

Nos. 16-1354 and 16-1419

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**IN THE UNITED STATES COURT OF APPEALS  
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

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UNITED PARCEL SERVICE, INC.,  
*Petitioner,*

v.

POSTAL REGULATORY COMMISSION,  
*Respondent.*

AMAZON FULFILLMENT SERVICES, INC.,  
NATIONAL ASSOCIATION OF LETTER CARRIERS, AFL-CIO,  
PARCEL SHIPPERS ASSOCIATION, and  
UNITED STATES POSTAL SERVICE,  
*Intervenors Supporting Respondent.*

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On Petitions for Review of Orders of the  
Postal Regulatory Commission

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**BRIEF FOR INTERVENORS IN SUPPORT OF  
THE POSTAL REGULATORY COMMISSION**

(Names of sponsoring parties and counsel appear inside front cover)

May 8, 2017

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**CERTIFICATE AS TO PARTIES,  
RULINGS AND RELATED CASES**

The Intervenors adopt the Certificate As To Parties, Rulings, and Related Cases in the Commission's brief.

**RULE 26.1 DISCLOSURE STATEMENTS**

**Amazon Fulfillment Services, Inc.**

Amazon Fulfillment Services, Inc. is a wholly-owned subsidiary of Amazon.com, Inc., a corporation whose common stock is publicly traded on the NASDAQ Global Select Market under the symbol "AMZN." No publicly-held company has a 10 percent or greater ownership interest in Amazon.com, Inc.

Amazon.com, Inc. engages in multiple businesses, including Internet retailing. Amazon Fulfillment Services, Inc. is the logistics and distribution subsidiary of Amazon.com, Inc.

**National Association of Letter Carriers, AFL-CIO**

National Association of Letter Carriers, AFL-CIO ("NALC") is a national labor union that serves as the collective bargaining representative of the more than 200,000 city letter carriers employed by the United States Postal

Service. NALC has no parent companies. No publicly-held company holds any ownership interest in NALC.

### **Parcel Shippers Association**

Parcel Shippers Association is a nonprofit corporation organized under the laws of Virginia, with a principal place of business in Alexandria, Virginia. Parcel Shippers Association is not publicly traded, and has no corporate parent. No publicly-traded entity has an ownership interest in Parcel Shippers Association.

Parcel Shippers Association is a voluntary membership organization whose primary mission is to foster competition in parcel delivery. Parcel Shippers Association seeks to promote the interests of its members, *inter alia*, by participating in administrative and civil litigation concerning the prices charged for shipping parcels via the United States Postal Service and competing private carriers such as United Parcel Service, Inc. Parcel Shippers Association is a trade association under Circuit Rule 26.1(b).

Respectfully submitted,

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## GLOSSARY OF TERMS

JA	Joint record appendix
OIG	United States Postal Service Office of Inspector General
Order No. 3506 (“Order”)	Postal Regulatory Commission Order No. 3506, issued on September 9, 2016, and updated on October 19, 2016, in PRC Docket No. RM2016-2, <i>Periodic Reporting (UPS Proposals One, Two and Three)</i> (available at <a href="https://www.prc.gov/docs/97/97527/Notice%20of%20Errata.pdf">https://www.prc.gov/docs/97/97527/Notice%20of%20Errata.pdf</a> ). All references in this brief are to the updated version of the order.
Order No. 3641	Postal Regulatory Commission Order No. 3641, issued on December 1, 2016, in PRC Docket No. RM2016-13, <i>Changes Concerning Attributable Costing</i> (available at <a href="https://www.prc.gov/docs/97/97990/Order3641.pdf">https://www.prc.gov/docs/97/97990/Order3641.pdf</a> )
PRC or Commission	Postal Regulatory Commission (before 2007, Postal Rate Commission)
UPS	United Parcel Service, Inc.
USPS or Postal Service	United States Postal Service

**BRIEF FOR INTERVENORS IN SUPPORT OF  
THE POSTAL REGULATORY COMMISSION**

**STATEMENT OF ISSUES**

39 U.S.C. §§ 3631(b) and 3633(a)(2) require that the rates charged by the United States Postal Service (“USPS”) for each competitive postal product cover, at a minimum, the “direct and indirect postal costs” that are “attributable” to the product. Since this requirement was first enacted in 1970, the Postal Regulatory Commission and its predecessor, the Postal Rate Commission, have attributed costs to a mail class or product only if the evidence establishes a “reliably identified causal relationship” between the class or product and the costs. In 2006, Congress codified the causation requirement in 39 U.S.C. § 3631(b), which defines the “costs attributable” to a product as the “direct and indirect postal costs attributable to such product through reliably identified causal relationships.”

The Commission has also held for several decades that costs—even variable costs—do not satisfy the causation test for attribution if caused by two or more mail classes or products in common. An individual class or product does not cause common costs, the Commission has reasoned, because eliminating the class or product would not avoid the costs.

In *National Association of Greeting Card Publishers v. USPS*, 462 U.S. 810 (1983), the Supreme Court upheld both the causation requirement and the Commission's refusal to allocate common costs to individual mail classes.

During the 34 years since *Greeting Card Publishers*, the Commission has repeatedly rejected proposals by United Parcel Service, Inc. ("UPS"), a competitor of the Postal Service, to inflate the attributable cost floor under postal rates with allocated common costs. Indeed, until 2016, the Commission (with exceptions not material here) attributed to each class or product only its volume-variable cost—*i.e.*, the *marginal* costs of the class or product (the costs caused by producing one more unit of the class or product, or avoided by producing one less unit, leaving all other outputs unchanged) multiplied by the volume produced.

In the two decisions under review here, the Commission adopted a slightly higher cost floor by redefining attributable costs as *incremental* costs—*i.e.*, the extra costs caused by producing all of a product, or the costs avoided by producing none of it, again leaving all other outputs unchanged. The Commission rejected, however, a renewed UPS proposal to inflate attributable costs by allocating common costs to individual mail products.

UPS, in its current petitions for review, contends that the Commission's action was error. UPS's petitions for review raise two issues:

- (1) Was the Commission's continued adherence to its causation requirement for attributing costs under 39 U.S.C. §§ 3631(b) and 3633(a)(2) a reasonable interpretation of the statute? (Yes.)
  
- (2) Was the Commission's latest rejection of UPS's recurrent proposal to attribute allocations of common costs to individual products a reasonable application of the causation requirement? (Yes.)

### **PERTINENT STATUTORY AND REGULATORY PROVISIONS**

Pertinent statutes and regulations appear in the addendum to this brief.

### **STATEMENT OF THE CASE**

We adopt the Statement of the Case on pages 4-26 of the Commission's brief except as noted below.

### **INTRODUCTION AND SUMMARY OF ARGUMENT**

The standards of review of the Commission's action are deferential. Because Congress has charged the Commission with interpreting and enforcing the attributable cost floor, 39 U.S.C. § 3633(a), the Commission's interpretation of Sections 3631 and 3633 must be upheld if a permissible statutory construction.

Commission Br. 26, 29, 37; *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842-45 (1984); *Greeting Card Publishers*, 462 U.S. at 821, 832; *All. of Nonprofit Mailers v. PRC*, 790 F.3d 186, 194 (D.C. Cir. 2015); *USPS v. PRC*, 640 F.3d 1263, 1266-67 (D.C. Cir. 2011). And the Commission's factual judgments on costing, econometric and other technical issues must be upheld unless arbitrary, capricious, or unsupported by substantial evidence. *Greeting Card Publishers*, 462 U.S. at 821, 825-26, 833; *All. of Nonprofit Mailers*, 790 F.3d at 197.

But judicial deference is unnecessary to uphold the decisions under review. This case is neither novel nor a close call. The Commission's grounds for rejecting the UPS costing proposal are supported by nearly 45 years of Commission and judicial precedent and the consensus of mainstream economics, explained in this case by two distinguished economists, Professor John C. Panzar of Northwestern University (emeritus) and the University of Auckland, and Professor Michael D. Bradley of George Washington University. UPS mentions virtually none of this in its brief.

The parties agree that the costs attributed to each product should include its incremental costs, including its (1) marginal costs (or, more precisely, "volume variable" costs, the Commission's term for marginal costs multiplied

by volume);<sup>1</sup> (2) any product-specific fixed costs;<sup>2</sup> and (3) any inframarginal costs<sup>3</sup> that would be avoided if the product were eliminated.

The disagreement before this Court involves a single costing issue: whether the costs attributed to a product should also include an allocated share of common costs—the inframarginal costs that do not qualify as incremental costs. PRC Docket No. RM2016-2, Order No. 3506 (“Order”) at 15-17. These are variable costs that are caused by two or more products in common, and which would not be avoided if any one product were eliminated.<sup>4</sup>

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<sup>1</sup> Order at 9 n.13; PRC Docket No. RM2016-2, Panzar Decl. (Jan. 29, 2016), at 9. “Volume variable” costs should not be confused with the more common terms “variable” costs or “average variable” costs, which normally exceed marginal cost. *See* UPS Br. 9-10; Panzar, Exh. 2 at 14-15.

<sup>2</sup> “Product specific costs” are fixed costs that are caused by a single mail class, product or group of products. Order at 9 & n.12; *accord* PRC Docket No. R74-1 Op. & Rec. Decis. (Aug. 28, 1975) at 100; *Greeting Card Publishers*, 462 U.S. at 815 n.5. The parties agree that product-specific costs should be attributed, but are minimal. UPS Br. 9 n.2; USPS Office of Inspector General, *A Primer on Postal Costing Issues 2* (2012) (“OIG Primer”). Accordingly, this brief does not discuss specific fixed costs further.

<sup>3</sup> Inframarginal costs are “variable costs that are not volume-variable costs”—*i.e.*, do not vary with marginal changes in the output of an individual class or product because the costs are caused by two or more products in common. Order at 10, 19-20, 35-36, 54 (citing Panzar, Exh. 2 at 11); OIG Primer at 20-21.

<sup>4</sup> A common cost is an outlay “which contributes simultaneously to the supply of two or more different goods and/or services.” PRC Docket No. R84-1 Op. & Rec. Decis. (Sept. 7, 1984) at ¶ 3026 n.11; Order at 7-8, App. A at 6; *see* OIG Primer at 2; PRC Docket No. RM2016-2, Amazon Comments (Jan. 27, 2016) at 2 n.1.

The Commission rejected UPS's proposal to attribute common costs because 39 U.S.C. §§ 3631(b) and 3633(a)(2) allow costs to be attributed to a product only if a "reliably identified causal relationship" exists between the costs and the product. Allocating common costs to an individual product fails this test because eliminating the product would not avoid the costs. Decades of Commission and judicial precedent and the consensus of mainstream economics support both of these propositions. UPS offers no valid counterargument.

## ARGUMENT

### **I. THE COMMISSION PROPERLY HELD THAT COSTS MAY NOT BE ATTRIBUTED TO A MAIL PRODUCT WITHOUT RELIABLE EVIDENCE THAT THE PRODUCT CAUSES THE COSTS.**

#### **A. The history of the attributable cost standard confirms the causation requirement for cost attribution.**

The Commission held that 39 U.S.C. §§ 3631(b) and 3633(a)(2) bar attribution of costs to a product without "reliably identified causal relationships" between the costs and the product. Order at 3, 53-56, 57-62, 123-24, App. A at 13-16. The history of this requirement since 1971 confirms that the Commission's holding was correct.

Until 1971, postal rates were set by Congress with little regard for efficient pricing principles. Costs of individual postal services were often estimated by

allocating fixed and common costs to individual services through arbitrary accounting conventions with no causal basis. This approach, known as fully allocated (or fully distributed) costing, was widely criticized as arbitrary and anticompetitive. Amazon at 39-41; R74-1 Op. & Rec. Decis. at 82-83; Report of the President's Commission on Postal Reorganization ("Kappel Commission Report") at 39, 130-31, 133 (1968).

The Postal Reorganization Act of 1970, Pub. L. No. 91-375, 84 Stat. 719, which transformed the Post Office Department into the Postal Service, revamped the minimum rate standards. In Congressional hearings that culminated in the 1970 legislation, the Post Office Department stated that it planned to replace fully-allocated cost with incremental cost as a rate floor if the legislation passed. *See* PRC Docket No. R71-1 Op. & Rec. Decis. (June 5, 1972) at 44 n.1 (citing legislative history). UPS, a competitor of the Post Office Department, argued that the prices charged for parcel post service (the predecessor of today's package delivery services) should be required to cover fully allocated costs. *Id.* at 44-46; *Newsweek, Inc. v. USPS*, 663 F.2d 1186, 1198-99 (2d Cir. 1981) (quoting S. Rep. No. 91-912, at 17 (1970)), *aff'd sub nom., Greeting Card Publishers*, 462 U.S. 810. The 1970 legislation, however, required only that the rates charged for each mail class cover its "attributable" costs.

84 Stat. at 760 (enacting former 39 U.S.C. § 3622(b)(3)); R71-1 Op. & Rec. Decis. at 44-46.

The statutory term “attributable” costs had “no technical meaning or significant antecedent legislative history.” *Greeting Card Publishers*, 462 U.S. at 832. The Commission initially filled this gap by defining attributable costs to mean *marginal* costs—the costs that economists define as caused, directly or indirectly, by producing one more unit (or avoided by producing one less unit) of output. Order at 6-12; Amazon at 27, 34-35; Panzar at 5; OIG Primer at 14-19. The Commission, like Congress, declined to adopt the fully allocated cost rate floor proposed by UPS and others. R74-1 Op. & Rec. Decis. at 124.

The Commission has repeatedly declined to attribute variable costs that are caused by two or more mail classes or products in common. Order at 7-8, 10, 35, 50, 52, 54-55, 67-68, App. A at 6-7, 16; UPS Br. 14-15. Cost attribution, the Commission held, required an “identified causal relationship” between an individual mail class and the costs attributed to it. Costs that do not vary with changes in output of a single class of mail are not caused by that class, and thus may not be attributed to it. Order at 2-3, 9-11, 14, 43-51.

The causation test became the cornerstone of a two-tier system of rate regulation. The first tier was attributable cost. Each mail class, with some narrow exceptions not relevant here, was required to cover its attributable costs.

The second tier consisted of “institutional” costs, which the Commission defined as all postal costs that could not be attributed to individual mail classes. Institutional costs were to be recovered from individual classes and subclasses of mail based on relative demand elasticities and other non-cost factors. Order at 11; *Greeting Card Publishers*, 462 U.S. at 814-25.

UPS and others who favored a higher cost floor challenged both the causation requirement for attribution and the two-tier ratemaking system. Twelve years of litigation ensued. *Ass’n of Am. Publishers v. Governors of the USPS*, 485 F.2d 768 (D.C. Cir. 1973); *Nat’l Ass’n of Greeting Card Publishers v. USPS*, 569 F.2d 570, 582-85 (D.C. Cir. 1976), *vacated as to other issues*, 434 U.S. 884 (1977); *Nat’l Ass’n of Greeting Card Publishers v. USPS*, 607 F.2d 392, 434 (D.C. Cir. 1979); *Newsweek*, 663 F.2d at 1198-99; Amazon at 42-48 (summarizing history). The Supreme Court ultimately resolved the issue in *Greeting Card Publishers*, upholding both the causation requirement and the two-tier ratemaking system. In “refusing to use distribution keys or other accounting principles lacking an established causal basis,” the Supreme Court held the Commission had “acted consistently with the statutory mandate and Congress’ policy objectives[.]” 462 U.S. at 826-29.

Between 1984 and 2016, the Commission defined attributable costs of a mail class as the costs that were caused by marginal changes in its output. Fixed

and variable costs caused by two or more classes in common were not attributed to individual mail classes. R84-1 Op. & Rec. Decis. at 117-46, *aff'd*, *Direct Mktg. Ass'n v. USPS*, 778 F.2d 96, 112 (2d Cir. 1985); Amazon at 48-50.

In 2006, Congress codified the Commission's definition of attributable cost at 39 U.S.C. § 3633(a)(2), which requires that each competitive product cover its "costs attributable," and § 3631(b), which defines the term as "the direct and indirect postal costs attributable to such product *through reliably identified causal relationships*." Postal Accountability and Enhancement Act, Pub. L. No. 109-435, § 202, 120 Stat. 3198, 3205-06 (2006) (emphasis added).

Neither the text nor the legislative history of the 2006 legislation required any major change in the existing cost tests. 39 U.S.C. §§ 3622(c)(2) and 3633(a)(2) adopted the Commission's attributable cost standard; § 3633(a)(1) adopted the Commission's existing cross-subsidy test. PRC Docket No. RM2007-1, Order No. 26 (Aug. 15, 2007) at ¶¶ 3044-47; Order at 9, 14. Both the Senate and House committee reports on the 2006 legislation emphasized this continuity. The Senate report stated:

The current analysis has been guided by a Supreme Court decision, *National Assoc. of Greeting Card Publishers v. USPS*, 462 U.S. 810, 829–34, (1982) [*sic*], that carefully analyzed how the term attributable should be interpreted. This definition has been further refined by U.S. Courts of Appeals and is well understood in the industry. The [Supreme] Court rejected a contention that it was appropriate to make classes responsible for the recovery of costs for which an

extended inference of causation was claimed. It emphasized the need for reliable indicators of causality without specifying any specific method for identifying causality. Governed by this ruling since 1982, the Postal Rate Commission must have reasonable assurance that any costs attributed to a class of mail are incurred as a result of providing that class of mail. *The Committee finds no reason for changing this standard.*

S. Rep. No. 108-318, at 9-10 (2004) (emphasis added). The House report added:

In addressing the attributable costs, the Commission should *continue to focus on the need to have reliable indicators of cost causality*. . . . The goal of the Commission should be a *technically correct result*, placing accuracy above achieving a particular outcome of higher or lower attribution.

H.R. Rep. No. 109-66, pt. 1 at 49 (2005) (emphasis added).

Between 2006 and 2016, the Commission refined its cost attribution standards, but rejected several more proposals by UPS to resurrect cost attribution by allocating common costs.

In 2007, the Commission adopted incremental cost as the test for cross-subsidy under 39 U.S.C. § 3633(a)(1). RM2007-1, Order No. 26 (promulgating 39 C.F.R. § 3015.7(a)). The Commission defined incremental costs as “the variable and fixed costs that would be eliminated if a product (or products) was (were) (hypothetically) discontinued.” *id.* at ¶ 3040.<sup>5</sup> The Commission rejected

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<sup>5</sup> The Commission’s definition of incremental costs is consistent with the standard economic literature. *Compare* Order at 8-10, 52, 54-55, 57-58, *with*

a UPS proposal that would have required competitive products to cover, in addition to incremental costs, a “fair share of the unattributable network costs from which competitive products benefit.” *Id.* at ¶ 3044; *see generally id.* ¶¶ 3046-48. Instead, the Commission required only that “[e]ach competitive product must recover its attributable costs as defined in 39 U.S.C. 3631(b).” RM2007-1, Order No. 43 (Oct. 29, 2007) at 137-38 (adopting 39 C.F.R. § 3015.7(b)). The Commission explained that it had chosen to “employ [the] long-established attribution method to determine compliance with section 3633(a)(2)” because the section merely “codifies [the Commission’s] long-standing attribution method” under the Postal Reorganization Act. RM2007-1, Order No. 26 at ¶¶ 3045, 3048; *see also* Order at 12-14 (discussing precedents).

**B. UPS’s collateral attacks on the causation requirement are meritless.**

**1. Individual products do not cause common costs.**

UPS argues that the Commission should attribute not just the variable costs caused by individual products, but *all* variable costs, including those that are caused only by two or more products in common. Common variable costs

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Amazon at 33-34 & n.13 (citing economic literature); Panzar at 4-7 & Exh. 2 at 5-6.

should be attributed, UPS asserts, because all variable costs by definition “vary with the amount of goods produced,” and therefore are caused by those goods. UPS Br. 43-44. UPS confuses collective causation with individual causation.

While all variable costs are caused by volume in the aggregate, variable costs that are caused in common by two or more products are not caused by any *individual* product: producing (or not producing) any individual product would not affect the common costs. Hence, common costs may not be attributed to any individual product. *Greeting Card Publishers*, 462 U.S. at 827; Order at 10, 31-32, 35, 45-51, 55-56, 123-24, 125 (ordering par. 2), App. A at 6, 16; PRC Docket No. RM2016-13, Order No. 3641 (Dec. 1, 2016) at 2, 11; Amazon at 80-82; PRC Docket No. RM2016-2, Reply Comments of Amazon (Mar. 25, 2016) at 21; Panzar at 7, 11-13; OIG Primer at 20-21.

The Commission’s brief is, if anything, too forgiving of UPS’s erroneous view on this point. The incremental cost of a product does not include “the minimum” (or maximum) “inframarginal cost the product possibly could have incurred,” PRC Br. 39, but rather the precise amount of cost that the product in fact causes. As the Commission found, the incremental cost methodology “results in the attribution of those inframarginal costs that meet the statutory requirements for cost attribution.” Order at 3. Incremental costs “are costs that result from providing a specific product, and can be traced to that specific

product.” *Id.* at 8. “[I]ncremental cost calculation accurately calculates the inframarginal costs that can be causally related to a product’s provision as a whole. These causally related costs can only be calculated through the development of incremental costs.” *Id.* at 43. “Allocating only the inframarginal costs that are part of a product’s incremental costs limits allocation to those inframarginal costs caused by providing a specific product.”

*Id.* at 51-52. Hence:

Using incremental costs to allocate inframarginal costs is appropriate, as the incremental cost-based allocation is restricted to only those inframarginal costs which have been causally related to the provision of a product through a clear and supported methodology as required by section 3622(c)(2). While it does not allocate all inframarginal costs, it provides a calculation of all inframarginal costs that can be reliably identified and are causally related to each product.

*Id.* at 52.

The record supports these findings. As Professor Panzar explained, the “costs *caused* by a product (or group of products) are, by definition, the incremental costs of that product (or group of products). Therefore, statutory attributable costs should be interpreted as excluding any costs that are not caused by the increment being costed—or, stated, otherwise, would not be avoided if the increment of output were discontinued.” Panzar at 7 (emphasis in original). “The economic concept of incremental costs is central to any notion of *cost*

*causality*. To say that service (or group of services) *X* causes an expenditure *Y* is *equivalent* to saying that *Y* is the Incremental Cost of *X*.” *Id.*, Exh. B at 6 (emphasis in original).

Professor Bradley agreed. A “product’s incremental cost is the *total* amount of cost caused by that product[.]” PRC Docket No. RM2016-2, Michael Bradley Analysis (Jan. 25, 2016), at 12 (emphasis in original). A “product’s incremental cost already captures all of the cost caused by that product.” *Id.* Incremental costs “represent the total cost caused by a product (or group of products) in that multiproduct firm. As a result, any attempt to add costs to a product’s (or group of products’) incremental cost necessarily involves an arbitrary assignment of cost that is not based upon cost causality.” *Id.* at 18. “[T]he only part of inframarginal costs caused by individual products is the portion that would be included in the product’s incremental cost.” *Id.* at 29.

**2. Common costs are not “indirect” costs under 39 U.S.C. § 3631(b).**

UPS also argues that the Commission, by “limiting ‘costs attributable’ to costs caused solely by a specific product,” violated 39 U.S.C. § 3631(b) because it requires the Commission to attribute *indirect* “postal costs [that are] attributable to [a] product through reliably identified causal relationships,” and common variable costs are “indirect” costs in this sense. UPS Br. 40-43; *see also*

Sidak Amicus Curiae Br. (“Sidak Br.”) 22-23. This argument ignores the Commission’s longstanding interpretation of “indirect” costs, which Congress incorporated into the statute in 2006.

At least since the mid-1970s, the term “indirect postal costs” has referred not to common variable costs, but to *piggyback* costs—costs that vary with other costs. Indirect or piggyback costs include the costs of the employees who supervise the workers who process mail, the mail processing equipment, and the buildings that house the equipment; fuel and electricity that power the buildings, the equipment, and mail delivery vehicles; maintenance of vehicles and equipment; general administrative costs; workers compensation; and labor-related benefits.<sup>6</sup>

When these costs have a reliably identified (albeit indirect) causal relationship with the volume of a product, the Commission does attribute the costs to the product—and has done so for decades.<sup>7</sup> Piggyback or indirect costs

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<sup>6</sup> See Financial Analysis of United States Postal Service Financial Results and 10-K Statement (Fiscal Year 2015, Mar. 29, 2016) (“FY2015 Financial Analysis Report”) at 47, 53 & n.69. *Accord* PRC Docket No. R87-1 Op. & Rec. Decis. (Mar. 4, 1988) at 766.

<sup>7</sup> Order at 9 n.14 and 103 n.122; FY2015 Financial Analysis Report at 47 n.64; *id.* at 53 n.69. *Accord* PRC Br. 50-51; PRC Docket No. R2006-1, Direct Testimony of Lillian Waterbury, USPS-T-10 (May 3, 2006) at 14; PRC Docket No. R97-1 Direct Testimony of Joe Alexandrovich, USPS-T-5 (July 10, 1997) at 3 & Exh. USPS-5C at 9-12; PRC Docket No. R80-1, Direct Testimony of Howard S. Alenier, USPS-T-7 (Apr. 21, 1980) at 6 & n.1 (“Attributable costs are

account for a large share of all attributable costs. In Fiscal Year 2016, for example, the mail processing piggyback factor for all mail was 1.667: for every dollar of mail processing attributable costs, another 66.7 cents of indirect costs were attributed. But when indirect costs piggyback on a direct cost that lacks a reliably identified causal link with the volume of a product, neither the underlying direct cost nor the piggyback cost are attributed to the product.

Congress, when enacting 39 U.S.C. § 3631(b) in 2006, made no change to the existing definition of “indirect postal costs” as established by the Commission. Hence, the Commission’s pre-2006 construction of “indirect” as a synonym for piggyback costs (rather than common variable costs) is implicitly codified in Section 3631(b). *United States v. Wilson*, 290 F.3d 347, 356-57 (D.C. Cir. 2002); *see also C.I.R. v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 159 (1993).

**3. A general dictionary definition of “institutional” does not make common costs “attributable.”**

UPS next argues that variable costs caused by two or more mail products in common must be attributed to individual products because (1) all postal costs are either attributable or institutional; (2) the statute does not explicitly define

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those either variable with volume or specific fixed. The terms direct and indirect indicate whether or not at least one intermediate element links cost to volume.”).

“institutional” costs; (3) ordinary dictionary definitions therefore control; (4) variable costs caused by multiple products in common are not “institutional” costs according to one ordinary dictionary definition; and (5) common variable costs therefore must be classified as attributable by default. UPS Br. 34-35; Sidak Br. 22. The first two steps are correct; the remaining three do not follow.

First, ambiguity in a statutory term whose definition and enforcement have been delegated to the Commission does not mean that general dictionary definitions control. The *Chevron* step one inquiry into whether the statute is ambiguous turns on the statutory “text, structure, purpose, and history.” *Gen. Dynamics Land Sys., Inc. v. Cline*, 540 U.S. 581, 600 (2004); *Petit v. Dep’t of Educ.*, 675 F.3d 769, 781 (D.C. Cir. 2012). If the statute is ambiguous, the Commission’s definition prevails unless “arbitrary, capricious, or manifestly contrary to the statute.” *Chevron*, 467 U.S. at 843-44; *see also Greeting Card Publishers*, 462 U.S. at 825-34.<sup>8</sup>

Second, UPS’s definition of attributable costs as all postal costs not classified as institutional inverts the statute. Institutional costs are the costs remaining after all attributable costs have been attributed, not *vice versa*. Order

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<sup>8</sup> *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995), on which UPS relies, is inapposite. The case reviewed an interpretation of a statute by a trial court, not an administrative agency.

at 10 n.15 (“institutional costs are calculated as a residual”); *accord UPS v. USPS*, 184 F.3d 827, 844 (D.C. Cir. 1999) (referring to “institutional” costs as “the remaining costs” after “the Commission has established attributable costs”); *Mail Order Ass’n of Am. v. USPS*, 2 F.3d 408, 425 (D.C. Cir. 1993) (same); *Direct Marketing Ass’n*, 778 F.2d at 101 (same); PRC Docket No. R97-1 Op. & Rec. Decis. (May 11, 1998) at 227 (same); R74-1 Op. & Rec. Decis. at 99 (same).

Third, the term “attributable cost” is not common usage, but a technical term of art defined by statute and decades of litigation. *See* pp. 6-12, *supra*. When Congress uses a term in a technical sense, the technical meaning prevails over ordinary dictionary definitions. *Corning Glass Works v. Brennan*, 417 U.S. 188, 201-02 (1974). Because the technical meaning of attributable costs excludes common variable costs, the technical meaning of institutional costs necessarily includes common variable costs.

Fourth, Congress ratified the above interpretation in 2006 by enacting the term “institutional costs” into 39 U.S.C. §§ 3622(b)(9), 3622(c)(1)(A)(i), 3622(e)(3)(A), 3633(a)(3), 3633(b) and 3652(b)(3). Legislation that uses terms with an established judicial and administrative interpretation incorporates that meaning unless the statute provides otherwise. *Wilson*, 290 F.3d at 356-57; *see also Keystone Consol. Indus.*, 508 U.S. at 159.

UPS gains nothing by seizing on a snippet from a 2004 Senate committee report as evidence that the 2006 legislation limited institutional costs to “such things as ‘salaries for management and overhead costs.’” UPS Br. 35-36. The actual report language confirms that those examples were merely illustrative, and the committee members intended to leave cost attribution issues to the Commission:

Institutional costs are those 40 percent of the Postal Service’s costs, *such as* salaries for management and other overhead costs, that the Postal Service says cannot be attributed to any specific product. While considering this legislation the Committee heard testimony . . . that specific rules for cost attribution should be incorporated into law. *The Committee has decided that the technical decision of what cost analysis methodologies are sufficiently reliable at any given time to form the basis for attribution should be left to the Postal Regulatory Commission . . . .*

S. Rep. No. 108-318, at 9 (emphasis added).

Finally, UPS acknowledged to the Commission that classifying common variable costs as institutional was consistent with longstanding precedent. UPS’s economic witness Kevin Neels stated, for example, that “inframarginal costs have traditionally been included as part of institutional costs, *even though they are variable costs and change as volume changes.*” PRC Docket No. 2016-2, Neels Report (Oct. 8, 2015) at 10 (emphasis added); *id.* at 13 (claiming that “nearly half of so-called ‘institutional’ costs are actually variable”; “inframarginal costs . . . are ‘institutional’ under postal parlance, but these are

decidedly not fixed costs and should not be thought of as such”); *see generally id.* at 9-13; *cf.* Amazon at 76-77 (reproducing figure from Panzar, Exh. 2 at 19). Having conceded that classifying inframarginal or variable common costs as institutional was established Commission policy, UPS may not now argue to the contrary.

**4. The Commission did not need to repeat its established statutory interpretation in detail.**

The above analysis also refutes UPS’s claim that the Commission’s decision was arbitrary and capricious because it “failed to address” the “key statutory terms” such as “institutional” and “indirect.” UPS Br. 46-47. The Commission relied in Order No. 3506 on well-established interpretations of the key terms (“attributable,” “indirect” and “institutional”). In particular, the causation requirement for cost attribution was upheld by the Supreme Court in *Greeting Card Publishers*. The Commission made clear that it was adopting the incremental cost standard because it satisfied the causation requirement for cost attribution, and rejecting the UPS allocation proposal because it did not. Order at 2-3, 35, 52, 55-56, 59-62; Order No. 3641 at 2-5. The Commission had no

duty to do more. *Western Coal Traffic League v. I.C.C.*, 735 F.2d 1408, 1411 (D.C. Cir. 1984) (agency need not begin anew each time it faces the same issue).<sup>9</sup>

**5. UPS has failed to show that the Commission's enforcement of the causation requirement yields unreasonable results.**

UPS asserts that the Commission's interpretation of the causation requirement must be unreasonable because it results in classifying nearly half of all costs as institutional. UPS Br. 38. UPS never explains, however, why this result is anomalous. In fact, high institutional cost ratios typify multi-output networks enterprises with scale and scope economies. *See, e.g.*, Kappel Commission Report at 131 (40-50 percent of Post Office Department costs were institutional); *Newsweek*, 663 F.2d at 1200 ("There is nothing in the legislative history" of the Postal Reorganization Act "to suggest that attribution of fifty percent of postal costs is inadequate."); S. Rep. No. 108-318, at 9 (declining to change Commission's cost attribution standards under which 40 percent of postal costs are institutional); OIG Primer at 20-21. Nothing in the record

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<sup>9</sup> The dictum in the Commission's August 23, 2012 decision in Docket No. RM2012-3 ("by definition, institutional costs do not vary with volume") (cited at UPS Br. 35, 47), does not warrant a contrary result. The Commission has repeatedly made clear before and after 2012 that common costs, even if variable, may not be attributed to an individual product. *See* pp. 8-15, 20-22, *supra*.

suggests that the Postal Service's true institutional cost percentage is lower. Amazon at 69.

UPS's related claim that the incremental cost test forces market dominant products to subsidize competitive products by giving them "nearly a free ride on a network funded by captive mail customers" (UPS Br. 53) is also baseless. A product that covers its incremental costs is not subsidized. Order at 8-10, 13, 59 (citing PRC Docket No. RM2010-4, Order No. 399 (Jan. 27, 2010) at 2-6); PRC Docket No. ACR2014 (Mar. 27, 2015) at 71; PRC Docket No. PI2008-2, Order No. 56 (Jan. 28, 2008) at 4, n.3; PRC Docket No. R2000-1 Op. & Rec. Decis. (Nov. 13, 2000) at ¶¶ 4010, 4043-55. *Accord* Amazon at 58-61; Panzar at 2-5, 10-15, 24, Exh. 2 at 2, 5-6, 15-16, 21-26; Bradley at 12; William J. Baumol, John C. Panzar, and Robert D. Willig, *Contestable Markets and the Theory of Industrial Structure* 351-56 (1982).

**6. The Commission had no duty to consider the competition issues raised by UPS.**

UPS also assails the Commission for not making findings on how the incremental cost floor will allow private carriers like UPS to "compete on a level playing field." UPS Br. 48-50; *accord* Sidak Br. 4-7. This criticism is incoherent.

(1) The Commission had no duty to make findings on competition issues in the proceedings below. The requirement that competitive products cover their attributable costs appears in 39 U.S.C. § 3633(a)(2). Nothing in the

provision directs the Commission to promote competition by adopting inflated measures of attributable cost. Sections 3633(a)(3) and 3633(b), by contrast, indisputably raise competition issues. Section 3633(a)(3), as enacted in 2006, required that the Commission initially include in competitive product prices a markup *over* attributable costs to “ensure that all competitive products collectively cover what the Commission determines to be an *appropriate share of the institutional costs* of the Postal Service.” (Emphasis added.) Section 3633(b) in turn requires the Commission to review the appropriate share (or minimum contribution) requirement every five years, and retain, modify or eliminate the required minimum contribution in light of “all relevant circumstances,” including “the prevailing competitive conditions in the market.”

In 2007, the Commission implemented Sections 3633(a)(3) and 3633(b) by requiring that competitive products generate a large enough contribution over attributable costs to cover at least 5.5 percent of the Postal Service’s total institutional costs. RM2007-1, Order No. 43 at ¶¶ 3040-47. The Commission reaffirmed the 5.5 percent requirement in 2012. RM2012-3, Order No. 1449 at 24-25. The next Commission review of the required minimum contribution is due this year.

Because the Commission knew in 2016 that it soon would reconsider the “appropriate share” requirement, it deferred the competition issues raised by

UPS to that docket instead of RM2016-2. Order at 2, 58 & n.79, 117-23, 125 ¶ 4. In November 2016, the Commission began a separate rulemaking to reconsider the appropriate minimum contribution requirement under 39 U.S.C. § 3633(b). PRC Docket No. RM2017-1, Order No. 3624 (Nov. 22, 2016). UPS and other parties filed extensive comments, and the matter now awaits a Commission decision.

Administrative agencies have discretion to manage their dockets by severing issues for separate proceedings. *Mobil Oil Expl. & Producing Se., Inc. v. United Distrib. Cos.*, 498 U.S. 211, 230 (1991). UPS has not shown that the Commission abused its discretion by reserving competition issues for a separate proceeding under Section 3633(b).

(2) In any event, UPS has failed to establish that an incremental cost floor under the Postal Service's competitive product prices would allow unfair competition. As noted above, competitive products whose revenue covers incremental costs are not being subsidized by market-dominant products. *See* p. 23, *supra*. The Postal Service's revenue from competitive products now exceeds their combined incremental costs by nearly \$6 billion annually. PRC Docket No. ACR2016 (Mar. 28, 2017) at 88. Tellingly, competitive product shippers and market dominant mailers, the parties most at risk if UPS's claims of unfair competition were valid, generally opposed UPS's position. Amazon

Reply at 3, 19-20; PRC Docket No. RM2016-2, “Market Dominant Mailers” Comments (Jan. 27, 2016); PRC Docket No. RM2016-2, Parcel Shippers Association Comments (Jan. 27, 2016).

(3) UPS waived this issue in its reply comments by arguing that “impacts on the market are immaterial” and “Congress intended for the Commission to consider market conditions only when determining the appropriate share of the institutional costs to be covered by competitive products.” Order at 111 (quoting PRC Docket No. RM2016-2, UPS Reply Comments (Mar. 25, 2016) at 33, 35, 36). Having argued to the Commission that the competitive implications of a cost floor are “immaterial,” UPS may not now offer an “inconsistent view” to this Court. *Mail Order Ass’n of America*, 2 F.3d at 432 (“court does not consider position not presented to agency”) (internal citations omitted); *see also* PRC Br. 29, 54-55.

## **II. THE COMMISSION PROPERLY FOUND THAT THE UPS PROPOSAL VIOLATED THE CAUSATION REQUIREMENT FOR ATTRIBUTION.**

The second major premise of Order No. 3506—that the UPS proposal failed to satisfy the causation requirement—is also amply supported by the record. The UPS proposal would have attributed all “inframarginal” costs (*i.e.*, common costs) to individual products—in most instances without any evidence of a “reliably identified causal relationship.” Order at 2-3, 18, 22-34, 43-51, 53-

56, 104. As the Commission found, even the aggregate amount of inframarginal costs cannot be quantified reliably because the fixed costs of each cost component can be estimated only by extrapolating far beyond the relevant range of the available regression data. *Id.* at 38-40, 42-43, 47.

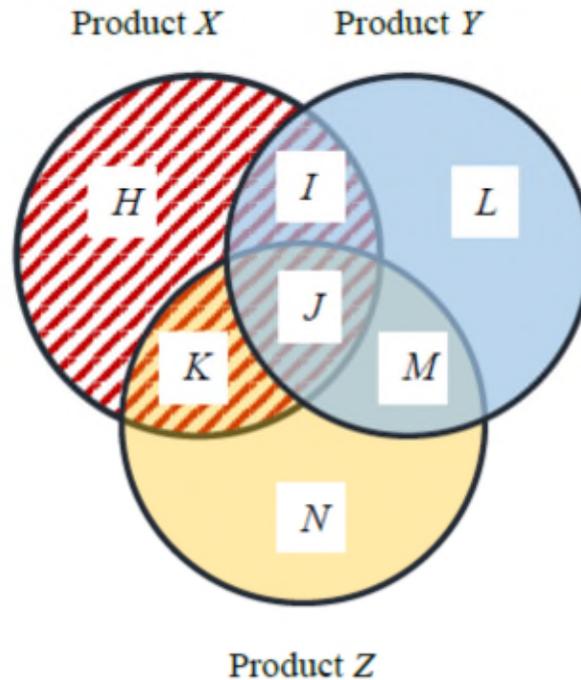
**A. The UPS/Shapley proposal would violate the causation requirement by allocating common costs to individual products.**

The record confirms that the UPS proposal, beneath its statistical veneer, would allocate all variable costs—including common costs not caused by any individual product—pro rata to individual products. Order at 22-32, 44-51; Amazon at 75-101; Panzar at 10-11, 17-30; Bradley at 31-32, 35; Amazon Reply at 20. Hence, the resulting “Shapley values do not reliably identify a causal relationship between inframarginal costs and products as required by section 3622(c)(2) and therefore are not an appropriate means of allocating inframarginal costs.” Order at 47.

The Sidak amicus brief confirms that the UPS/Shapley approach attributes common costs to products by “cost allocation.” Sidak Br. 19-20, 24; *see generally id.* at 15-23. The diagram on page 19 of the brief underscores how much the UPS proposal relies on allocating common costs. In the diagram, the areas marked H, L, and N represent the incremental costs caused by products X, Y, and Z, respectively; the areas marked I, K, and M represent costs jointly

caused by two products each; and the area marked J represents costs caused jointly by all three products:

**Figure 2: Incremental Costs in a Firm with Three Products**



The costs in the areas I, J, K, and M would *not* be avoided if product X, Y, or Z were discontinued but the other two products continued to be produced. The Commission correctly found that *a product does not cause a cost unless eliminating the product would eliminate the cost*. Yet Mr. Sidak concedes that the Shapley methodology would attribute to product X an allocated share of costs I, J and K:

The Shapley Value cost of product X is therefore equal to the costs caused by X alone (H) combined with one-half of the cost that X causes jointly with Y (I), one-half of the cost that X causes jointly with Z (K), and one-third of the cost that X causes jointly with both

*Y and Z (J). That pattern holds generally: a product's Shapley Value cost always equals the cost caused by each product combined with its proportional share of common costs.*

*Id.* at 26-27 (emphasis added).

The Commission's rejection of the UPS/Shapley proposal for allocating common costs without a causal basis has ample support in precedent. The Commission and other regulators have repeatedly rejected Shapley allocation methods in ratemaking. Order at 45-46 (discussing PRC Docket No. R94-1 Op. & Rec. Decis. (Nov. 30, 1994) at App. F, ¶¶ 122-25); Amazon at 93-99 (discussing R94-1 and other precedents).

More generally, the Commission and economists have rejected for decades the practice of attribution by allocation of common costs. "The problem with [fully distributed cost] is that institutional costs by definition are not caused by any product. Therefore any method used to allocate institutional costs to products is by its very nature arbitrary." OIG Primer at 4, 25-27. *Accord* Amazon at 8, 29-33 (citing economic literature); Order at 27-28; R74-1 Op. & Rec. Decis. at 4, 110-11, 124-25; PRC Docket No. R76-1 Op. & Rec. Decis. (June 30, 1976) at 12, 10-13, 75-103; PRC Docket No. R80-1 Op. & Rec. Decis. (Feb. 19, 1981) at App. B (castigating "extended attribution" as contrary to sound economic principles, and defending the Commission's reliance on causation-based cost attribution as the only economically sound basis for setting

price floors), *aff'd*, *Greeting Card Publishers*, 462 U.S. 810; R84-1 Op. & Rec. Decis. ¶ 3052 (noting that fully distributed costing “is condemned by the majority of economists because it allocates costs to classes of service by arbitrary criteria that do not reasonably reflect causation.”); R87-1 Op. & Rec. Decis. ¶ 3024 n.8 (“[I]t is a commonplace among economists that [fully distributed cost pricing systems] are highly arbitrary and yield ill-designed rate schedules.”); R94-1 Op. & Rec. Decis. at App. F, ¶ 118 (criticizing cost allocation approaches as “essentially arbitrary” and inconsistent with “economic efficiency”); Panzar at 17-18.

Even Mr. Sidak, who advocates the UPS allocation methodology in his brief,<sup>10</sup> has rejected in his peer-reviewed work the use of cost allocations to set regulatory price floors or ceilings. In 1994, he wrote that fully allocated cost ratemaking, although a “traditional tool of price regulation,” is an “admittedly arbitrary rule of thumb” that “is now generally discredited and is increasingly

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<sup>10</sup> Mr. Sidak has been a paid consultant to UPS for 20 years on minimum rate issues against the Postal Service. His recent projects included work for UPS in the minimum price floor rulemaking described at pp. 24-25, *supra*. [www.criterioneconomics.com/docs/gregory-sidak-curriculum-vitae.pdf](http://www.criterioneconomics.com/docs/gregory-sidak-curriculum-vitae.pdf) (listing his work for UPS in PRC Docket No. RM2017-1, *Institutional Cost Contribution Requirement for Competitive Products*, Reply Declaration filed March 9, 2017 (making many of the same arguments advanced in his *amicus* brief here); *id.*, Declaration filed Jan. 23, 2017 (same). See also J. Gregory Sidak and Daniel F. Spulber, *Protecting Competition from the Postal Monopoly* xi (1996) (noting that book grew out of a report commissioned by UPS).

being abandoned in regulatory practice.” William J. Baumol and J. Gregory Sidak, *Toward Competition in Local Telephony* 56 (1994). “[S]ince the FDC [fully distributed cost] figures are arbitrary, only by very unlikely happenstance will the numbers that emerge from any particular FDC calculation have any relation to the prices required for economic efficiency.” *Id.*

“There can be no excuse for continued use of such an essentially random, or, rather, fully manipulable calculation process as a basis for vital economic decisions by regulators.” J. Gregory Sidak and Daniel F. Spulber, *Deregulatory Takings and the Regulatory Contract* 42 (1998) (quoting with approval William J. Baumol, *et al.*, *How Arbitrary is “Arbitrary”?—or, Towards the Deserved Demise of Full Cost Allocation*, 21 *Pub. Util. Fortnightly* (Sept. 3, 1987) at 16)). “Fully allocated cost figures . . . have no economic content.” Sidak and Spulber, *Deregulatory Takings* at 42, 386 (quoting William J. Baumol and J. Gregory Sidak, *Transmission Pricing and Stranded Costs in the Electric Power Industry* 64 (1995)).

Mr. Sidak has also recognized the anticompetitive effect of price floors based on cost allocations when applied asymmetrically to the competitive services offered by a regulated carrier but not to the services offered by its unregulated rivals:

The proponents of any given cost allocation formula will predictably justify their recommendation on the grounds that it will advance ‘the public interest.’ Yet elementary price theory will usually reveal the contrary—that the recommendation has the practical effect of . . . reducing consumer welfare. In the FCC’s 1996 cost allocation proceeding, for example, the cable television industry’s principal proposal—that 75 percent or more of common costs be allocated to the [local exchange carriers’] video services and 25 percent to its . . . telephony services—had no economic substance. With as much intellectual weight the industry could have proposed that the FCC allocate the LEC’s common costs between video and telephony on the basis of the ratio of the total offensive yardage of the Washington Redskins to that of the Dallas Cowboys. *Such cost allocation procedures erect regulatory barriers to competitive entry by telephone companies.*

Sidak and Spulber, *Deregulatory Takings* at 46 (emphasis added).

**B. Incremental costing does not share the defects of the UPS proposal.**

UPS does not dispute that the Shapley methodology relies in large part on cost allocations, not causation. UPS contends, however, that rejecting the methodology on this ground was arbitrary because (1) incremental costing relies on equally arbitrary assumptions about the “order” in time in which individual outputs are produced; and (2) the allocation formula proposed by UPS relies on the same “distribution keys” (formulas) that the Commission uses to distribute attributable costs to individual products. UPS Br. 52-60. These supposed contradictions are illusory.

**1. Incremental costing does not require knowing the order in which outputs are produced.**

UPS asserts that its allocation proposal is sounder than incremental costing because the costs of producing outputs depend on the order or sequence in which they are produced. Because this is unknown, UPS contends, the assumption of incremental costing that the incremental output is produced “last” is inherently arbitrary. UPS Br. 24-26, 51-52 (figure). The Commission properly rejected the argument, however, for it misconceives the very concept of incremental cost.

Although marginal or incremental outputs are often described in shorthand as being produced “last,” the actual definition of incremental costs makes no assumption about the order or time sequence of production. As the Commission emphasized in Order No. 3506, incremental cost is a *ceteris paribus* concept: the analyst compares two alternative states, one in which the incremental output is produced along with all other outputs, and one in which only the other outputs are produced. Order at 57-58. The incremental cost of a product (or set of products) is simply the difference in total costs between the assumed two states. The actual order in which the individual outputs are produced is irrelevant:

[E]ven if the order of products were to change, the area under the curve of the cost function (the incremental cost) remains the same

because the calculation of incremental cost test is a difference test: the difference between the total costs of the enterprise and the total costs without one product.

*Id.* at 57-58 & n.77, App. A at 19-22 (illustrating point with graphs).

UPS's own economic witness, Kevin Neels, acknowledged that the incremental cost test "involves a comparison of two states of the world—one where the enterprise offers its current set of products and one where it offers all products other than competitive products." Neels at 21. *Accord* OIG Primer 22-23; Panzar at 11-13, 19, Exh. 2 at 6; Amazon at 90 (quoting Alfred E. Kahn, *Whom the Gods Would Destroy, or How Not To Deregulate* 14 (2001) ("[T]he incremental cost of common service B is the difference between the cost of providing its common product A on a stand-alone basis and the cost of providing A and B together.")); *cf.* 1 Alfred E. Kahn, *The Economics of Regulation* 140 (1970) ("As far as causal cost responsibility is concerned, however, all customers are marginal"). Accordingly, the Commission's rejection of UPS's proposal was quite rational.

**2. Using distribution keys to attribute costs to a product is proper when supported by causation, but not otherwise.**

UPS's claim that the Commission should have accepted the UPS allocation proposal because it used the same distribution "keys" (formulas) that the Commission uses to apportion attributable costs among individual products

(UPS Br. 56-60) suffers from similar confusion. Although the distribution keys used in the UPS proposal mimic the distribution keys used in cost attribution, the underlying economic logic is missing.

The costs attributable to cost components are properly distributed to individual products because the costs vary with the cost driver activity caused by each product. Order at 50; Panzar at 16; PRC Docket No. RM2016-2, Panzar Reply Decl. (Mar. 25, 2016), at 7-8, 15-17; Bradley at 15-22; OIG Primer at 16-18. By contrast, UPS's approach of allocating all component variable costs, including inframarginal costs, to individual products in proportion to the level of *average* cost realized by the cost component *as a whole*—regardless of whether all of the inframarginal costs so allocated are actually caused by changes in the volume of a product—has no causal basis. Order at 26-28, 45-51, App. A at 5-22; *accord* Panzar at 15-17; Panzar Reply at 7-10, 14-17; Market Dominant Mailers at 12-13 & nn.6-7; PRC Docket No. RM2016-2, USPS Comments (Jan. 27, 2016) at 26; Amazon Reply at 22-23.

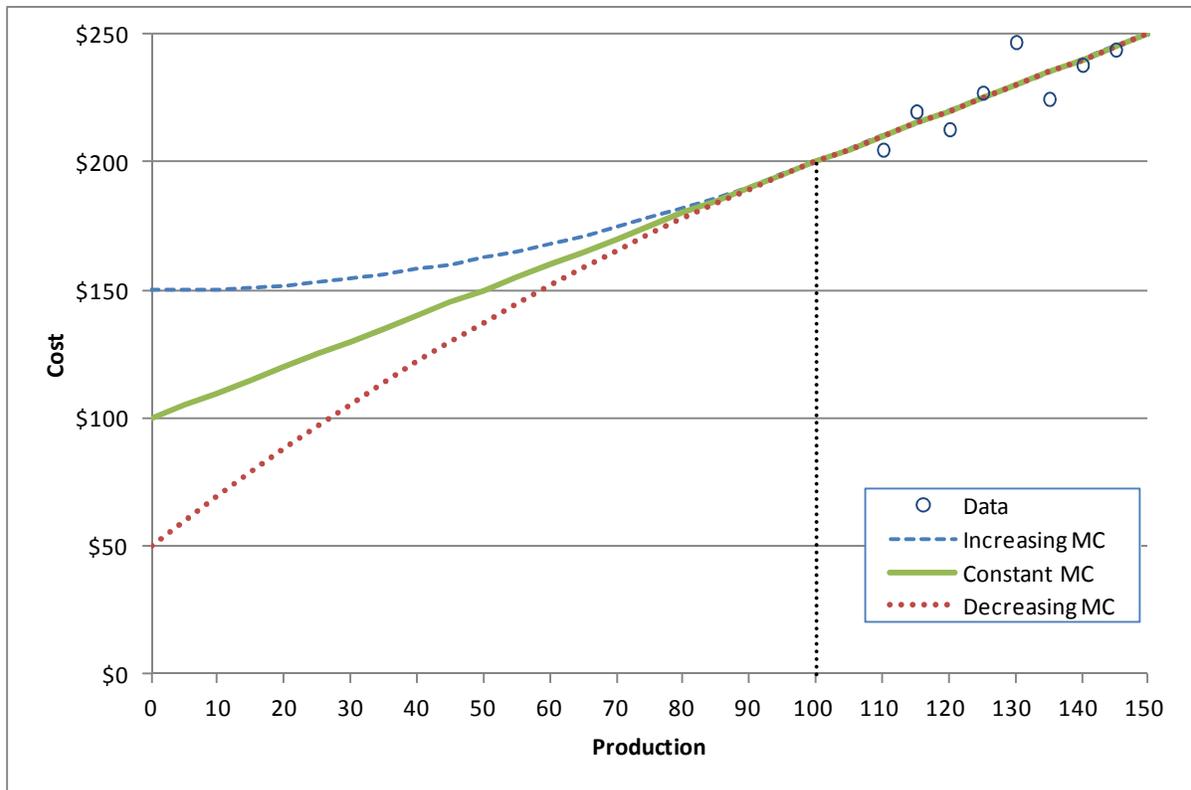
This distinction is crucial. As the Commission explained long ago: “Distribution keys have an existence of their own, independent of causation. They are nothing more than mathematical formulae. Their use must be *preceded* by an analysis of causation. The use of a formula to distribute costs cannot by itself establish a causal relationship.” R80-1 Op. & Rec. Decis. at ¶ 451

(emphasis in original; internal footnote omitted), *aff'd*, *Greeting Card Publishers*, 462 U.S. at 825, 827-29 (upholding the Commission's "refus[al] to use distribution keys or other accounting principles lacking an established causal basis").

**C. Reliable data on the total amount of inframarginal costs do not exist.**

The Commission also rejected the UPS proposal because no reliable way exists to quantify inframarginal costs, even in the aggregate. Order at 20-21, 36-40, 42-43, 47, 55-56. The record supports this finding too.

The only way to estimate inframarginal costs is to subtract fixed costs from total costs. But fixed costs—*i.e.*, the costs incurred when the output is zero—are unobservable because mail is produced in a quantity greater than 100 billion pieces, not zero. Hence, fixed costs can be estimated only by extrapolating from existing regression data back to the vertical axis. The extrapolation necessarily takes the econometric curves far outside the relevant range of the data. The resulting inferences about where the cost curves hypothetically would intercept the vertical axis on the left if output were zero are little more than guesswork:



PRC Docket No. RM2016-2, T. Scott Thompson Decl. (Jan. 27, 2016), at 27-28 (Figure 6).

Hence, available estimates of inframarginal costs are too unreliable, even in the aggregate, to satisfy either the causation requirement of 39 U.S.C. § 3631(b) or the requirement of 39 U.S.C. § 3652(e) that changes in cost attribution methods “significantly improve” cost attribution.

This obstacle cannot be brushed off by calling for “better recordkeeping” (UPS Br. 62); no zero-output observations exist to record. The “Postal Service has not experienced the levels of volume necessary to verify [the] assumption” that a constant elasticity function accurately models Postal Service costs at “very

low levels of volume.” Order at 38-39; Amazon at 85-89; Thompson at ¶¶ 61-72; Panzar at 6 n.7.

UPS’s response that incremental cost estimates suffer from comparable imprecision (UPS Br. 60-63) is also unfounded. The Commission’s method for estimating incremental costs “avoids the issues facing UPS’s proposed method by restricting itself to limited amounts of volume . . . in a very small range of a component’s cost curve where the constant elasticity assumption has been empirically verified based on observed volumes.” Order at 42. As the Commission properly noted, the “Postal Service does not attempt to calculate the inframarginal costs of an entire component.” *Id.* Hence, the extrapolation needed to estimate marginal and incremental costs is unlikely to cause significant error. *Id.* at 42-43; Amazon at 64-67; Panzar at 10, Exh. 2 at 14-15, 24-25.

### **III. THE SEPARATE ARGUMENTS IN SIDAK’S *AMICUS* BRIEF DO NOT WARRANT CONSIDERATION BY THIS COURT, AND, IN ANY EVENT, LACK MERIT.**

Most of the arguments presented in the Sidak amicus brief are unrelated to claims raised by UPS and thus are not properly before the Court.

The brief consists largely of (a) broadsides against the supposedly “opaque” and “bespoke” character of postal regulation generally (Sidak Br. 7-13); (b) allegations that the Postal Service will misattribute current or future

investments in specific asset classes such as motor vehicles (*id.* at 10-11); (c) elaborate new economic analyses—including algebraic formulas, geometric analyses, and stylized Venn diagrams unsupported by record data (*id.* at 16-28); and (d) a claim that the Postal Service should mimic the internal cost accounting practices of the private delivery companies, which assertedly base their prices on fully allocated costs (*id.* at 13-15).

These claims are not properly before the Court. First, UPS has not advanced these claims in its own brief. An amicus “generally cannot expand the scope of an appeal to implicate issues that have not been presented by the parties to the appeal.” *Eldred v. Reno*, 239 F.3d 372, 378 (D.C. Cir. 2001) (citations omitted).

Second, neither UPS nor Mr. Sidak may raise claims here that were not presented to the Commission. *United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 36-37 (1952). Moreover, if “a court is to review an agency’s action fairly, it should have before it neither more nor less information than did the agency when it made its decision.” *Walter O. Boswell Mem’l Hosp. v. Heckler*, 749 F.2d 788, 792 (D.C. Cir. 1984). “[F]undamental principles of judicial review of agency action” require that the “focal point for judicial review should be the administrative record already in existence, not some new record made initially in the reviewing court.” *Fla. Power & Light Co. v. Lorion*, 470 U.S. 729, 743-44

(1984) (quoting *Camp v. Pitts*, 411 U.S. 138, 142 (1973)). Accordingly, the Court should not reach these issues.

## CONCLUSION

For the above reasons, and those advanced by the Commission in its brief as respondent, the UPS petitions for review should be denied.

Respectfully submitted,

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May 8, 2017

**CERTIFICATE OF COMPLIANCE  
WITH FED. R. APP. P. RULE 32(a)**

This brief complies with the type-volume limitations set forth in Fed. R. App. P. 32(a)(7)(B) and Circuit Rule 32(e)(2) because the brief contains 8,642 words as counted by Microsoft Word, excluding the parts of the brief that are exempted by Fed. R. App. P. Rule 32(f) and Circuit Rule 32(e)(1).

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/s/

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David M. Levy

May 8, 2017

**CERTIFICATE OF SERVICE**

I hereby certify that true and correct copies of this brief were served today by filing electronically with the Court through the appellate CM/ECF system.

/s/

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David M. Levy

May 8, 2017

# **ADDENDUM**

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**39 U.S.C. § 3622 – Modern rate regulation**

**(a) AUTHORITY GENERALLY.**—The Postal Regulatory Commission shall, within 18 months after the date of enactment of this section, by regulation establish (and may from time to time thereafter by regulation revise) a modern system for regulating rates and classes for market-dominant products.

**(b) OBJECTIVES.** — Such system shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others:

- (1) To maximize incentives to reduce costs and increase efficiency.
- (2) To create predictability and stability in rates.
- (3) To maintain high quality service standards established under section 3691.
- (4) To allow the Postal Service pricing flexibility.
- (5) To assure adequate revenues, including retained earnings, to maintain financial stability.
- (6) To reduce the administrative burden and increase the transparency of the ratemaking process.
- (7) To enhance mail security and deter terrorism.
- (8) To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.
- (9) To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

**(c) FACTORS.** — In establishing or revising such system, the Postal Regulatory Commission shall take into account —

- (1) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not

limited to the collection, mode of transportation, and priority of delivery;

- (2) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
- (3) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
- (4) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;
- (5) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
- (6) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;
- (7) the importance of pricing flexibility to encourage increased mail volume and operational efficiency;
- (8) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;
- (9) the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery;
- (10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that —

(A) either —

- i. improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or
- ii. enhance the performance of mail preparation, processing, transportation, or other functions; and

(B) do not cause unreasonable harm to the marketplace.

(11) the educational, cultural, scientific, and informational value to the recipient of mail matter;

(12) the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services;

(13) the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail; and

(14) the policies of this title as well as such other factors as the Commission determines appropriate.

\* \* \*

**(e) WORKSHARE DISCOUNTS.—**

(1) **DEFINITION.** — In this subsection, the term “workshare discount” refers to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a).

(2) **SCOPE.** — The Postal Regulatory Commission shall ensure that such discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity, unless—

(A) the discount is —

- (i) associated with a new postal service, a change to an existing postal service, or with a new work share initiative related to an existing postal service; and
    - (ii) necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discount in excess of the cost that the Postal Service avoids as a result of the workshare activity will be phased out over a limited period of time;
  - (B) the amount of the discount above costs avoided —
    - (i) is necessary to mitigate rate shock; and
    - (ii) will be phased out over time;
  - (C) the discount is provided in connection with subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value; or
  - (D) reduction or elimination of the discount would impede the efficient operation of the Postal Service.
- (3) **LIMITATION.** — Nothing in this subsection shall require that a work share discount be reduced or eliminated if the reduction or elimination of the discount would —
- (A) lead to a loss of volume in the affected category or subclass of mail and reduce the aggregate contribution to the institutional costs of the Postal Service from the category or subclass subject to the discount below what it otherwise would have been if the discount had not been reduced or eliminated; or
  - (B) result in a further increase in the rates paid by mailers not able to take advantage of the discount.
- (4) **REPORT.** — Whenever the Postal Service establishes a workshare discount rate, the Postal Service shall, at the time it publishes the

workshare discount rate, submit to the Postal Regulatory Commission a detailed report that —

- (A) explains the Postal Service's reasons for establishing the rate;
- (B) sets forth the data, economic analyses, and other information relied on by the Postal Service to justify the rate; and
- (C) certifies that the discount will not adversely affect rates or services provided to users of postal services who do not take advantage of the discount rate.

\* \* \*

**Former 39 U.S.C. § 3622. Rates and fees (enacted in 1970; repealed in 2006)**

(a) From time to time the Postal Service shall request the Postal Rate Commission to submit a recommended decision on changes in a rate or rates of postage or in a fee or fees for postal services if the Postal Service determines that such changes would be in the public interest and in accordance with the policies of this title. The Postal Service may submit such suggestions for rate adjustments as it deems suitable.

(b) Upon receiving a request, the Commission shall make a recommended decision on the request for changes in rates or fees in each class of mail or type of service in accordance with the policies of this title and the following factors:

(1) the establishment and maintenance of a fair and equitable schedule;

(2) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;

(3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;

\* \* \*

**39 U.S.C. § 3631 – Applicability; definitions and updates**

**(a) APPLICABILITY.**—This subchapter shall apply with respect to—

- (1) priority mail;
- (2) expedited mail;
- (3) bulk parcel post;
- (4) bulk international mail; and
- (5) mailgrams;

subject to subsection (d) and any changes the Postal Regulatory Commission may make under section 3642.

**(b) DEFINITION.** — For purposes of this subchapter, the term “costs attributable”, as used with respect to a product, means the direct and indirect postal costs attributable to such product through reliably identified causal relationships.

**(c) RULE OF CONSTRUCTION.**—Mail matter referred to in subsection (a) shall, for purposes of this subchapter, be considered to have the meaning given to such mail matter under the mail classification schedule.

**39 U.S.C. § 3633 – Provisions applicable to rates for competitive products**

**(a) IN GENERAL.** — The Postal Regulatory Commission shall, within 18 months after the date of enactment of this section, promulgate (and may from time to time thereafter revise) regulations to —

- (1) prohibit the subsidization of competitive products by market-dominant products;
- (2) ensure that each competitive product covers its costs attributable; and
- (3) ensure that all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service.

**(b) REVIEW OF MINIMUM CONTRIBUTION.** — Five years after the date of enactment of this section, and every 5 years thereafter, the Postal Regulatory

Commission shall conduct a review to determine whether the institutional costs contribution requirement under subsection (a)(3) should be retained in its current form, modified, or eliminated. In making its determination, the Commission shall consider all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products.

### **39 U.S.C. § 3652 – Annual Reports to the Commission**

**(a) COSTS, REVENUES, RATES, AND SERVICE.**—Except as provided in subsection (c), the Postal Service shall, no later than 90 days after the end of each year, prepare and submit to the Postal Regulatory Commission a report (together with such nonpublic annex to the report as the Commission may require under subsection (e))—

- (1) which shall analyze costs, revenues, rates, and quality of service, using such methodologies as the Commission shall by regulation prescribe, and in sufficient detail to demonstrate that all products during such year complied with all applicable requirements of this title; and
- (2) which shall, for each market-dominant product provided in such year, provide—
  - (A) product information, including mail volumes; and
  - (B) measures of the quality of service afforded by the Postal Service in connection with such product, including—
    - (i) the level of service (described in terms of speed of delivery and reliability) provided; and
    - (ii) the degree of customer satisfaction with the service provided.

The Inspector General shall regularly audit the data collection systems and procedures utilized in collecting information and preparing such report (including any annex thereto and the information required under subsection (b)). The results of any such audit shall be submitted to the Postal Service and the Postal Regulatory Commission.

**(b) INFORMATION RELATING TO WORKSHARE DISCOUNTS.** — The Postal Service shall include, in each report under subsection (a), the following information with respect to each market-dominant product for which a workshare discount was in effect during the period covered by such report:

- (1) The per-item cost avoided by the Postal Service by virtue of such discount.
- (2) The percentage of such per-item cost avoided that the per-item workshare discount represents.
- (3) The per-item contribution made to institutional costs.

\* \* \*

**(e) CONTENT AND FORM OF REPORTS.**—

- (1) **IN GENERAL.** — The Postal Regulatory Commission shall, by regulation, prescribe the content and form of the public reports (and any nonpublic annex and supporting matter relating to the report) to be provided by the Postal Service under this section. In carrying out this subsection, the Commission shall give due consideration to—
  - (A) providing the public with timely, adequate information to assess the lawfulness of rates charged;
  - (B) avoiding unnecessary or unwarranted administrative effort and expense on the part of the Postal Service; and
  - (C) protecting the confidentiality of commercially sensitive information.
- (2) **REVISED REQUIREMENTS.**—The Commission may, on its own motion or on request of an interested party, initiate proceedings (to be conducted in accordance with regulations that the Commission shall prescribe) to improve the quality, accuracy, or completeness of Postal Service data required by the Commission under this subsection whenever it shall appear that —
  - (A) the attribution of costs or revenues to products has become significantly inaccurate or can be significantly improved;

- (B) the quality of service data has become significantly inaccurate or can be significantly improved; or
- (C) such revisions are, in the judgment of the Commission, otherwise necessitated by the public interest.

\* \* \*

### **39 C.F.R. § 3015.7 – Standards for Compliance [effective January 6, 2017]**

For purposes of determining competitive products' compliance with 39 U.S.C. 3633, the Commission will apply the following standards:

(a) 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 the sum of competitive products' volume-variable costs and product-specific costs supplemented to include causally related, group-specific costs to test for cross-subsidies.

(b) Each competitive product must recover its attributable costs as defined in 39 U.S.C. 3631(b). Pursuant to 39 U.S.C. 3631(b), the Commission will calculate a competitive product's attributable costs as the sum of its volume-variable costs, product-specific costs, and those inframarginal costs calculated as part of a competitive product's incremental costs.

(c) Annually, on a fiscal year basis, the appropriate share of institutional costs to be recovered from competitive products collectively is, at a minimum, 5.5 percent of the Postal Service's total institutional costs.

### **39 C.F.R. § 3015.7 – Standards for Compliance [effective November 9, 2007, through January 5, 2017]**

For purposes of determining competitive products' compliance with 39 U.S.C. 3633, the Commission will apply the following standards:

(a) 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 products' attributable costs supplemented to include causally related, group-specific costs to test for cross-subsidies.

(b) Each competitive product must recover its attributable costs as defined in 39 U.S.C. 3631(b).

(c) Annually, on a fiscal year basis, the appropriate share of institutional costs to be recovered from competitive products collectively is, at a minimum, 5.5 percent of the Postal Service's total institutional costs.