Postal Regulatory Commission
Submitted 9/15/2017 12:05:40 PM
Filing ID: 101633
Accepted 9/15/2017

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

Periodic Reporting (Proposal Seven)	)))	**Docket No. RM2017-11**

COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE
(September 15, 2017)

The Association for Postal Commerce ("Postcom") submits these comments with respect to the Postal Service's proposed change in analytic principles relating to the "calculation" of workshare discounts "passthroughs" for dropshipped USPS Marketing Mail. The proposal in question has been designated as Proposal Seven and is, as the Postal Service states in its Petition, used in connection with the preparation of "periodic reports and compliance determinations." USPS Petition, Periodic Reporting (Proposal Seven) at 1, (hereinafter "Petition"). While Postcom does not object to Commission acceptance of Proposal Seven, we think it imperative that the Commission explicitly recognize that the formula advanced in Proposal Seven is not a measurement of the extent to which drop entry avoids cost that would otherwise be incurred by the Postal Service and, therefore, the results yielded by the new formula are not determinative of whether a particular drop entry rate category is compliant with the Act or its purposes.

A. <u>The Calculation of Workshare Discounts Must Not be Conflated with the Measurement of Avoided Cost. It is Meaningless to Characterize a Particular Formula as Having Greater or Lesser Accuracy.</u>

As the Postal Service explains, in recent years the Postal Service has converted into rate levels its estimates of the avoided cost associated with Mailer Dropship entry for flats and Marketing Mail parcels by the use of a formula which uses only the per-pound element above the breakpoint in the numerator but uses all volume in the denominator. Petition at 1. Under Proposal Seven, the Postal Service would use all volume in both the numerator and the denominator. Petition at 1-2.

As a matter of abstract theory the proposal seems unexceptional. Since the discounted rates are applicable to all drop entered flats and Marketing Mail Parcels, it seems logical that both the numerator and the denominator of the formula used to calculate the rates at drop entry levels be symmetrical. Where the Proposal goes astray, however, is in the Postal Service's insistence that the proposed methodology will yield "a more accurate representation of the passthroughs" and therefore yield a more precise measure of the degree of its compliance with Section 3622(e)(2) of the Act. Petition at 2.

The explanation improperly conflates the measurement of avoided cost with a formula whose only purpose is to convert a predetermined measurement of avoided cost into a multi-tier rate structure. The formula is simply not, in and of itself, a measurement of the per-piece or per-pound avoided costs which are depicted in the formula. Indeed, the Postal Service itself recognizes that the measurement of avoided cost does not logically entail the formula it has chosen since the denominator could, with equal precision, be expressed as "total avoided costs per pound times the total number of pounds." Petition at 2. That is, the avoided costs are inputs to the formula. Of course, if the inputs are themselves inaccurate, greater precision in the output of the formula does not make the resultant rate more accurately reflective of cost.

We are not suggesting that the old shibboleth – "garbage in, garbage out" – applies here. But the measurement of avoided costs resulting from drop entry is considerably more complicated than the Postal Service would have the Commission conclude. In fact, there is more to the question of cost causation and cost avoidance than total pieces or total pounds. The principal – although by no means the exclusive – cost driver underlying dropship is transportation costs, and transportation costs are significantly affected by cube since trucks can and do often reach maximum cubic space before weight limitations come into play. In addition, length of haul and externalities such as fuel costs affect cost causation in ways which are not, and probably cannot, be captured in the formula. Even when confined to piece and weight cost facts, the number of pieces and average weights are, at best, approximations of cost that would otherwise be incurred by the Postal Service; and, while the Postal Service uses weighted averages in certain of its

analytic principles, *see* USPS Petition Periodic Reporting (Proposal Eight) Docket No. RM2017-12, it does not propose to do so in the context of Proposal Seven.

In short, it may not be arbitrary or capricious for the Commission to conclude that Proposal Seven should be allowed. It would, however, be arbitrary and unsupported by the record for the Commission to allow Proposal Seven on the grounds that the new formula yields a more precise measure of avoided costs underlying the drop entry workshare. To do so could lead the Commission to results that are at odds with both the terms and purposes of Section 3622(e) as we explain below.

B. **The Calculation of Workshare Avoided Costs May be Formulaic. The Application of Section 3622(e) Decidedly is Not.**

The Postal Service's confusion of the difference between the measurement of avoided cost and the calculation of a workshare discount leads it to a further and more fundamental problem. Conceding that the change in the analytic principle "could have future price impacts," the Postal Service insists that the new formula will better enable it to "ensure" that "discounts do not exceed the cost that the Postal Service avoids *as a result of dropshipping.*" Petition at 2 (emphasis added). This fundamentally distorts and misapplies Section 3622(e).

The first defect in the Postal Service's rationale is the assumption that Section 3622 requires that each component of a rate category may not exceed avoided cost. That is not what the statute says. On the contrary, what the statute says is that the term "workshare discount" refers to "rate discounts provided to mailers" for certain cost avoiding activities as defined by the Commission in establishing the "rate schedule" under Section 3622(a). 39 USC § 3622(e)(1). What the Commission – and the Postal Service – have established is a multi-tier rate schedule with "rate discounts" that often aggregate several workshare functions into a single tier and afford the mailer the option of electing the tier that most closely conforms to the mailer's need. Thus, for example, the published Rate Schedule does not show a drop entry discount at all. What the schedule shows, for example, is that automation flats (a) sorted to the carrier route level

and (b) entered at the DSCF pay a different rate than, for example, automation flats that are (c) carrier route sorted but entered at the DDU level or, for that matter, nonautomation flats that are (d) carrier route sorted and DSCF entered. Each of the elements in each of these tiers does of course turn on a measurement of the avoided cost for each element. But compliance with Section 3622(e) clearly is to be made at the rate level and not at the level of each function reflected in the rate.

To hold otherwise would lead to absurd results and, moreover, defeat the long stated objective that in combination, each rate tier should reflect 100% of the combined costs that the rate tier avoids. *See* Opinion and Recommended Decision, Docket No. R2006-1 at paragraph 5460, February 26, 2007. Under the approach advanced by the Postal Service in Proposal Seven, it would be justified in resetting a drop entry passthrough that exceeds 100% of avoided cost under the new formula even though the rate tier itself passes through less than 50% of the aggregate of avoided costs resulting from presentation and other mailer cost saving work share efforts. That certainly is not what the Commission intended in its R2006-1 Decision. Indeed, to the extent that the Commission tolerates rates that pass through less than 100% of aggregate avoided cost, it would invite exclusionary access to workshare rates to the detriment of all mailers. *See, e.g.*, Comments of the Public Representative, Docket No. ACR2011 at 2-7, February 17, 2012 (Citing Comments of John C. Panzar on Behalf of Pitney Bowes Inc., February 3, 2012).

Last, but by no means least, the Commission must, if it accepts this revised formula, explicitly recognize that Section 3622 does not absolutely forbid rates even when the rate level does not fully recover its costs. As the Postal Service itself notes in passing, there are "exception[s]" to the basic requirement of Section 3622(2). Petition at 3. While there may, in some circumstances, be concern that the exceptions could swallow the rule, it is equally critical to the proper exercise of the Commission's duties that the exceptions not be ignored or understated. Of paramount importance, in the current context, is the requirement of Section 3622(e)(3) which is ignored in the Postal Service's discussion of Proposal Seven. The subsection specifically recites that the general rule that workshare discounts (as defined) should not exceed avoided costs does not require that a discount be reduced or eliminated if the reduction

or elimination would either (a) lead to a loss of volume in the affected category or subclass or (b) result in a further increase in the rates paid by mailers who are not able to take advantage of the discount. Experience has shown that if the drop entry discounts are significantly reduced or the differential between workshare and no workshare mail is significantly altered, there will be volume losses and, inevitably, an increased rate burden on mail that remains in the system.

CONCLUSION

For these reasons, if the Commission accepts Proposal Seven and allows that formula to be used in the periodic reports related to Postal Service performance and in the Commission's Compliance Determinations, it must make clear that there is nothing in this action that modifies or alters the manner in which rate proposals and compliance determinations are to be judged in accordance with the requirements of Section 3622(e), and that therefore the output of the formula is not, in and of itself, determinative of compliance or noncompliance with the Act.

Respectfully Submitted,

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