Postal Regulatory Commission
Submitted 2/12/2018 4:24:27 PM
Filing ID: 103774
Accepted 2/12/2018

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

ANNUAL COMPLIANCE REVIEW, 2017	Docket No. ACR2017

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
(February 12, 2018)

In Order No. 4323, the Postal Regulatory Commission solicited comments on the United States Postal Service's Annual Compliance Report (ACR) for Fiscal Year (FY) 2017.[1] The Public Representative (PR) and several parties filed comments.[2] In these reply comments, the Postal Service addresses the principal concerns raised by the commenters.

Before proceeding, the Postal Service notes that it appreciates the diversity of perspectives presented by the commenters, a number of whom acknowledge the progress the Postal Service has made across many areas as well as the steps it is taking to continue to improve.[3] The Postal Service will consider the commenters' perspectives as it moves forward.

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[1] Order No. 4323, Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments, Docket No. ACR2017 (Jan. 2, 2018); United States Postal Service FY 2017 Annual Compliance Report, Docket No. ACR2017 (Dec. 29, 2017).

[2] Beyond the Public Representative, parties filing comments (individually or jointly) on or before February 1, 2018, included the Association for Postal Commerce (PostCom), American Catalog Mailers Association (ACMA), American Consumer Institute Center for Citizen Research (ACI), Frontiers of Freedom, Major Mailers Association (MMA), National Association of Presort Mailers (NAPM), National Postal Policy Council (NPPC), National Taxpayers Union, Pitney Bowes Inc. (Pitney Bowes), and United Parcel Service, Inc. (UPS).

[3] For example, one commenter notes that service performance continues to improve. Public Representative Comments (Feb. 1, 2018), at 1 [hereinafter "PR Comments"]. Another commenter credits the Postal Service's most recent price adjustments with improving the rate design of First-Class Mail and USPS Marketing Mail Automation Letters by moving key presort workshare discounts closer to 100

I. Many of the Issues Raised in the Comments are Outside the Scope of this Proceeding

Under Section 3653, the task before the Commission in this docket is to review the Postal Service's ACR and issue a written determination on two matters:

> (1) whether any rates or fees in effect during such year (for products individually or collectively) were not in compliance with applicable provisions of this chapter (or regulations promulgated thereunder); or
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> (2) whether any service standards in effect during such year were not met.[4]

Where the comments seek to expand the ACR docket beyond these two subjects, the Commission should either disregard them or take them up in other, more suitable Commission dockets.

For example, and most notably, several parties take issue with, or seek to apply to this proceeding, the conclusions and proposals made by the Commission as part of its statutory review of the system for regulating rates and classes of market dominant products in Docket No. RM2017-3 (the "10-Year Review").[5] One commenter asks the Commission for an update on two separate costing rulemakings.[6] Another commenter acknowledges that the Commission's rules "do not explicitly direct the Postal Service to

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percent of modeled costs. Comments of Pitney Bowes Inc. (Feb. 1, 2018), at 1-3 [hereinafter "Pitney Bowes Comments"]. Two commenters express their agreement with the Postal Service that competitive products are generally in compliance with applicable statutory requirements. PR Comments at 2-3, 55-57; Pitney Bowes Comments at 4-5. Yet another commenter, while raising concerns and suggested opportunities for improvement in some areas, nevertheless points out that it "does not contest the Postal Service's compliance with its statutory responsibilities in FY 2017." Comments of the Association of Postal Commerce (Feb. 1, 2018), at 1 [hereinafter "PostCom Comments"].

[4] 39 U.S.C. § 3653(b).

[5] *See, e.g.,* Initial Comments of the American Catalog Mailers Association (Feb. 1, 2018), at 8, 20 [hereinafter "ACMA Comments"]; Reply Comments by Frontiers of Freedom (Feb. 1, 2018), at 2 [hereinafter "Frontiers of Freedom Comments"]; Comments of the National Postal Policy Council, the National Association of Presort Mailers, and the Major Mailers Association (Feb. 1, 2018), at 2-4 [hereinafter "First-Class Business Mailers' Comments"]; Comments of the National Taxpayers Union (Feb. 1, 2018), at 2-3 [hereinafter "NTU Comments"].

[6] Initial Comments of United Parcel Service, Inc. on United States Postal Service's Annual Compliance Report for Fiscal Year 2017 (Feb. 1, 2018), at 16-19 [hereinafter "UPS Comments"].

discuss significant volume declines, nor do they require the Postal Service to address plans to stem or reverse such losses," but nevertheless asks that the Postal Service be directed to do just that.[7] The Commission should decline these invitations to stray beyond the scope of its Section 3653 review.

II. Market Dominant Products

Comments relating to market dominant products are addressed in this Section II, with one important exception: the Postal Service will address the Public Representative's comments regarding cost coverage for Inbound Letter Post[8] in a second set of reply comments submitted in accordance with the Commission's extended schedule for comments related to Inbound Letter Post.[9]

A. Rates for First-Class Mail Presort Letters and Cards Are Not Unjust

NPPC, NAPM, and MMA (collectively, First-Class Business Mailers) argue that First-Class Mail Presort rates violate the statutory "just and reasonable" objective because the product's cost coverage is significantly higher than the cost coverages of other products.[10] They also contend that certain low-cost characteristics of Presort mail – such as local entry, traying and facing, entry near the destination, and a lower cost sales channel – should be considered in workshare discount calculations.[11]

Where cost coverages equal or exceed 100 percent, the Commission has consistently declined to find variances among them unjust. Rather, as the Commission

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[7] First-Class Business Mailers' Comments at 8-10. The Postal Service agrees that exploring the reasons behind these declines in volume, and taking steps to address them, are worthwhile and necessary endeavors. But they simply are outside the scope of this docket.

[8] PR Comments at 22-26.

[9] *See* Order No. 4395, Order Modifying the Procedural Schedule, Docket No. ACR2017 (Jan. 31, 2018) (establishing deadline of February 27, 2018 for reply comments related to Inbound Letter Post).

[10] First-Class Business Mailers' Comments at 2-7.

[11] *Id.* at 5-6.

has noted in past Annual Compliance Determinations (ACDs), the Postal Accountability and Enhancement Act (PAEA) provides for the current price cap to be applied at the class level rather than the product level, affording the Postal Service the flexibility to apply non-uniform price adjustments within a class.[12] Moreover, the Commission's responsibility in this proceeding is to determine "whether any rates or fees in effect during [FY 2017] were not in compliance with applicable provisions" of the statute and implementing regulations.[13] It need not consider whether a different mix of compliant prices could also have been established. In this regard, the cost coverage for Presort First Class Mail has been larger than that of other products throughout the PAEA period, without the Commission concluding in prior ACDs that those rates were noncompliant. There is no basis to render a different decision in this year's ACD.[14]

As for the First-Class Business Mailers' points on worksharing, the analytical principles to be applied in creating workshare cost avoidance models have been the subject of separate proceedings in which the First-Class Business Mailers, among other parties, participated.[15] There is no basis on which to conclude that the characteristics cited by the First-Class Business Mailers constitute "workshare activity" within the meaning of Section 3622(e).[16]

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[12] Docket No. ACR2016, Annual Compliance Determination Report for Fiscal Year 2016 (Mar. 28, 2017), at 76.

[13] 39 U.S.C. § 3653(b)(1).

[14] As noted above, broader arguments concerning this issue are more appropriately addressed in the 10-Year Review docket, although these particular arguments would be equally unavailing there.

[15] *See generally* Order No. 1320, Order Resolving Technical Issues Concerning the Calculation of Workshare Discounts, Docket No. RM2010-13 (Apr. 20, 2012); Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, Docket No. RM2009-3 (Sept. 14, 2010), at 46-47 (establishing preliminary guidelines to be used in defining the workshare activity to which 39 U.S.C. § 3622(e) should apply).

[16] *See, e.g.,* Order No. 1890, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, Docket No. R2013-10 (Nov. 21, 2013), at 49-50 (rejecting the argument that a

B. The Postal Service Continues Its Efforts to Improve the Cost Coverage of USPS Marketing Mail Flats

1. The Postal Service Will Consider ACMA's Points on Flats Product Similarities

ACMA discusses the similarities between the three flats-mailing options in USPS Marketing Mail. For instance, ACMA notes that the High-Density Flats rate category has received volume from both the USPS Marketing Mail Flats product and Carrier Route Flats rate category within the Carrier Route product, due to co-mailing and other factors.[17] Indeed, Carrier Route Flats and High-Density Flats appear to contain more finely presorted mail from many of the same mailers who use the less finely presorted rates in the USPS Marketing Mail Flats product. In addition, Flats, High-Density Flats, and Carrier Route Flats are frequently prepared together in the same containers and, in Flats Sequencing System (FSS) zones, the same bundles. The Postal Service also confirms the accuracy of ACMA's calculation in Table 1 of its comments, showing that if commercial USPS Marketing Mail Flats and commercial Carrier Route Flats had been combined in FY 2017, cost coverage would have exceeded 100 percent for this commercial-only product.[18] The Postal Service will consider ACMA's points, to the extent they are applicable, in future pricing and classification cases.

2. The Commission is Exploring Flats Costs in Docket No. RM2018-1

ACMA identifies a number of factors that it believes have contributed to Flats cost increases, including mail mix changes, the migration of lower-cost pieces to Carrier Route Flats and High-Density, lost economies of scale, and increases in labor,

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new metered letters rate was effectively a new workshare discount requiring a separate proceeding to determine its compliance with Section 3622(e)).

[17] ACMA Comments at 5.

[18] *Id.* at 2.

transportation, and equipment costs. It is also critical of current costing methodologies.[19] PostCom criticizes the Postal Service's operational efforts to reduce flats costs.[20]

The Postal Service believes the appropriate forum for addressing the flats cost issues raised by the parties is Docket No. RM2018-1, where the Postal Service has already provided information about FSS performance and operational and other efforts to improve flats efficiency.[21] Here, the Postal Service simply notes that PostCom is mistaken in its assertion that the Postal Service is "indifferent" to the effect of operations decisions on Flats costs.[22] The Postal Service has recently described to the Commission new operational changes it plans to undertake to reduce flats costs in FY 2018, including the removal of additional Automated Flats Sorting Machine 100s.[23]

C. The Postal Service Has Addressed the Public Representative's Concerns About USPS Marketing Mail Parcels

The Public Representative raises concerns about USPS Marketing Mail Parcels cost coverage, and urges the Commission to direct the Postal Service to "report on the steps it has taken to reduce the cost-per-piece of USPS Marketing Mail Parcels," including "an analysis illustrating how much of the observed FY 2017 cost decrease is the result of the Postal Service's initiatives rather than other factors."[24] The Postal

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[19] ACMA Comments at 5-7, 9-15.

[20] PostCom Comments at 7-8.

[21] *See generally* Response of the United States Postal Service to Commission Information Request No. 1, Docket No. RM2018-1 (Dec. 4, 2017); *see also* Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 5, Docket No. ACR2017 (Jan. 26, 2018), Responses to Questions 1-4.

[22] PostCom Comments at 8.

[23] *See* Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 5, Docket No. ACR2017 (Jan. 26, 2018), Response to Question 6.b.

[24] PR Comments at 29.

Service explained in the ACR that the decline in revenue per piece of USPS Marketing Mail Parcels was due to a number of factors, including the fall in average per-piece weight and the removal of the exigent surcharge.[25] As for the operational information the Public Representative would like to see, the Postal Service already provided it in response to Chairman's Information Request No. 5, stating:

> There were no specific efforts to reduce the unit cost of USPS Marketing Mail Parcels in FY 2017. However, the deployment of additional bins on APBS machines reduced the number of sortations, which likely resulted in lower costs. Note that, compared with letter-shaped and flat-shaped pieces, parcel-shaped pieces are a relatively small fraction of total Marketing Mail volume, and the opportunities to achieve substantial overall cost improvements are correspondingly more limited.[26]

The Postal Service could perhaps have been clearer on the last point: Whether measured by volume, revenue, or cost, the Parcels product composes less than 1 percent of the USPS Marketing Mail class. While it would be ideal to direct operational resources to address every issue, that is not realistic. A sense of proportion should inform both the operator and the regulator.

D. The Postal Service's Pricing Flexibility Includes the Ability to Choose the Timing of Future Market Dominant Rate Adjustments

The Public Representative suggests that non-compliant passthroughs be remedied by a requirement that the Postal Service submit updated cost avoidances concurrent with every market dominant rate case, rather than relying on the cost avoidance estimates filed after the end of the previous fiscal year.[27] Practically, this suggestion would require either that the Postal Service time its market dominant price

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[25] FY 2017 ACR at 14.

[26] Responses of the United States Postal Service to Questions 1-10 of Chairman's Information Request No. 5, Docket No. ACR2017 (Jan. 26, 2018), Response to Question 5.

[27] PR Comments at 53-55.

cases immediately after preparation of the annual Cost and Revenue Analysis (CRA) and associated cost avoidance models, or that the Postal Service create a comprehensive mid-year or hybrid-year cost avoidance model before each price case.

Neither approach is feasible. As the Commission has recognized, "[t]he Postal Service's pricing flexibility allows the Postal Service to set its schedule of price adjustments and make revisions to the schedule at will."[28] The Commission has traditionally deferred to the Postal Service's business judgment as to when price adjustments should occur, an approach that is consistent with the statutory objective promoting pricing flexibility.[29]

As for creating mid-year or off-cycle cost estimates, the CRA is developed using a wide variety of data-driven inputs (such as retiree health benefits and workers' compensation expenses) that are determined on a fiscal year basis, and these data often undergo major adjustments in Quarter 4, so mid-year reports would likely be subject to change as year-end numbers are finalized. It would also be challenging to incorporate the ongoing methodology changes that go into effect at various points throughout the typical year. The result would be a highly burdensome process,[30] with cost avoidance estimates that are less stable from year to year than the year-end estimates that the Postal Service currently prepares, which themselves can be somewhat unstable for some products even with the use of full-year data.

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[28] Docket No. ACR2015, Annual Compliance Determination Report for Fiscal Year 2015 (Mar. 28, 2016), at 11.

[29] *See* 39 U.S.C. § 3622(b)(4).

[30] The Public Representative acknowledges that the proposal "might make the rate adjustment process more burdensome to both parties." PR Comments at 54.

E. Claims Alleging Cross-Subsidization of Market Dominant Products by Other Market Dominant Products are Without Merit

Some commenters suggest that the Postal Service is inappropriately "cross-subsidizing" unprofitable market dominant products by raising prices on more profitable products such as First-Class Mail Single-Piece Letters.[31] As noted above, market dominant products are currently subject to a price cap that is applied at the class level, thereby giving the Postal Service the flexibility to apply non-uniform price adjustments within a class. The Postal Service has also discussed in the ACR its plans under the current cap regarding those limited products that are underwater, and is fully complying with prior Commission directives regarding those products (including through the application of above-average price increases). Moreover, when viewed more closely, the details provided in support of these claims suggest that the concerns relate primarily to the proposals set forth by the Commission in the 10-Year Review proceeding,[32] and would more appropriately be addressed in that docket, if necessary.

F. The Postal Service Has Provided the Information the Public Representative Requests Relating to Inbound Registered Mail

The Postal Service explained in the ACR that International Ancillary Services did not cover costs because of a loss in Inbound Registered Mail.[33] The Public Representative notes a similarity between the factors that the Postal Service cited in the FY 2016 and FY 2017 ACRs, and recommends that the Commission ask the Postal

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[31] Comments of American Consumer Institute Center for Citizen Research (Jan. 30, 2018), at 1-2 [hereinafter "ACI Comments"]; Frontiers of Freedom Comments at 1-2.

[32] *See, e.g.,* ACI Comments at 1 ("What's more, under the Commission proposal, the Postal Service would be allowed to raise rates 2 to 3 percent on top of the rate of inflation for each of the next five years."); Frontiers of Freedom Comments at 2 ("Thus, we ask, how can – after a ten year review of the postal ratemaking system – USPS be allowed to raise rates 2 to 3 percent beyond the rate of inflation for each of the next 5 years?").

[33] FY 2017 ACR at 44.

Service about its strategy concerning Inbound Registered Mail.[34] The Postal Service notes that the increase in the additional payment per item for Inbound Registered Mail between 2017 and 2018, from 0.69 special drawing right (SDR) to 1.1 SDR, is significantly greater than the increase that occurred between 2016 and 2017. Furthermore, the Postal Service has already provided additional information concerning factors that contributed to the decrease in unit revenue and the increase in unit cost for Inbound Registered Mail from FY 2016 to FY 2017, as well as concerning reporting.[35] This information should aid the Commission in its evaluation of the product.

G. The Concerns Raised by the Public Representative Regarding Implementation of the New Definition of Attributable Costs Lack Substance

The FY 2017 ACR was the first opportunity for the Postal Service to implement fully the new definition of attributable costs adopted by the Commission in late 2016 in Docket Nos. RM2016-2 and RM2016-13. The Public Representative is generally supportive of the approach taken by the Postal Service to achieve this result, but raises concerns about certain details of the procedures.[36] The Postal Service addresses those concerns here.

The Public Representative believes that reporting attributable costs for each market dominant class in the CRA as the sum of the attributable costs of the products in that class is inconsistent with Order No. 3506's instruction that the Postal Service "use

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[34] PR Comments at 43-44.

[35] Responses of the United States Postal Service to Questions 1-15 of Chairman's Information Request No. 3, Docket No. ACR2017 (Jan. 19, 2018), Responses to Questions 3 and 4.

[36] PR Comments at 44-47, 56-57, 62-64.

incremental costs as the basis for class-level and product-level attributable costs."[37] To begin, the class-level group incremental costs that the Public Representative would prefer are already provided in USPS-FY17-1, in the CRA Notes on page 7 of the Public CRA. The figures there mirror the figures arrived at in Table IV-7 of the Public Representative's comments.

To the Public Representative's point that the sum of the individual product incremental costs of all the products in a class will generally be less than the group incremental costs of that class,[38] the Postal Service already highlighted this in its ACR materials,[39] and indeed this holds true of almost any aggregation of products, whether the component products be within the same class, across multiple classes, or themselves constitute several entire classes. Incremental costs simply are not additive. That does not change the fact that, for the distinct regulatory concept of attributable costs, the approach taken in the FY 2017 ACR makes the most sense because it accords with the Commission's focus on product-level compliance.[40] The cost

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[37] PR Comments at 45. It could be argued that, in some sense, the Postal Service effectively is using incremental costs "as the basis for" both class-level and product-level attributable costs in the CRA. This logically follows from the facts that, first, the product-level attributable costs now extend (beyond the former definition of volume variable plus product specific) to include the inframarginal costs estimated as part of the incremental costs, and, second, that the class-level attributable costs reported are the sum of those product-level costs in each class. Certainly when compared with attributable costs as defined in years past, both product-level and class-level attributable costs are now based on incremental cost calculations.

[38] *See, e.g.,* PR Comments at 45-46.

[39] *See, e.g.,* USPS-FY17-43 Preface at 4; FY 2017 ACR at 68.

[40] It is curious that, immediately after criticizing the Postal Service's approach to adding *attributable* costs, the Public Representative's comments immediately take things one step further in Table IV-7, by adding the group *incremental* costs of the market dominant classes. Regarding the Commission's general focus on product-level costs, it bears noting that, even during the Postal Reorganization Act (PRA) era, notwithstanding the "each class" language of previous section 3622(b)(3), for purposes of evaluating relative institutional cost burdens, cost coverages and cost markups as a practical matter were primarily analyzed at the product (subclass) level. As but one of many possible examples illustrating the main emphasis on subclasses (rather than whole classes) during that era, see pages 228-29 of the Postal Rate Commission Op. & Rec. Dec., Docket No. R97-1, Vol. 1 (May 11, 1998). Similarly, on page 233 of the

presentation in the FY 2017 ACR represents a simple, intuitive, direct, and tractable approach to incorporating the inframarginal cost component into the estimation of attributable costs.[41]

Similarly mistaken is the Public Representative's statement that the Postal Service did not comply with a "clearly stated" directive in the FY 2016 ACD to initiate a rulemaking regarding the new procedures relating to the incremental costs of international mail.[42] The Public Representative is referring to the following statement from the FY 2016 ACD:

> *The Postal Service used a methodology for the ICRA that was not approved by the Commission. If the Postal Service intends to use this methodology in its FY 2017 ACR, it should file the proposed methodology in a rulemaking proceeding.*[43]

The Public Representative appears to have misread the quote as applying to the immediately preceding paragraph in the ACD, which discussed incremental costs, whereas the quote rather relates back to the Commission's discussion on the previous page regarding the aggregation of target/transition countries. The Postal Service

same Opinion, the Commission restated the position that "attributable cost means costs which can be said to be reliably caused by a subclass of mail or special service." Under the PAEA, the primary focus remains at the subclass/product level. *See, e.g.,* Section 3652(a)(1), which sets the focus of the ACR on a demonstration that all "products" comply with the applicable requirements. Moreover, it is highly unlikely that any class of mail can be underwater unless at least one of its component products is underwater. In the case of an underwater class, the more pressing question would thus immediately proceed to whether the deficiency flows from a mix of above and below water products, or from uniformly below water products. Practically speaking, therefore, the significant analysis from a remedial perspective must almost invariably be focused on the product-level data.

[41] Specifically with respect to institutional costs, it is also fully consistent with Order No. 3506. As recently as last week, the Commission, citing page 10 of Order No. 3506, noted that "[a]ny cost that cannot be specifically attributed to an individual product is considered a residual or institutional cost." Order No. 4402, Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, Docket No. RM2017-1 (Feb. 8, 2018), at 43. In the FY 2017 ACR, the Postal Service uses the difference between accrued costs and the sum of attributable costs over products to identify institutional costs, and the Public Representative is therefore mistaken to claim on pages 46-47 that this approach is somehow at odds with Order No. 3506.

[42] PR Comments at 56, note 54.

[43] FY 2016 ACD at 65.

complied with the directive by submitting Proposal Two in Docket No. RM2017-6.

The Public Representative's misgivings regarding the cost driver approximation method used for Negotiated Service Agreement (NSA) products appear to stem from a misunderstanding of how incremental costs are developed. In particular, pages 62-64 of the Public Representative's comments do not properly distinguish between the unique features of the approximation method and the procedures common to incremental cost estimation more broadly. For example, on page 64, the assumption that "the cost per unit driver is the same for all units of the driver consumed" is identified as an additional assumption necessary for the NSA approximation methodology, when in reality that assumption is also embedded in the established incremental cost estimation methodology.[44] Moreover, the comments do not appear to distinguish between empirical results potentially caused by the approximation method, and empirical results that would not change even if resort to the approximation method were unnecessary.

Specifically, the comments state on page 63:

> Consequently, within NSA product groups that contain a significant number of individual NSAs, for NSAs with relatively low volume-variable costs, the estimated volume-variable shares might be either inadequately low, or even equal to zero.

In actuality, however, the circumstance of small NSAs having extremely low (to the point of negligible) shares of costs is correctly a function of their relative size, and would

[44] It may, however, be useful to clarify that, in context, the assumption quoted was merely intended to recognize that all units of the cost driver are considered fungible across products. In other words, the effect on total costs of a reduction of, for example, 15 percent of the cost driver is assumed to be the same whether the 15 percent reduction happens to be associated with all of the cost driver units of product A, or all of the cost driver units of product B, or the combined cost driver units of products C and D. Furthermore, the context in which that assumption was discussed was not the "volume variable cost share" approximation actually adopted by the Postal Service, but rather a potential alternative "volume share" approximation that was not adopted by the Postal Service. USPS-FY17-43, Appendix A at 3. This distinction appears to have been missed.

necessarily pertain whether the approximation method is used or if instead actual NSA product data were available at the cost pool level. In other words, rather than being "inadequately low," the resulting cost shares are in fact entirely appropriately low. An NSA's incremental cost is just the sum of the marginal costs for each of the pieces in the NSA. For the very low volume NSAs, the marginal costs for all pieces are virtually the same. In this circumstance, the inframarginal costs are not measurable, and are effectively zero. To ignore that reality in pursuit of immaterial detail would constitute a gross misappropriation of time and effort in the final stages of ACR preparation, when the Postal Service's resources are very limited. The result is not a cogent basis upon which to question the cost driver approximation method applied to NSAs (and to other products in other circumstances in which cost pool level data are unavailable).

III. Service Performance, Customer Satisfaction, and Consumer Access

A. The Postal Service's Commitment has Continued to Produce Annual Improvements in Service Performance

1. The Public Representative Recognizes a Second Year of Service Performance Improvement

The Public Representative acknowledges that the Postal Service has continued to improve its annual service performance for the second year in a row.[45] As quantified in the ACR,[46] the Postal Service built upon its broad successes of the year before and continued to produce improvements in annual performance in almost all service categories. Nonetheless, the Postal Service seeks not only to improve its service performance, but also ultimately to attain its aggressive stretch service targets.

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[45] PR Comments at 1, 3-4, 6-9, 13.

[46] *See* FY 2017 ACR at 49-54; *see also* USPS-FY17-29, Service Performance of Market Dominant Products.

Improvement, though, is the only way to reach the ambitious stretch targets, so the Postal Service remains committed to continuing the efforts that have worked so well these past two years and also to developing new strategies to achieve even higher results.

The Postal Service appreciates the Public Representative's close attention to the actual annual data and the Public Representative's consequent conclusion that generally "service performance continues to improve" for a second year.[47] The Public Representative "finds that in most instances, service performance levels in FY 2017 have increased over FY 2016."[48] Even though the Postal Service did not achieve all of its targets, the Public Representative observes that "many individual First-Class Mail products are only a few percentage points away from meeting their applicable service performance targets."[49]

Probing the granular First-Class Mail improvements in the three-to-five day reporting categories, the Public Representative infers that the Postal Service may have "been successful in addressing related transportation and processing issues," which is "positive news."[50] The Public Representative is similarly "encouraged by the Postal Service's progress" for USPS Marketing Mail, within which "nearly five out of seven products" met their targets,[51] and the Public Representative also describes the Postal Service's improvements for Periodicals as "very positive."[52] The Commission should

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[47] PR Comments at 1; *see also id.* at 5-9 (supporting data).

[48] PR Comments at 3.

[49] *Id.* at 6.

[50] *Id.* at 4.

[51] *Id.* at 8.

[52] *Id.* at 8.

likewise recognize the continued and broad annual improvements that the Postal Service has achieved.

2. Other Comments Ignore and Conflict with Actual Annual Improvements

In contrast to the Public Representative's data-driven conclusions that the Postal Service's annual service performance has in fact continued to improve, several other commenters lodge generalized claims of a lack of improvement, yet with essentially no data to back up those assertions. For example, the National Taxpayers Union states that "in many aspects Service [sic] performance has been on a steady decline for years."[53] Frontiers of Freedom says "that there has been no conscious or effective effort by postal leadership to fix the shortfalls of the US Postal Service."[54] The American Consumer Institute professes a lack of "faith that services will improve anytime soon."[55]

All of these claims are premised solely upon the Postal Service having missed some of its own aggressive service targets, but that fact does not support the statements quoted above. To the contrary, based instead on the actual annual data and results for the past two fiscal years, service performance is not "on a steady decline," but instead continues to improve; there has been "effective effort by postal leadership" to improve service performance; and there is much more than mere "faith" in improvement "anytime soon" because in fact annual service performance has improved for the past two years in a row.

[53] NTU Comments at 1.

[54] Frontiers of Freedom Comments at 1.

[55] ACI Comments at 1.

3. The Postal Service and the Commission Should Stay the Successful Course

While more improvement is needed to reach a number of the Postal Service's aggressive service performance targets, the fact that efforts have worked well to improve annual performance for two years in a row counsels against radical departures in approach. The Public Representative raises several suggestions for more active Commission intervention, particularly for flats.[56] However, in light of the Postal Service's positive annual trends, the Commission should refrain from any approach that imposes unnecessary costs and burdens or may otherwise impede the Postal Service's progress.

With respect to First-Class Mail (FCM) Flats, the Public Representative "encourages the Commission to continue requesting any additional information that would help reveal which efforts and methods are working and which are ineffective."[57] At the same time, the Public Representative explicitly "agrees" with the Postal Service that its efforts to improve the performance of FCM Flats "are working."[58] The data bear out this conclusion, as the on-time figures for Overnight, Two-Day, and Three-To-Five-Day FCM Flats have all increased for the second year in a row.[59] Because these efforts "are working," the Public Representative does not demonstrate any need for additional action by the Commission in this area.

Moreover, the Postal Service continues to work diligently with the Commission to identify and address the root causes of problems with service performance, especially

[56] PR Comments at 2, 6, 10, 13.

[57] PR Comments at 6.

[58] *Id.*

[59] *Id.* at 5.

with respect to flats. During FY 2017, the Postal Service provided a 97-page supplemental response to the Commission's flats directive.[60] More recently, less than three months ago the Postal Service provided the Commission a 78-page response detailing how the Postal Service uses its data sources to track, measure, and report on flats cost and service performance issues.[61] In that recent response, for example, the Postal Service analyzed how the use of Lean Six Sigma and Kaizen studies is beneficial for improving flats service; how Service Performance Measurement (SPM) is used to measure the impact of last mile delivery on flats service through identification of delays between processing and delivery; and how the Transit-Time Measurement System (TTMS) is also used to measure that impact on flats service using scan, start-the-clock, and delivery information.[62]

Second, with respect to Bound Printed Matter Flats, the Public Representative details the leaps in annual on-time performance achieved during the past two years, while also expressing concern that the performance for this particular product still falls far short of its current stretch target.[63] However, the Public Representative's characterization that efforts to improve this service are "not showing significant results"[64] is belied by the fact that the data displayed in the Public Representative's own comments evince a rate of growth in this product's performance of over 25 percent from

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[60] Response of the United States Postal Service to Commission Information Request No. 1, Docket No. ACR2015 (Nov. 28, 2016).

[61] Response of the United States Postal Service to Commission Information Request No. 1, Docket No. RM2018-1 (Dec. 4, 2017).

[62] *See id.* at responses to PP2-5.g; PP6-2.h; & PP6-4.

[63] PR Comments at 4, 9-10.

[64] *Id.* at 10.

FY 2015 to FY 2017.[65] In any event, the Postal Service concurs that this product is an outlier compared to others in that it is not close to its target, notwithstanding notable annual improvements during the past two years. Stopping short of opining that the target is necessarily wrong, the Public Representative instead suggests that "the Commission could inquire as to whether or not the Postal Service believes the Bound Printed Matter Flats service performance target is realistic," and, if it is unrealistic, then the Public Representative recommends revision of the target.[66] The Postal Service certainly agrees that its targets, while designed to be aggressive in order to drive continuous improvement, should be realistic; however, it is often only in hindsight that one can meaningfully evaluate whether a target was realistic or not.

The Postal Service will continue to strive towards further annual improvements in its service performance for the American public. As its annual fiscal year results demonstrate, and as the Public Representative has acknowledged, Postal Service management's initiatives and Postal Service employees' efforts together have achieved broad annual improvements over the past two years. The Postal Service remains committed both to continuing the initiatives that have contributed to these improvements and to developing new strategies to improve even more.

B. Customer Satisfaction and Consumer Access

The Public Representative notes with approval the Postal Service's improvement in FY 2017 in reducing both the number of suspended post offices and the wait-time-in-line (WTIL) experienced by customers.[67] The Postal Service will continue to work to

[65] *Id.* at 9, Table II-5 (BPM Flats, (FY 2017 – FY 2015)/FY 2015).

[66] PR Comments at 10.

[67] PR Comments at 14-17.

improve in these areas, including reviewing the remaining suspended offices to determine the proper course of action.

The Public Representative also opines that the reduction in collection boxes may be "accelerating" after several years of "modest" reductions.[68] The Postal Service will continue to perform its annual density testing of collection boxes in FY 2018 to address this matter, with the goal of ensuring that it has a collection box network that is cost-effective while meeting the needs of customers.

The Public Representative notes that Customer Insight (CI) measurement system scores improved in FY 2017, but expresses concerns about the satisfaction of large business customers in such areas as value for the price being charged, the need for the Postal Service to better understand its largest customers' businesses, and more accuracy in delivery.[69] The Postal Service will look into the Public Representative's concerns and continue to identify ways to improve the customer delivery experience, including management response to customer issues. The Postal Service does not expect a decrease in either delivery accuracy or mail condition based on product classification, but will carefully explore these concerns.

IV. Competitive Products and Costing Methodologies

To the extent they address the issue of competitive product compliance directly, the comments reflect a general consensus that competitive products collectively met the requirements of Section 3633 in FY 2017. As noted by Pitney Bowes, and confirmed by the Public Representative, competitive products "were not cross-subsidized by market dominant products" and "collectively . . . cover an appropriate share of institutional

[68] *Id.* at 16.

[69] *Id.* at 17-21.

costs" in FY 2017.[70] The Public Representative's comments relating to certain international competitive products, as well as UPS's comments relating to competitive product costing methodologies, are addressed in this section IV.

A. The Postal Service is Addressing the Financial Performance of International Competitive Products

The Public Representative raises concerns about the cost coverage of certain international competitive products, making recommendations for further action with respect to International Money Transfer Service (IMTS), Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1, Outbound International Insurance, and Special Services overall.[71] In general, the Public Representative's observations appear to align with the Postal Service's analysis of these products.

First, with regard to IMTS, in the ACR the Postal Service noted the difficulty in obtaining enough In-Office Cost System (IOCS) tallies to reliably estimate attributable costs and explained the measures that the Postal Service has taken to improve cost coverage for IMTS-Outbound, including a 73.7 percent increase in prices on January 22, 2017, and a 3.6 percent increase in prices on January 21, 2018.[72] The Public Representative acknowledges the recent price increases for IMTS-Outbound, and notes that cost coverage for IMTS-Outbound in FY 2017 was "slightly below 100 percent" and that "the January 2018 price increase would have a positive impact on IMTS-Outbound cost coverage, allowing the product to cover its costs for FY 2018." Concerning IMTS-Inbound, the Public Representative recommends that the Postal Service follow the Commission's recommendation and request the authority necessary to terminate the

[70] Pitney Bowes Comments at 4-5; PR Comments at 2-3, 55-57.

[71] PR Comments at 57-61.

[72] FY 2017 ACR at 70-71.

agreements in IMTS-Inbound.[73] In response to Chairman's Information Request (ChIR) No. 1, Questions 11 to 13, the Postal Service provided additional information concerning IMTS-Outbound and IMTS-Inbound, which should aid the Commission in its evaluation of this product.[74]

As for Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1, the Postal Service acknowledged in the ACR that three competitive bilateral agreements did not cover costs, two of which have expired. In addition, the Postal Service stated that it intends to replace the third – which fell short of full cost coverage by a very small percentage – with a successor agreement providing adequate cost coverage at the product level.[75] The Public Representative acknowledges this but observes that the cost coverage for two other agreements is only slightly above 100 percent, noting that should any of the remaining agreements fail to cover costs, the Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1 product might not cover costs. The Public Representative states that "the Postal Service should carefully monitor cost coverage of the remaining agreements within the product, and, if necessary, modify rates to ensure adequate cost coverage for the product."[76] The Postal Service notes that, of the remaining three agreements, the Commission recently reviewed the agreement with Canada Post that is the subject of Docket No. CP2018-96. In addition, the Postal Service is carefully monitoring cost coverage for the other two agreements, which expire on June 30, 2018, and will pay particular attention to the cost

[73] PR comments at 57-58.

[74] Responses of the United States Postal Service to Questions 1-16 of Chairman's Information Request No. 1, Docket No. ACR2017 (Jan. 12, 2018), Responses to Questions 11-13.

[75] FY 2017 ACR at 72.

[76] PR Comments at 59.

coverage of those existing agreements during the negotiation of possible successor agreements.

With respect to Outbound International Insurance, in the ACR the Postal Service stated that one reason that Outbound International Insurance did not cover costs may be that claims for Priority Mail International (PMI), for which no fee is paid, are assigned to the Outbound International Insurance product, rather than to the PMI product. The Postal Service noted that prices for Priority Mail Express International (PMEI) and PMI insurance fees were raised by 4.7 percent and 4.8 percent, respectively, in the January 22, 2017 price change, and that the January 21, 2018 price change included price increases for PMEI and PMI insurance fees of 4.0 percent and 3.9 percent, respectively.[77] The Public Representative suggests that another reason for the low cost coverage could be related to the relatively high volatility of IOCS-based unit cost estimates. The Public Representative cannot conclude that the provided cost coverage for Outbound International Insurance is fully reliable, based on the limited number of IOCS-tallies and high variability of the cost estimates. The Public Representative agrees with the Postal Service's plan to explore whether to make changes to reporting of the costs associated with PMI claims, but suggests that the Postal Service also investigate how to improve measurement for Outbound International Insurance cost coverage.[78] The Postal Service is continuing to explore whether to make changes to reporting of the costs associated with PMI claims and has provided additional information concerning IOCS-tallies in response to ChIR No. 1, Question 7 in this

[77] FY 2017 ACR at 71.

[78] PR comments at 60.

docket.[79]

Finally, with respect to Special Services overall, the Public Representative notes that, as discussed above, Outbound International Insurance, as well as IMTS-Inbound and IMTS-Outbound, failed to cover costs. As a result, International Ancillary Services and the competitive Special Services class did not cover costs. The Public Representative believes the Commission should request additional information concerning the steps the Postal Service will take to improve cost coverage for Special Services overall, as well as for the underwater products within Special Services.[80] In the discussion above concerning Outbound International Insurance, as well as IMTS-Inbound and IMTS-Outbound, the Postal Service set forth the steps that it plans to take.

B. UPS's Comments Are Both Outside the Scope of this Docket and Based on Mistaken Assumptions

United Parcel Service, Inc. (UPS) questions the current costing models for competitive products. However, rather than examine the costing models directly, UPS offers various discrete observations that, in its view, cast doubt on the models. Then, in closing its comments, UPS requests that the Commission initiate new proceedings to reconsider the models.

Implicit to UPS's request is an acknowledgment that its comments go beyond the scope of the Commission's ACR review. For the Commission's benefit, the Postal Service responds to UPS's points briefly below, to demonstrate that they fail to raise any material concerns regarding the current models.[81] At the same time, any regulatory

[79] Responses of the United States Postal Service to Questions 1-15 of Chairman's Information Request No. 3, Docket No. ACR2017 (Jan. 12, 2018), Response to Question 7.

[80] PR Comments at 61.

[81] In reading the UPS Comments, one cautionary note is required. UPS repeatedly calculates the proportion of different types of costs assigned to competitive products as the ratio of volume variable

action on UPS's proposals would require appropriate notice from the Commission in a new docket, with an informed opportunity to comment.

1. UPS's Claims Regarding Capital Investments Are Not Borne Out

On the first page of its comments, UPS states that, over the past two years, "the Postal Service has continued to invest heavily in package sorting equipment, new vehicles, and handheld scanners – all specifically intended to be used to process, deliver and track packages." This is mistaken, both as to the level of investment and the focus. The Postal Service's 2017 Annual Report on Form 10-K shows that average capital expenditures have decreased from an average of $1.5 billion from 2009 to 2011 to an annual average of $1.3 billion from 2015 to 2017, a reduction of approximately 10 percent.[82] In addition, as discussed further below, the sources of the Postal Service's need to make these purchases extend well beyond simply the handling of competitive products. Regarding package sorting equipment, the existing costing models also appropriately attribute their costs.

2. UPS's Statements on Peak Season are Mistaken

On page 5 of its comments, UPS states:

> The large number of packages the Postal Service delivers during its peak season, combined with the fact that letter mail volumes remain flat or decline during this season, indicates that much if not all of this seasonal

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competitive costs of that type to total accrued costs of that type. Typically, in the past, these types of ratios have instead been computed as the share of volume variable competitive costs in relation to total volume variable costs (both within the same cost pool). The customary calculation gives a much more informative picture of the relative distribution of attributable costs of any type between market dominant and competitive products. What becomes particularly troubling, however, is when the UPS comments juxtapose a competitive attributable cost proportion of accrued costs (in which the market dominant and competitive shares do not total to 100 percent because some of the accrued costs are institutional) with a weight or volume proportion (in which the market dominant and competitive shares necessarily do total to 100 percent). *See, e.g.,* pages 2-3 of the UPS Comments. While the arithmetic may be correct, the impression being conveyed is not.

[82] Postal Service's 2017 Annual Report on Form 10-K (Nov. 14, 2017), at 37 [hereinafter the Form 10-K].

variation in cost is caused by competitive products.

In reality, both market dominant and competitive products peak during the first quarter, as demonstrated by the FY 2017 Revenue Pieces and Weight (RPW) report data in USPS-FY17-42. And, while the difference is not material, the market dominant spike (27.84 percent) is greater than that for competitive products (27.78 percent).[83]

3. Parcel Delivery Is Not the Primary Driver of Operations

While it is true that the share of competitive products has increased in recent years, it is incorrect to state that parcel delivery is a primary driver of the Postal Service's operations overall.[84] Two facts illustrate this point. One, according to the RPW report, competitive products volume in FY 2017 was 5.1 billion pieces, or 3.4 percent of the originating volume handled by the Postal Service. Two, given that the Postal Service serves 157 million delivery points daily,[85] and assuming 303 delivery days and uniform distribution of competitive products across delivery points and delivery days, on average only 10.7 percent of delivery points receive a competitive product on any given delivery day during the year. Of course, mail volumes are not uniformly distributed, so the actual percentage is almost certainly lower.

4. New Handheld Scanners Were Purchased for a Variety of Purposes

UPS cites an Office of Inspector General (OIG) report to support its statement that the Postal Service's handheld scanners "were purchased for the very purpose of

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[83] It perhaps bears mention that while UPS seeks (page 6) to require date and time stamp information within the data collection system materials, the date a test is conducted is already a field in the IOCS and Transportation Cost System (TRACS) data files provided. However, as UPS essentially concedes in footnote 16, knowing the date is insufficient to overcome the fact that the data systems were not designed to support monthly reporting.

[84] UPS Comments at 2.

[85] Form 10-K at 49.

tracking package deliveries." However, the very first page of the report contradicts this:

> The Postal Service's goal is to scan all barcoded mailpieces (flats, letters, and packages) that enter the mailstream and track those items with additional scans up to the point of delivery. Scanning accuracy is critically important to the success of real-time visibility.

In other words, the scanners have an array of purposes, not just parcel visibility. For example, carriers scan a barcode before leaving the office when they are delivering Saturation mail, and, when prompted randomly, carriers use their scanners to enter the collection volume captured by collection points.

5. Vehicle Purchases are Motivated by a Number of Factors

On page 37 of the Form 10-K, the Postal Service acknowledged the purchase of approximately 9,000 vehicles in FY 2017.[86] UPS cites this purchase, describes the vehicles' increased cargo capacity, and concludes that the vehicles are intended for parcel delivery and that their depreciation should reflect that focus. In reality, the Postal Service's delivery fleet is at its end-of-life and needs to be replaced to perform all functions – the delivery of letters, flats, and parcels. While the recently purchased Promaster vehicles are larger than the Grumman Long Life Vehicles (LLVs), the specific magnitudes of the size differences prove very little, because the left-hand drive Promasters are not intended to be the replacement vehicles for the right-hand drive LLVs, and also because the Postal Service has a number of reasons for increasing vehicle size. For example, more mail is delivery point sequenced through automation now than when the LLVs were purchased, leading to more carrier time spent on the

[86] Curiously, while UPS on page 7 makes the claim that 80 percent of the new vehicles were delivery vehicles, the response to ChIR No. 8, Question 4 presenting the inventory of the 9,044 new vehicles indicates that only 6,414, or 71 percent, were delivery vehicles. Responses of the United States Postal Service to Questions 1-15 of Chairman's Information Request No. 8, Docket No. ACR2017 (Jan. 29, 2018), Response to Question 4.

street and longer carrier routes, which result, even in the face of overall volume declines, in some routes on which a bigger vehicle is required. Also, ergonomic improvements and concerns relating to employee safety and well-being similarly weigh in favor of larger vehicles.

6. The Office of Inspector General (OIG) Audits Cited by UPS Do Not Support its Claims

UPS cites findings from two recent OIG reports in an effort to undermine the credibility of the Postal Service's costing systems.[87] Neither of these reports have the significance that UPS suggests.

UPS claims that in one report, entitled "Inbound ePackets Cost Attribution", the OIG found that the Postal Service did not capture or attribute the costs associated with returning undeliverable inbound ePackages to the product, resulting in an understatement of the costs of inbound ePackets and an overstatement of outbound international packets between \$1.02 and \$1.13 per returned mailpiece (depending on the destinating country). *Id.* However, UPS fails to mention two important components associated with this finding that were also contained in the same OIG report, which demonstrate that this issue is immaterial. First, in Appendix C: Management Comments, the Postal Service agreed to establish procedures to track returns and identified a potential remedy currently being investigated. Second, the total amount at risk of being improperly attributed was \$310,984, a trivial amount considering that ePackets costs were over \$200 million.[88]

UPS also notes that, in the report titled "Delivery Charge Codes," the OIG

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[87] UPS Comments at 15-16.

[88] OIG Report at 6.

indicates that Postal Service delivery personnel "did not consistently charge Sunday delivery time to appropriate MODS[89] operation numbers, which resulted in hours being associate[d] with incorrect LDCs,"[90] and that between February and June 2017, the OIG "found personnel inappropriately charged about 67,165 hours (3 percent) of the total universe of Sunday workhours to LDCs other than Sunday delivery LDC." Appendix B of the report clarifies that the investigation occurred in February 2017, before specific clocking procedures were established and communicated to the field in May 2017. Considering this timing, and that the investigation was done just after LDC 24 was established, a 3 percent error rate indicates that the carriers did a reasonable job in clocking to the right operation associated with Sunday activities.

UPS also notes that the OIG reported that "of the total 13,053 workhours logged by the 160 sampled delivery personnel, supervisors changed or moved 2,578 (20 percent) of the hours between different MODS operations without documented justification." UPS concludes that if this same ratio (20 percent) applies nationally, millions of work hours may be improperly entered without apparent documented justification.[91] But this assumes that all or a high proportion of the hours moved between MODS operations without documented justification were shifted incorrectly. UPS makes this assumption without support or justification. In fact, it is extremely unlikely that the assumption holds true, because there is a small set of MODS operations within which a supervisor is likely to apply the adjustments, so even without documentation, the chances are small that a high proportion of these adjustments result

[89] *I.e.,* Management Operating Data System.

[90] *I.e.,* Labor Distribution Codes.

[91] UPS Comments at 16.

in erroneous entries.

7. The Postal Service Follows the Commission Rules for CPF Reporting

UPS criticizes what it characterizes as “the Postal Service’s narrow view of cost causation” in the specific context of Competitive Product Fund (CPF) reporting.[92] In particular, UPS objects to a Postal Service information request response that defines financial obligations or investments for competitive products as consisting of only those activities where “the activity in question would need to relate solely to the provision of a single competitive product, or solely to the provision of multiple competitive products.” *Id.* UPS’s implication appears to be that the Postal Service unilaterally decides what approach to apply for reporting Competitive Product Fund assets. In reality, the Postal Service simply follows the provisions of the Commission’s rules, which direct the Postal Service to identify asset accounts “used solely for the provision of competitive products.”[93]

[92] UPS Comments at 13-14.

[93] 39 C.F.R. Section 3060.12(a).

V. Conclusion

The Postal Service appreciates the opportunity to comment on the issues raised by the parties in their initial comments.

Respectfully submitted,

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February 12, 2018