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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

Annual Compliance Report, 2017	)))	**Docket No. ACR2017**

COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE
(February 1, 2018)

Pursuant to Order No. 4323, the Association for Postal Commerce ("PostCom") submits these comments on the Annual Compliance Report ("ACR") for Fiscal Year 2017 filed by the United States Postal Service ("Postal Service") on December 29, 2017. While PostCom does not contest the Postal Service's compliance with its statutory responsibilities in FY 2017, the information presented in the ACR nevertheless illustrates several ongoing and recurring concerns of which the Commission should be aware. In short, the concerns PostCom has expressed in its comments on previous ACRs have not been addressed—the Postal Service continues to make decisions that impose additional costs on mailers without creating corresponding efficiencies in the postal network, causing costs to both the Postal Service and the industry to continue to rise. PostCom urges the Commission to remain cognizant of this dynamic as it evaluates and makes recommendations regarding cost coverage and workshare discounts reported in the ACR.

I. The Importance of Transparency in Reporting

As was the case last year, the Commission takes up the ACR while previous ACR dockets remain open. The duration of these proceedings and the fact that they have yet to lead to significant improvement in many areas is of great concern to PostCom and its members. While the conduct of these proceedings may satisfy the Commission's statutory obligation to determine compliance with PAEA, as an inquiry into important operations and service issues they leave much to be desired. As in previous years, the Postal Service grudgingly offers required information that is often incomplete, heavily edited and or redacted, and lacking contextual information that might lead to clarity and insight. The Postal Service's unfortunate obstinacy with regard to the unsealing of inbound letter post volume information is a telling example. The Commission has contributed to the inefficiency of these proceedings as well by failing to impose any kind of sanction on the Postal Service for declining to provide requested information.

The mailing community is poorly served by this kabuki; the process imposes significant costs on the interested parties yet allows the Postal Service to avoid any and all accountability for improving performance. PostCom notes the continued issuance of Chairman's Information Requests (CHIR) in this proceeding as helpful in identifying missing and potentially helpful contextual information. As a general principle, PostCom endorses all efforts to increase the transparency of the ACR process with regard to identifying relevant cost and cost avoidance estimates, operational performance data, and service information. But CHIRs should not be left open for years, well after the rates underlying the ACR in question have changed and compliance has been determined. It is one thing to require periodic reports from the Postal Service on matters. But if a serious issue has been identified, the Commission should open a new docket, aggressively pursue an answer, and order any relief it finds appropriate.

Furthermore, PostCom suggests that the Commission encourage USPS to share much more unedited information. As the Postal Service's Informed Visibility (IV) platform expands, it creates millions of data points daily. USPS is collecting information on mailpieces and employee activity that could provide a wealth of information on USPS operations performance, yet much of that data is shielded from this inquiry. In part that may reflect the mere fact that technological change outpaces regulatory change. Given that some of USPS service and productivity problems appear intractable, we suggest that open access to raw information collected through IV—with appropriate safeguards to hide the identity of individual employees or customers—would benefit all parties.

II. Workshare Discounts

As PostCom indicated in its comments in Docket No. R2018-1, the Postal Service continues to reduce workshare passthroughs, risking unintended consequences as it does so.[1] The current ACR indicates that the Postal Service reduced numerous passthroughs such that, with the price changes in R2018-1, it now expects them to pass through less than 100% of avoided costs. *See, e.g.*, ACR at 16-18. The ACR suggests that the Postal Service has made these changes at least in part to protect against a finding by the Commission that the discounts are not in compliance with 39 U.S.C. § 3622(e)(2). These changes, however, raise the question of whether the Commission and the Postal Service are so focused on limiting passthroughs to 100% of avoided costs that they are ignoring the practical realities of both the calculation of avoided costs and the processing and entry of mail and driving discounts to less efficient levels.

In its R2018-1 comments, PostCom highlighted an issue with certain DNDC and DSCF Dropship Letters discounts. *See* PostCom R2018-1 Comments at 3-4. There, PostCom pointed out that entry discounts were diverging for CR Basic SCF and Nonautomation-HD/Sat SCF even though the avoided costs should be nearly identical, determined as they are by the volume of weight being shipped rather than the contents of a pallet. Id. at 4. Thus, PostCom argued, to the extent the disparities in these discounts are driven by an attempt to match discounts to avoided costs, it appeared that the avoided costs are not being measured correctly, since the same freight costs should be avoided for each of these products.

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[1] *See* Comments of the Association for Postal Commerce, Docket No. R2018-1 at 3 (Oct. 26, 2017) ("PostCom R2018-1 Comments").

The Commission did not address these comments in its order approving the price changes in R2018-1, but it did acknowledge similar unexplained variability in avoided costs with respect to Automation AADC Letters and encouraged "the Postal Service to investigate the fluctuations in the avoided cost . . . to reduce volatility in the future." Order No. 4215 at 43-44. PostCom's Comments on the FY 2016 Annual Compliance Report also highlighted this variability, noting that the cost avoidance for First-Class Mixed AADC Automation Letters increased 75%, from 3.3 cents in FY 2015 to 5.8 cents in FY 2016, while it had decreased by 28 percent between FY 2014 and FY 2015.[2] This trend continued in FY 2017 with cost avoidance rising 18% to 6.8 cents for First-Class Mixed AADC Automation Letters. *See* USPS-FY17-3 Worksharing Tables.

These vagaries and variability in avoided costs cast doubt on whether the changes enacted by R2018-1 will result in more efficient processing of mail. For example, the Postal Service reports that the passthrough for First Class Mail Automation AADC Letters was 117.6% in FY 2017 and will be reduced to 94.1% when the R2018-1 prices take effect. ACR at 10. In absolute terms, the discount is being reduced from 2 cents to 1.6 cents, with the cost avoidance calculated at 1.7 cents. Given the approximation inherent in cost avoidance calculation, it is impossible to tell whether the new discount is more or less efficient than the prior discount.

As another example, the passthrough for Nonautomation AADC Machinable Letters was 106.3% in FY 2017 with a discount of 1.7 cents and cost avoidance of 1.6 cents. The Postal Service reduced this discount to 1.3 cents in Docket No. R2018-1, reducing the passthrough to 81.3%. *See* ACR at 17. While these discounts may now comply with the Commission's interpretation of the standards imposed by 39 U.S.C 3622(e), it is not clear that these changes have resulted in more efficient pricing. They may, in fact, be increasing the total combined cost

[2] Initial Comments of the Association for Postal Commerce, Docket No. ACR2016 at 3 (Feb. 2, 2017).

to mailers and the Postal Service of processing and transporting mail in the affected categories. Indeed, in this particular instance, the passthrough only exceeded 100% cost avoidance by 6.3 percentage points. The Postal Service's response, however, was to reduce the passthrough to 81.3%, nearly 19 percentage points below 100% cost avoidance. It is hard to imagine how this change represents more efficient pricing than what was in place before.

The calculation of avoided costs and the setting of workshare discounts is an inexact science, and PostCom does not contend that avoidable costs must be measured with absolute precision before the Commission can make a finding of compliance or non-compliance. But PostCom does contend that the Commission has not adequately accounted for this uncertainty in its past rulings. Indeed, it has paid little more than lip service to these issues. In Order No. 4215, the Commission failed to substantively engage with PostCom's comments regarding the DNDC and DSCF discounts. In Docket No. ACR2016, the Commission did not address PostCom's comments regarding the variability of avoided costs for First-Class Mixed AADC Automation letters, nor did it respond to PostCom's suggestion that the Postal Service address this issue by providing standard errors or confidence intervals to help participants better understand the reliability of the cost estimates used in setting and analyzing workshare incentives.

Moreover, the Commission has applied standards in evaluating workshare discounts that encourage the Postal Service to make inefficient pricing decisions. For example, tn the FY 2016 Annul Compliance Determination, the Commission found the discount for Automation Mixed AADC Letter "adequately justified pursuant to 39 U.S.C. § 3622(e)(2)(D) . . . because encouraging mailers to use IMbs should improve operational efficiency." FY 2016 Annual Compliance Determination at 25. But then the Commission stated that it "supports the Postal Service's commitment to eliminate the portion of the discount above avoided cost." Id. If the discount above avoided cost is justified by the operational efficiency it creates for the Postal Service—a benefit that is not measured by the avoided cost—why would the Commission encourage the Postal Service to reduce this discount? Doing so would *discourage* mailers from using IMbs and *reduce* the operational efficiency of the Postal Service.

Section 3622(e) does not establish an absolute requirement that workshare discounts never exceed 100 percent of avoided costs, and the Commission must stop acting as if it does. Its decisions are discouraging efficient mail preparation, entry, and processing. This impact is even more adverse when one considers how many workshare discounts still pass through *less than* 100% of avoided costs.

a. Passthroughs Less Than 100% Must Be Considered And Balanced With Those That Exceed 100% of Avoided Costs

The Commission's rules require the Postal Service to "identify and explain discounts that are set substantially below avoided costs, and explain any relationship between discounts that are above and those that are below avoided costs" in its notice of price changes. Order No. 4215 at 11 (citing 39 C.F.R. § 3010.12(b)(6)). Yet in the ACR dockets, the Postal Service and Commission focus only on those discounts that pass through more than 100 percent of avoided costs. The FY 2017 ACR has no discussion of discounts set below avoided costs. This imbalance adds to the risk that the Postal Service will continually reduce passthroughs in ways that lead to less efficient mail entry and processing.

Just as an example, dropship passthroughs for Commercial and Nonprofit Basic Carrier Route Flats (DNDC) are only 55.9%. Dropship passthroughs for Nonprofit Machinable and Irregular Parcels (DNDC) are only 29.1%. And presorting passthroughs for Commercial and Nonprofit Marketing Mail Flats—Automation range from 31.5% to 72.4%. *See* USPS-FY17-3 Worksharing Tables. These discounts are not discussed at all in the ACR even though they are just as, and in some cases significantly more, inefficient than the discounts the Postal Service justifies in the ACR.

Postal prices should encourage mailers to participate in worksharing and ensure that mail is delivered at the lowest total combined cost. Those incentives fail when the discount is insufficient to drive a change in behavior, a result that is inevitable when workshare discount passthroughs are consistently below 100%.

The Commission's requirement that the Postal Service analyze, report on, and provide detailed justifications for every passthrough that exceeds 100% causes the Postal Service to err on the side of reducing passthroughs well below 100%. This reduces the flexibility of the Postal Service to price efficiently in response to market forces while simultaneously undermining the purpose for providing workshare discounts. For instance, in our 2015 and 2016 comments we noted that:

> Through its price signals and operational decisions, the Postal Service has been driving mail upstream to less efficient operations. This has caused costs, through no fault to the mailing industry, to continue to increase as the USPS chases efficiencies that either do not exist or no longer exist due to decreased economies of scale and lost volumes.

See Initial Comments of the Association for Postal Commerce, Docket No. ACR2016, at 2. So long as the Commission continues to focus on passthroughs that exceed 100% of avoided costs to the exclusion of those that pass through less than 100% of avoided costs, it will continue to discourage efficient pricing.

III. Promised Flats Efficiencies Remain Elusive

The shortfall from Standard Mail flats grew to $669M in FY 2016 (a new record), with cost per piece increasing by 9.6 percent. Interestingly, because the combined costs of flats and carrier route only increased by 1.63 percent, the Postal Service contends that this change does not reflect inefficiency.

In addressing its "compliance" with the Commission's directives on improving flats cost coverage, the Postal Service lists a number of planned operational changes that are intended to improve efficiency. But as we stated last year, the flats sequencing system can no longer be considered new technology, so it is unlikely that significant productivity improvements should be anticipated from learning curve or experience curve effects. As we have pointed out before, the continued inability of the Postal Service to articulate how FSS performance is improving is troubling. It is readily apparent that the only strategy the Postal Service has for improving cost coverage is to increase prices. In fact, the Postal Service willingly admits that "the information generated by the Postal Service's existing data systems does not support reliable estimates of the impact of operational initiatives on flats costs." ACR at 26. That this language appears unchanged from last year's ACR demonstrates a contempt for the ACR process. It is truly disappointing that the Postal Service remains largely indifferent to the importance of understanding how its operational decisions impact the costs that it is able to pass directly onto its customers due to its monopoly status. PostCom appreciates that the Commission has launched RM2018-1 to explore the issue of flats costs in a more exhaustive fashion. Given the pace of change in this area, we hope that this effort bears fruit before flats have disappeared from the mail altogether.

IV. The Flats Story is Part of a Larger Problem

The Postal Service's total factor productivity index is at its lowest point since 2012, and this year's decline is the largest over the last ten years.[3] This despite labor productivity that is increasing. Because it is an aggregate indicator, total factor productivity is the single most important indicator of how well the Postal Services uses resources in carrying out its mission; the

[3] *See* USPS-FY17-17, FY2017 Annual Report and Comprehensive Statement of Postal Operations at 26.

fact that is declining portends higher costs. While the Postal Service is quick to admonish that results should be looked at only over a period of years, productivity has declined over the last four years. And as the Postal Service points out, “the decline in mail volume in recent years, has made it more challenging to generate additional productivity growth.”[4] With those declines expected to continue, the prospects for improved productivity appear bleak.

V. Conclusion

PostCom respectfully offers the foregoing comments on the FY 2017 ACR. As noted above, the Postal Service appears to be using its existing infrastructure in an inefficient manner and driving costs to mailers in a manner that does not reduce overall costs. In addition, the FY 2017 ACR illustrates a series of unexplained, and highly troubling, cost increases. These cost increases are a source of mystery to PostCom as the Postal Service has putatively been shedding costs through its continued transfer of tasks (as reflected in the Postal Service’s increasingly stringent rules) to mailers. PostCom respectfully requests that the PRC encourage the Postal Service to make better use of the data in its possession, particularly IV data, to analyze ways in which it can improve its processes and its pricing practices.

Respectfully Submitted,
/s/ Matthew D. Field

Matthew D. Field
Ian D. Volner
Chris L. Boone

VENABLE LLP
600 Massachusetts Ave., NW
Washington, DC 20001
(202) 344-8281
mfield@venable.com
idvolner@venable.com
clboone@venable.com
Counsel for Association for Postal Commerce

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[4] *Id*.