATORY COMMISSION

Section 701 Report	:	**Docket No. PI2016-3**

COMMENTS OF UNITED PARCEL SERVICE, INC. ON THE SECTION 701 REPORT

(June 14, 2016)

United Parcel Service, Inc. ("UPS") respectfully submits these comments in response to Commission Order No. 3238 and appreciates the opportunity to provide input for the Commission's report pursuant to Section 701 of the Postal Accountability and Enhancement Act of 2006 ("PAEA").

I. POSTAL SERVICE FINANCIAL SITUATION AND COMPETITIVE RATE SYSTEM

The Commission welcomed "any comments or suggestions about provisions of the PAEA that impact the overall financial position of the Postal Service . . . ."[1] The Commission also invited comments "on the statutory framework for review of competitive product rates."[2] UPS addresses these topics together in this section.

As UPS explained in its petition filed in Docket No. RM2016-2, PAEA, among other things, addressed the Postal Service's request for greater pricing flexibility for parcels so the Postal Service could compete more aggressively against private sector

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[1] Order No. 3238 at 5.

[2] *Id.* at 7.

companies by acting more like a private sector company itself.[3] As the Postal Service's parcel business began to expand, along with the advent of the internet and the growth of business-to-consumer commerce, the Postal Service argued it needed greater price and service flexibility in its competitive offerings in order to improve its overall financial position.

In response, Congress enacted 39 U.S.C. § 3633. The principal goal of this section was to ensure that "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 recognition of its governmental status."[4] Congress made clear that the Postal Service is *not* allowed to ignore the costs of its competitive products or to bury those costs in accounting entries elsewhere in the enterprise. As UPS has shown in Docket No. RM2016-2, however, that is precisely what the Postal Service is doing today.

UPS's petition has established that the Postal Service is attributing only (currently identified) *marginal* costs to its competitive products, along with a nominal amount of product-specific fixed costs. In the process, the Postal Service is simply ignoring, for cost attribution purposes, all of the other variable costs that are generated by those products. This result would be intolerable for a private sector company and should be equally intolerable for a government agency.[5]

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[3] *See* Petition of UPS at 3, Dkt. No. RM2016-2 (Oct. 8, 2015).

[4] H.R. Rep. No. 109-66 at 44 (2005).

[5] As explained in Docket No. RM2016-2, UPS does not believe that PAEA's statutory framework needs to be changed to address this problem. Rather, the changes proposed by UPS in its petition are fully consistent with the plain language of PAEA and supported by its legislative purpose.

The Postal Service is using the artificial costing advantages it has over price sector rivals to grow aggressively in parcel markets. In fact, UPS believes that by leveraging these costing advantages, the Postal Service may well have become the *largest* parcel carrier in the nation, delivering more parcels than any private sector competitor, including DHL, FedEx, or UPS. This is happening even though PAEA also mandated that the Postal Service continue to "give the *highest* consideration to the requirement for the most expeditious collection, transportation, and delivery of important *letter mail*."[6]

There are serious questions about whether the Postal Service is giving the highest consideration to the delivery of the letter mail or whether it is instead prioritizing growth in its parcel business. There are also questions about the impact of the Postal Service's focus on growing its parcel business on the finances of the enterprise as a whole.

Unfortunately, the extraordinary complexity and opacity of Postal Service costing and its finances makes these questions difficult to answer. PAEA was meant to "mandate[] transparency in the Service's finances, costs, and operations." *See* H.R. Rep. No. 109-66 at 43 (2005). But this mandate is not being met. The opaque nature of Postal Service costing detracts from the ability of Postal stakeholders to meaningfully participate in Commission dockets. Monopoly letter mailers too have raised concerns about the Postal Service's costing system in the Annual Compliance Review process, arguing that the Postal Service's costs and accounting practices are opaque, outdated,

[6] *See* 39 U.S.C. § 101(e) (emphases added).

and fail to account properly for or to utilize information provided by the Postal Service's ever-increasing slate of technological upgrades.[7]

In particular, it is extremely difficult to evaluate how the Postal Service is handling the many large investments it is making in growing its parcel business. For example, the Postal Service has recently made significant investments in purchasing larger delivery trucks precisely so it can deliver more parcels. But it is unclear how those investments are being handled as a financial matter. The Postal Service's cost data implies it is attributing just 6.7% of the depreciation of its existing city delivery vehicle fleet to competitive products.[8] The new parcel vehicles, however, cost almost twice as much as current delivery vehicles, and the Postal Service has acknowledged that the changes in specification that drive this cost differential are motivated by the need to accommodate growing parcel volumes. In other words, the Postal Service is purchasing these vehicles specifically for its parcel delivery business, but then apparently attributing less than one tenth of the costs to the competitive products that comprise the bulk of that parcel business. That is a surprising result — and it is also very difficult to analyze how exactly the Postal Service is arriving at that result.

In previous submissions to this Commission, UPS has provided evidence of a widespread tendency of current Postal Service costing procedures to understate the extent to which major elements of its cost structure vary with changes in mail volume.[9] UPS has identified numerous instances in which the attribution of costs to products is

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[7] *See, e.g.,* Initial Comments of the Association for Postal Commerce, Dkt. No. ACR2015 (Feb. 2, 2016); *see also* Reply Comments of the Association for Postal Commerce at 1-4, Dkt. No. ACR2014 (Feb. 13, 2015).

[8] *See* PRC-LR-ACR2015/1 FY15 B Public, Dkt. No. ACR2015.

[9] *See* UPS Proposal Two at 9, Dkt. No. RM2016-2 (Oct. 8, 2015).

based upon assumptions, analogies, or judgments that appear to be contradicted by the actual behavior of costs over time. The complexity and opacity of current postal service costing procedures makes such situations difficult to identify and time-consuming to evaluate and correct.

UPS has previously proposed that the Postal Service be required to provide a clear and complete disclosure of how it is accounting for new large investments, such as those requiring over $100 million in capital investment or $100 million in increased operational costs over five years, including a detailed description of how those costs are being attributed to individual products under 39 U.S.C. § 3633(a)(2).[10] UPS continues to believe that adopting this proposal will help the Commission, the public, and affected entities better evaluate the Postal Service's costing practices and its financial situation. UPS urges the Commission to impose this reporting requirement going forward or, alternatively, to ask Congress to make it mandatory.

II. THE 2007 FEDERAL TRADE COMMISSION REPORT

The Commission also invited comments "on the FTC Report's findings, including those regarding the postal and mailbox monopolies and the competitive products industry."[11] As an initial matter, UPS notes that the FTC's 2007 analysis of the competitive products industry is somewhat outdated. As noted, today, the Postal Service may well be the largest parcel-delivery enterprise in the industry and is aggressively pursuing further growth. UPS doubts the FTC anticipated this rapid growth at the time of its report.

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[10] *See, e.g.,* Initial Comments of the United Parcel Service, Dkt. No. ACR2014 (Feb. 2, 2015).

[11] *See* Order 3238 at 7.

The FTC did identify a number of advantages the Postal Service has as a government enterprise, but appears to have underestimated the magnitude of these advantages.[12] This is true for the Postal Monopoly in particular, which the FTC did not account for at all in its estimate of the net benefit or cost of laws that apply differently to the Postal Service and its private competitors.

As a government entity with a statutory monopoly over mail delivery, the Postal Service faces no competition for its market-dominant products and services, and thus it can collect monopoly-level prices from customers of those products to fund its delivery infrastructure. Under current cost attribution methodologies, competitive products and services are costed, for pricing purposes, on a marginal basis, allowing the Postal Service to charge prices for those products that do not reflect the cost of building or maintaining that infrastructure. The financial advantage of these economies of scale and scope generated by the Postal Service's statutory monopoly is truly massive, easily amounting to billions of dollars per year. Private sector rivals have no governmentally protected monopoly that provides revenues they can use to build and maintain their own delivery infrastructures.

The FTC Report mistakenly concluded that the Postal Service's economies of scope "may no longer provide a substantial benefit to the USPS" because competitors "regularly purchase access to the USPS's networks through workshare rates."[13] The FTC Report apparently contemplated a parcel industry where the Postal Service obtains a monopoly over "last mile" delivery and companies like UPS or FedEx abandon their

[12] *See* Federal Trade Commission, Accounting for Laws that Apply Differently to the United States Postal Service and its Private Competitors (2007) ("FTC Report").

[13] *See id.* at 50.

delivery networks and instead focus their businesses on only the components of parcel delivery before the last mile. This outcome, where the Postal Service's expansion into competitive markets would force private sector companies to abandon last-mile delivery, is inconsistent with UPS's understanding of Congress' intent under PAEA.

The FTC Report also appears to discount the significance of the advantages conferred by the Postal Service's economies of scale and scope on the grounds that these advantages are "merely the natural outcome of the market process."[14] This justification conflicts with Congress' mandate that the Report account for "the net economic effects" flowing from the relevant federal and State laws.[15] The mandate did not mention anything about ignoring economic effects that are believed to be a "natural outcome of the market process."[16] Instead, the FTC was tasked with identifying ways "for bringing such legal differences to an end."[17]

With regard to the mailbox monopoly, UPS observes that the relevant statute, 18 U.S.C. § 1725, was enacted in 1934, in the midst of the Great Depression. Congress passed the statute in response to "[b]usiness concerns, particularly utility companies, [who] within the last few years adopted the practice of having their circulars, statements of accounts, etc., delivered by private messenger" and surplus low-wage company employees.[18] The statute sought "to curb the practice of depositing statements of

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[14] *See id.* at 49.

[15] *See* Postal Accountability and Enhancement Act (PAEA), Pub. L. No. 109-435, § 703(b) (2006).

[16] *See* FTC Report at 49.

[17] *See* Postal Accountability and Enhancement Act (PAEA), Pub. L. No. 109-435, § 703(b) (2006).

[18] H.R. Rep. No. 709, 73d Cong., 2d Sess. at 1 (Feb. 13, 1934).

accounts, circulars, sale bills, etc., in letter boxes . . . without payment of postage thereon, by making this a criminal offense."[19]

As one commentator has observed: "It seems fair to surmise that, in adopting the mailbox monopoly, Congress was significantly influenced by the unusual economic and legislative developments of the period."[20] Much has changed since 1934. It may be appropriate for Congress to revisit the need for, and appropriate scope of, the mailbox monopoly in light of the current landscape.

III. SERVICE STANDARDS

The Commission also urged "commenters to review background information on service standards and performance and welcomes comments on issues not already raised in Docket No. PI2016-1."[21]

UPS appreciates the Commission's continued interest in ensuring that the Postal Service is meeting modern service standards by 39 U.S.C. § 3691. These service standards are essential to ensuring reliable and high-quality service for mailers in the U.S. and across the world. The Postal Service, however, has had difficulty satisfying these standards. As the Commission recently concluded, numerous Postal Service products "have not met their [service] targets and have not shown significant improvement" for several years.[22] Perhaps more troubling, is the Postal Service's

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[19] *Id.*

[20] James I. Campbell Jr., *Postal Monopoly Laws: History and Development of the Monopoly on the Carriage of Mail and Monopoly on Access to Mailboxes* at 167 (George Mason University Nov. 2008), available at http://www.jcampbell.com/Reports/2008_PRC/App_C_Ver_1.00.pdf.

[21] *See* Order 3238 at 9.

[22] Annual Compliance Determination Report – Fiscal Year 2015 at 102, Dkt. No. ACR2015 (Mar. 28, 2016).

apparent attempt to prioritize service standards for specific high-growth products, like parcels, over the service standards for monopoly products, like letter mail. For example, the Postal Service has proposed stopping Saturday delivery of letter mail, while maintaining seven-day delivery of parcels.

Service performance results for Standard Mail Carrier Route, Standard Mail Flats, Standard Mail Letters have not met their targets for several years and have not shown significant improvement.[23] In 2015, Standard Mail Flats, Standard Mail Letters, and Standard Mail Carrier Route delivering on time only 73.8%, 85.8%, and 82% of the time, respectively.[24] But for parcels, and other high density shipments, the Postal Service has "exceeded the performance targets set by the Postal Service."[25]

This difference between the performance standards of letter mail versus parcels suggests the Postal Service is abusing its monopoly power over letter mail by prioritizing its parcel products. The Postal Service's responses to the Commission's service inquiries suggest, for example, that poor letter delivery performance is at least partly driven by the prioritization of parcels. After the Public Representative recently found that "the Postal Service completely failed to meet its letter mail performance goals"[26] and asked the Postal Service for an explanation, the Postal Service responded that the "ongoing growth in packages" has required them to restructure their

[23] *See id.*

[24] *See id.* at 139.

[25] *Id.* at 138.

[26] Public Representative Initial Comments on the FY 2015 Performance Report and FY 2016 Performance Plan at 5, Dkt. No. ACR2015 (Feb. 26, 2016).

transportation and delivery networks, resulting in poor performance for letter mail.[27] More anecdotally, a former postal worker in Greensboro, North Carolina, authored several articles detailing internal management practices that prioritize competitive products over market dominant, claiming that "packages are treated as 'gold' and given the utmost importance" and "[p]riority parcels are considered top tier for the USPS."[28]

As a consequence of the Postal Service not placing the highest priority on letter mail delivery, mailers around the country suffer, as their mailings are subordinated to the higher-growth competitive parcel products. UPS requests that the Commission and Congress monitor this situation and, to the extent necessary, request additional information from the Postal Service to ensure it does not continue.

Specifically, Congress could require the Postal Service to adhere to "quality of service" reporting requirements of 39 U.S.C. § 3652 for its competitive product lines as well. This requirement would allow for a fair comparison of the quality of service being provided for the Postal Service's market-dominant business against its competitive products business, providing a mechanism to ensure that the Postal Service is fulfilling its mandate to "give the highest consideration to the requirement for the most expeditious collection, transportation, and delivery of important letter mail."[29]

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[27] Analysis of the Postal Service's FY 2015 Annual Performance Report and FY 2016 Performance Plan at 25, Dkt. No. ACR2015 (May 4, 2016).

[28] *See* Paul Barbot, *The Horrific New Marriage Between Your Post Office and Amazon Sunday* (Feb. 8, 2015), available at http://www.alternet.org/new-marriage-between-your-post-office-and-amazon-sunday-and-grocery-delivery-makes-life-hell-workers.

[29] *See* 39 U.S.C. § 101(e).

IV. THE POSTAL SERVICE FUND AND THE POSTAL SERVICE COMPETITIVE PRODUCTS FUND

The Commission also invited comments "on the operation of the Postal Fund and Competitive Products Fund to the extent they are not duplicative of matters raised within Docket No. RM2016-2."[30] The Postal Service continues to maintain the Competitive Products Fund throughout most of the year at a balance of zero.[31] As has been discussed in prior dockets, UPS continues to be concerned that Congress' mandates regarding the Competitive Products Fund are not being followed.

V. REQUIREMENT OF A PUBLIC REPRESENTATIVE

The Commission also welcomed comments "on the utility of the public representative in Commission proceedings."[32] In UPS's experience, the Public Representative serves a valuable role in Commission proceedings. As noted, Postal Service costing issues are extraordinarily complex and often opaque. UPS knows from first-hand experience that it is very challenging, and costly, for a private entity to develop a thorough understanding of the Postal Service's practices. The Public Representative facilitates the public's understanding of the Postal Service's practices and serves an important advocacy role for the public.

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[30] *See* Order No. 3238 at 10.

[31] *See* National Trial Balance, March, 2016 (FY 2016); and Statement of Revenue and Expenses, March, 2016 (FY 2016), *available at* http://www.prc.gov/dockets/document/95846.

[32] *See* Order No. 3238 at 13.

Respectfully submitted,

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