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

ANNUAL COMPLIANCE REVIEW, 2018	Docket No. ACR2018

**REPLY COMMENTS OF THE
UNITED STATES POSTAL SERVICE**

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Introduction

The United States Postal Service hereby replies to the public's comments on its Annual Compliance Report (ACR) for Fiscal Year (FY) 2018.[1] Several industry and other groups commented, as did the Public Representative.[2] The Postal Service addresses their principal concerns below.

At the outset, the Postal Service notes that the Postal Regulatory Commission's charge in this docket is to determine:

(1) whether any rates or fees in effect in FY 2018 were not in compliance with applicable law; and

(2) whether any service standards in effect in FY 2018 were not met.[3]

Where the comments seek to expand the docket beyond these two subjects, the Commission should either disregard them or defer them to other, more suitable proceedings.[4]

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[1] United States Postal Service FY 2018 Annual Compliance Report, Docket No. ACR2018 (Dec. 28, 2018).

[2] In addition to the Public Representative, parties filing comments (individually or jointly) on or before February 14 included the Alliance for Nonprofit Mailers (ANM), American Catalog Mailers Association (ACMA), American Consumer Institute Center for Citizen Research (ACI), Greeting Card Association (GCA), MPA – The Association of Magazine Media (MPA), National Association of Presort Mailers (NAPM), National Postal Policy Council (NPPC), Pitney Bowes Inc. (Pitney Bowes), Quad Graphics, Small Business and Entrepreneurship Council (SBEC), and Taxpayers Protection Alliance (TPA).

[3] 39 U.S.C. § 3653(b).

[4] For example, several parties criticize the Commission's recently adopted final rule on the institutional cost contribution requirement for competitive products. See, e.g., Comments of American Consumer Institute Center for Citizen Research Regarding Docket No. ACR2018, Docket No. ACR2018 (Jan. 31, 2019), at 3-4 [hereinafter "ACI Comments"]; Small Business & Entrepreneurship Council Comments, Docket No. ACR2018 (Jan. 31, 2019), at 2 [hereinafter "SBEC Comments"]; Taxpayers Protection Alliance Comments, Docket No. ACR2018 (Jan. 31, 2019), at 1-2 [hereinafter "TPA Comments"]. One commenter submits a detailed report with critiques and suggestions across a broad range of topics that are outside the scope of this proceeding, including highway contract route agreements, employee scheduling tools, alleged "taxpayer subsidies," and several other issues. TPA Comments (attachment).

I. Market Dominant Pricing and Workshare Discounts

Comments relating to pricing and workshare discounts for market dominant products are addressed in this Section I.

A. No Commenter Disputes the Fact that First-Class Mail Rates and Workshare Discounts Were in Compliance with the PAEA

Several commenters raise concerns and offer suggestions relating to First-Class Mail rate design. Notably, however, none question the overall compliance of First-Class Mail products in FY 2018.

For example, the Public Representative concludes that "cost coverage for First Class Mail continues to be strong," with every product except Inbound Letter Post covering its attributable costs.[5] She observes, in addition, that First-Class Mail had no workshare discount passthroughs over 100 percent in FY 2018.[6]

Pitney Bowes concedes that the workshare discounts for First-Class Mail Automation Letters comply with the statutory requirements, but suggests that the Postal Service use future price adjustments to raise these discounts back to 100 percent of

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[5] Public Representative Comments, Docket No. ACR2018 (Feb. 14, 2019), at 29 [hereinafter "PR Comments"]. The Postal Service is unable to replicate the 208.8 percent cost coverage figure the Public Representative cites for FY 2017, and the footnote citing sources for this figure does not include any cell references that might show how it was derived. In addition, the Public Representative questions the Postal Service's use of values from the Annual Compliance Determination (ACD) and Financial Analysis report to compare year-over-year cost coverage at the class level. The Postal Service maintains that it is appropriate to use the Commission's values for Fiscal Year 2017, rather than the FY 2017 Cost and Revenue Analysis (CRA), due to a change in class-level cost reporting between the FY 2017 and FY 2018 CRAs. Specifically, the FY 2017 ACD and Financial Analysis report reflect the inclusion of group incremental costs at the class level; the FY 2017 CRA does not. The FY 2018 CRA, on the other hand, was prepared using the Commission's methodology for calculating class-level attributable costs. Thus, the ACR's year-over-year cost coverage comparison, showing a slight increase in First-Class Mail cost coverage at the class level, is an appropriate apples-to-apples comparison.

[6] PR Comments at 56 & n. 111.

avoided costs.[7] Similarly, NAPM and Idealliance assert that the Postal Service could improve First-Class Mail efficiency by passing through "the full value" of costs avoided when setting workshare discounts, particularly for 5-Digit Presort letters.[8]

As the Commission has noted, the worksharing requirements of Section 3622 "impose a ceiling but not a floor on passthroughs," and "passthroughs below 100 percent are lawful."[9] The Postal Service's flexibility is constrained under the current price cap, and it is not an easy task to balance the interests of diverse mailers with operational considerations and the need to apply adjustments across a broad range of products while still maintaining overall price cap compliance. The Postal Service will continue to seek opportunities to align workshare discounts with avoided costs where appropriate and advisable.

Pitney Bowes also points to the difference between the unit contributions and cost coverages of Presort versus Single-Piece First-Class Mail Letters. Opining that the recent price adjustments in Docket No. R2019-1 "appropriately minimized the increases on more price sensitive and profitable Presort letters," Pitney Bowes recommends that long-term pricing strategy continue to lower prices on Presort categories to "rebalance the cost coverage and unit contributions among First-Class Mail products."[10] NAPM and Idealliance express a similar view, that future rate adjustments "should reflect a greater

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[7] Comments of Pitney Bowes Inc., Docket No. ACR2018 (Feb. 14, 2019), at 1-2 [hereinafter "Pitney Bowes Comments"].

[8] Comments of the National Association of Presort Mailers and Idealliance, Docket No. ACR2018 (Feb. 14, 2019), at 3-4 [hereinafter "NAPM/Idealliance Comments"].

[9] *See, e.g.,* Annual Compliance Determination Report, Fiscal Year 2016, Docket No. ACR2016 (Mar. 28, 2017), at 11, 77 [hereinafter "FY 2016 ACD"].

[10] Pitney Bowes Comments at 3.

emphasis on pricing efficiency by fully incentivizing the most efficient preparation of mail."[11]

The Postal Service recognizes these perspectives. As the Commission has noted in past ACDs, the Postal Accountability and Enhancement Act (PAEA) affords the Postal Service the flexibility to apply non-uniform price adjustments within a class.[12] The Postal Service, of course, is aware that some products have higher cost coverages than others, and takes that fact into consideration in its rate design.[13] However, the Commission's responsibility in this proceeding is to determine "whether any rates or fees in effect during [FY 2018] were not in compliance with applicable provisions" of the statute and implementing regulations.[14] It need not consider whether a different mix of compliant prices and discounts could also have been established. As it has done in the past, the Postal Service will in future rate cases continue to balance the needs of its customers with opportunities for greater pricing and operational efficiencies, consistent with the PAEA's requirements.

B. The Postal Service Has Followed Commission Guidance on USPS Marketing Mail Passthroughs

Pitney Bowes concedes that USPS Marketing Mail Automation Letter discounts comply with statutory requirements, but suggests that the Postal Service increase

[11] NAPM/Idealliance Comments at 3.

[12] *See, e.g.,* Annual Compliance Determination Report, Fiscal Year 2017, Docket No. ACR2017 (Mar. 29, 2018), at 79 [hereinafter "FY 2017 ACD"]; FY 2016 ACD at 76.

[13] *See, e.g.,* United States Postal Service Notice of Market-Dominant Price Change, Docket No. R2019-1 (Oct. 10, 2018), at 7-8 (noting that the January 2019 price adjustment's "smaller increase for Presort Letters as compared to Stamped and Metered Letters should help preserve volume in the category of First-Class Mail that both provides higher unit contribution and is most at risk for electronic diversion").

[14] 39 U.S.C. § 3653(b)(1).

workshare discounts with passthroughs below 100 percent to maximize pricing and operational efficiency.[15] The Postal Service offers the same observations here as in Section I.A, above, with respect to passthroughs that are below 100 percent.

NAPM and Idealliance raise concerns with respect to USPS Marketing Mail dropship discounts. Specifically, they highlight statements the Postal Service made in the ACR to the effect that, in the next rate case, the Postal Service plans to recommend to the Governors a reduction of at least 10 percentage points for certain workshare discounts exceeding 100 percent of avoided costs. NAPM and Idealliance urge the Commission to "reassess whether further reductions in the pricing incentives for destination entered mail will have unintended adverse effects" on operational efficiency.[16] As the commenters implicitly acknowledge, the Postal Service's approach to reducing these passthroughs over time is consistent with the direction provided by the Commission in recent price change dockets.[17] The Postal Service recognizes that a balance must be struck between encouraging efficient entry of Marketing Mail volume by mailers, exercising the Postal Service's pricing flexibility subject to price cap limitations at the class level, and maintaining compliance with the Commission's interpretation of the worksharing requirements in Section 3622(e).

C. There Is No Basis to Direct the Postal Service to Increase the Periodicals Carrier Route Basic Passthrough

MPA and ANM assert that certain Periodicals workshare discounts send inefficient pricing signals to mailers by failing to provide incentives for mailers to enter

[15] *See* Pitney Bowes Comments at 1-2.

[16] NAPM/Idealliance Comments at 5-6.

[17] *Id.*

their magazines at destination facilities presorted to Carrier Route. They argue that the Commission should "direct the Postal Service to immediately pass through as close to 100 percent of the Carrier Route Basic cost avoidance as possible."[18] MPA and ANM also claim that recent Periodicals rate design changes have had little effect on Periodicals cost coverage.[19]

As noted above, passthroughs below 100 percent are permissible under the PAEA, and there is no statutory basis to force the Postal Service to pass through more of the cost avoidance than it currently does.[20] Although Periodicals cost coverage has declined over the years, the rate design changes discussed in the FY 2018 Report Responding to Periodicals Pricing Directives have resulted in modest improvements to Periodicals Outside County finances.[21] Moreover, as noted by the Public Representative, "the decline in cost coverage was less in FY 2018 than in the previous years."[22] The Postal Service intends to continue using its pricing flexibility to encourage

[18] Comments of MPA – The Association of Magazine Media and the Alliance of Nonprofit Mailers, Docket No. ACR2018 (Feb. 14, 2019), at 4-6 [hereinafter "MPA/ANM Comments"].

[19] *Id.*

[20] On a related note, the Postal Service disagrees with MPA/ANM's contention that the 70 percent Carrier Route Basic passthrough presented in USPS-FY18-3 "is mistaken because the cost avoidance used in the calculation reflects only the mail processing cost avoided by Carrier Route presort." MPA/ANM Comments at 5. In fact, delivery costs were also included in the Postal Service's calculation. *See* USPS-FY18-3, FY18.3 Worksharing Tables.xlsx, Tab "Periodicals Outside County," row 10. This passthrough was 70 percent in FY 2018, not 49.3 percent as MPA/ANM assert.

[21] See Docket No. ACR2018, USPS-FY18-44.

[22] PR Comments at 45.

efficient preparation of Periodicals through price signals, workshare discount adjustments, and other initiatives consistent with statutory requirements.

D. The Postal Service is Working Toward an Improved Pricing Regime for Inbound Letter Post

In its comments, the Small Business & Entrepreneurship Council notes that it has been "imploring that the USPS work in close coordination with the Secretary of State to ensure a non-discriminatory pricing system."[23] The Postal Service has taken action to address this matter. First, the Postal Service secured a transfer of small packets and bulky letters in Inbound Letter Post to the competitive products list, as a precursor to establishing self-declared rates for this portion of the product. This measure will position the Postal Service to price Inbound Letter Post small packets and bulky letters using higher self-declared rates.[24] As discussed in Docket No. CP2019-83, the Postal Service is now working assiduously on a proposal for self-declared rates for Inbound Letter Post small packets and bulky letters, and expects to come forward with a proposal in the near future. These efforts will undoubtedly lead to an improved pricing regime for Inbound Letter Post.[25]

II. Flats Costs and Operations

The American Catalog Mailers Association offers an analysis of the flat-shaped categories of USPS Marketing Mail that is, at times, thought-provoking, and appears to have some facial validity. For example, of obvious merit is its observation that the

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[23] SBEC Comments at 2.

[24] *See* Order No. 4980, Order Conditionally Approving Transfer, Docket No. MC2019-17 (Jan 9, 2019).

[25] *See* Response of the United States Postal Service to Order No. 4997, Docket No. CP2019-83 (Feb. 6, 2019); Notice Regarding Postal Service Response to Order No. 4997, Docket No. CP2019-83 (Feb. 8, 2019).

increasing share of USPS Marketing Mail Flats volume consisting of Nonprofit pieces would logically be expected to reduce the cost coverage.[26] The Postal Service rejects, however, ACMA's ultimate conclusion that flats "seem out of control."

While an ACR proceeding is not the appropriate forum to delve into the myriad costing topics that ACMA raises, it may suffice to explain in one aspect why the chaotic picture that ACMA paints does not comport with reality. Throughout its comments, ACMA is dubious that factors associated with lost economies of density or scale could possibly explain observed increases in costs for USPS Marketing Mail Flats.[27] Yet the same figures on which ACMA relies indicate why that skepticism is not well founded.[28]

Economies of density or scale are technological phenomena. Consequently, the correct cost to use when measuring their effect is one that removes the impact of any input price changes. Failure to do so risks conflating the effects of input price changes with scale and/or density effects. ACMA does not present or discuss the USPS Marketing Mail Flats unit cost change adjusted for input factor price changes, even though it calculates all of the data inputs needed to derive it. From 2008 to 2018, the unadjusted USPS Marketing Mail Flats unit cost increase was 62.9 percent, but the

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[26] Initial Comments of the American Catalog Mailers Association, Docket No. ACR2018 (Feb. 14, 2019), at 5 [hereinafter "ACMA Comments"].

[27] *See, e.g.*, ACMA Comments at 19-20.

[28] ACMA gets off on the wrong foot with its erroneous claim in the footnote on page 20 that "economies of density refer to dividing a fixed cost by a large volume." Economies of density do not refer to fixed costs at all. Rather, economies of density refer to the reduction in unit variable cost that arises because of increases in spatial density. In delivery, economies of density arise because, as volume grows, more pieces of mail are delivered to the same number of stops. This increases the number of pieces per stop, and lowers unit costs.

adjusted (deflated) unit cost increase was 28 percent.[29] It is this latter figure that needs to be “explained” by scale and density effects.

To properly evaluate the plausibility of scale and density effects explaining the observed real unit cost increase, it would seem necessary to calculate the expected unit cost response to the observed USPS Marketing Mail flats volume decline, yet ACMA presents no such calculation. From 2008 to 2018, the volume of USPS Marketing Mail flats fell by 59.3 percent.[30] What might be the expected increase in unit costs associated with a volume reduction of this magnitude?

Recall that, systemwide, CRA volume variable costs are in the ballpark of 60 percent of accrued costs. With a variability of 60 percent, costs will fall by far less than any given volume reduction, meaning that unit costs will increase. The widely-used constant elasticity formula can be applied to calculate the expected change in marginal cost, caused by scale and density effects, following a volume decline. To a first approximation, this expectation can be formed using simple arithmetic. Under constant elasticity, the percentage change in marginal cost for a given percentage change in volume is roughly approximated by the variability minus one (thus, in the instance of a variability of 60 percent, 0.6 – 1 = -0.4). Accordingly, for a 59.3 percent decline in volume, the expected percentage change in marginal cost would be (-.593) times (-0.4), or a 23.6 percent increase. This is reasonably close to the ACMA-measured increase of 28 percent.

[29] The 62.92 percent figure can be found in the ACMA ACR 2018 Workbook Excel file, in cell N32 of the “3-Flat” tab. Applying the same formula applied to column N in cell N32 to the adjacent column O (presenting the corresponding deflated annual values) yields the 28.02 percent change in the real cost index over those years.

[30] The 59.3 percent volume decline is shown in cell P32 in the same tab of the same ACMA Workbook.

Moreover, for a large volume decline, the actual percentage change in marginal cost will be much larger than the above shortcut approximation would suggest. The difference arises because the simple approximation holds only for small volume changes. Using a slightly more sophisticated procedure employing exponents to directly calculate the expected effects on costs, a volume decline of 59 percent and an assumed 60 percent variability leads to an expected decline in total costs of 41.4 percent, and an expected increase in marginal costs of 42.9 percent. An expected marginal cost increase of 42.9 percent comfortably exceeds the ACMA calculated real unit cost increase of 28 percent.[31] ACMA is plainly off base to dismiss out of hand the possibility that scale and density effects, in conjunction with factor input changes, could largely explain the observed cost trends in USPS Marketing Mail Flats between 2008 and 2018.

At one point, ACMA goes so far as to claim that the scale of operations has not changed, without citing any supporting data.[32] With respect to mail processing, that claim is clearly contrary to data on mail processing inputs and outputs for flat-related operations. For example, automated flats TPF workload (primarily AFSM100 operations, and excluding FSS) decreased 60 percent from FY 2008 to FY 2018, while workhours (including flat prep) decreased 45 percent over the same period.[33] Similarly,

[31] Assume $Vol_{base} = 100$. $\%\Delta MC = \frac{MC_{new}}{MC_{base}} - 1 = \frac{\varepsilon \times Vol_{new}^{\varepsilon-1}}{\varepsilon \times Vol_{base}^{\varepsilon-1}} - 1 = \left(\frac{Vol_{new}}{Vol_{base}}\right)^{\varepsilon-1} - 1 \xrightarrow{yields} \left(\frac{41}{100}\right)^{0.6-1} - 1 = 42.9\%$.

[32] ACMA Comments at 9.

[33] Relatedly, MPA incorrectly characterizes AFSM workhours as having increased from FY 2017 to FY 2018 by using partial data from AFSM operations. MPA/ANM Comments at 4. Using the correct data, total workhours declined 3.6 percent and workload decreased 5.2 percent (on a constant methodology basis) year-over-year.

measured manual flats TPH workloads declined 54 percent and workhours declined 48 percent from FY 2008 to FY 2018. Moreover, FSS workload declined 16 percent and workhours (including prep) declined 11 percent from the peak year of FY 2012 to FY 2018. Furthermore, ACMA's comparison on page 21 of processing costs for Automation 5-Digit flats between FY 1998 and FY 2018 does not provide a valid basis for concluding that there have been no scale effects, because flats automation technology has changed dramatically over that period. FY 1998 costs were based on lower-productivity FSM881 and FSM1000 flat sorters that are no longer in service, apart from a handful of remaining UFSM1000s.

At several places, ACMA also expresses surprise at the cost difference between USPS Marketing Mail Automation 5-Digit Flats and Letters.[34] In reality, however, cost differentials between these Flats and Letters mainly reflect several known factors. These begin with lower modeled costs for letters, due to higher productivity on DBCS versus AFSM, and higher automation coverage for incoming secondary/DPS distribution. Next, similar magnitudes of proportional adjustment factors (1.31 for letters, 1.358 flats) are applied to the very different modeled costs. Plus, lower fixed costs are identified for letters than flats, largely reflecting lower allied labor costs, which are a foreseeable consequence of letters' smaller average piece size and weight. These relationships should not be surprising.

More generally, the Postal Service believes the appropriate forum for addressing the flats cost issues raised by ACMA and others[35] is Docket No. RM2018-1. The types

[34] *See, e.g.*, ACMA Comments at 21-22.

[35] *See, e.g.,* MPA/ANM Comments at 2-4; Comments of Quad Graphics, Docket No. ACR2018 (Feb. 14, 2019), at 1-2.

of issues that these commenters attempt to raise cannot be adequately addressed, much less resolved, in this docket. Of course, as already explained in the ACR, the Postal Service is constantly seeking operational improvements to process flat-shaped mail more efficiently.[36]

III. Competitive Products

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 Sections 3633(a)(1) and (a)(3) in FY 2018. As noted by Pitney Bowes, and confirmed by the Public Representative, “competitive products were not cross-subsidized by market dominant products” and collectively covered 24.7 percent of institutional costs, which is “more than four times the 5.5 percent minimum.”[37] Several commenters take issue with the Commission’s recently announced final rule relating to the institutional cost contribution requirement, current Commission costing methodologies, and the effectiveness of the Postal Service’s competitive pricing and negotiated service agreement strategies. None of these have any bearing on this proceeding.

A. Criticisms of the Appropriate Share Formula Were Addressed in Docket No. RM2017-1

The American Consumer Institute Center for Citizen Research repeats arguments that it made in Docket No. RM2017-1, criticizing the formula-based approach the Commission adopted in Order No. 4963 and urging adoption of a full cost allocation

[36] FY 2018 ACR at 26-30.

[37] Pitney Bowes Comments at 4-5; PR Comments at 65-66, 71-72.

model.[38] The Small Business and Entrepreneurship Council opines that "a rigid 8.8 percent appropriate share is insufficient" to reflect the "burgeoning segment of USPS overall products" that competitive products represent.[39] These criticisms, of course, either were already raised or could have been raised during the Commission's most recent review of the institutional cost contribution requirement. They are not germane to the Commission's review of competitive products compliance in this proceeding.

Along the same lines, the Taxpayers Protection Alliance asserts that the "net financial position" of the Postal Service "is compromised by the PRC's required minimum institutional cost attribution," arguing that the PRC's cost formulations "implicitly assumed that packages only contributed to 5.5 percent of incremental costs."[40] This argument appears to conflate the cost attribution principles grounded in Sections 3631(b) and 3633(a)(2) with the institutional cost contribution requirement of Section 3633(a)(3). In fact, the Commission's cost formulations are designed to give effect to the requirement that every competitive product cover the "costs attributable to such product through reliably identified causal relationships."[41] When a cost (including an incremental cost) is attributable to a competitive product or set of competitive

[38] ACI Comments at 3-4.

[39] SBEC Comments at 2. Notably, the "8.8 percent appropriate share" to which SBEC refers is not the minimum contribution requirement that applied in FY 2018. The final rule announced in Order No. 4963 does not change the appropriate share values for any prior years. *See* Order No. 4963, Order Adopting Final Rules Relating to the Institutional Cost Contribution Requirement for Competitive Products, Docket No. RM2017-1 (Jan. 3, 2019), at 95. Nor is it "rigid." Instead, the final rule prescribes a formula-based approach to calculate the minimum contribution requirement for the next fiscal year; based on this calculation, the requirement will not necessarily be the same year after year. *See* Order No. 4963, Attachment A. If the new rule had been in effect earlier, Table III-1 in Order No. 4963 indicates that the appropriate share requirement would have been 8.8 percent in FY 2019. Order No. 4963 at 28. In FY 2018 – the year currently under review – the minimum contribution requirement was 5.5 percent.

[40] TPA Comments at 1-2.

[41] 39 U.S.C. §§ 3631(b), 3633(a)(2).

products, the costing methodologies reviewed and approved by the Commission already attribute that cost to the relevant competitive product or products. It is only when a cost cannot be attributed through "reliably identified causal relationships" that it is considered "institutional."[42] In any event, TPA's criticisms of the Commission's cost attribution methodologies and appropriate share rule are outside the scope of this proceeding. TPA does not appear to contend that the Postal Service's competitive products were out of compliance with Section 3633 in FY 2018.

B. ACI's Arguments Relating to Cross-Subsidization and Cost Allocation Are Unsupported and Irrelevant

ACI cites the recent increase in the First-Class Mail stamp price as an indication that profitable letter mail products are subject to "cost, revenue, profit and risk shifting" between market dominant and competitive product lines, somehow resulting in cross-subsidization of competitive products by market dominant products. ACI suggests, further, that the current methodologies used by the Postal Service and the Commission fail to allocate capital expenditures, depreciation expenses, and other costs to competitive products appropriately.[43]

These arguments are entirely without merit. In the FY 2017 ACD, the Commission rejected a similar argument alleging that "price increases for already-profitable First-Class Mail Single-Piece Letters/Cards" were "inappropriately subsidizing other products."[44] Other commenters agree with the Postal Service that competitive

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[42] Order No. 4963 at 138; *see also* 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 2, 43-45.

[43] ACI Comments at 2-3.

[44] FY 2017 ACD at 78-79. *See also* Annual Compliance Determination Report, Fiscal Year 2015, Docket No. ACR2015 (Mar. 28, 2016) (rejecting an argument by ACI that the Postal Service "subsidizes its

products easily satisfied the cross-subsidy test in FY 2018, since competitive product total aggregate revenues exceeded their total group incremental costs by a wide margin.[45] The Commission has also declined to address criticisms of cost attribution and allocation methodologies in past annual compliance reviews, describing the scope of its Section 3653 review as follows:

> The scope of the Commission's ACR review is limited to determining the Postal Service's compliance with rates and services in FY 2017. 39 U.S.C. § 3653(b). During the statutorily-limited time allotted for the Commission to review the Postal Service's ACR and issue its ACD, there are not sufficient resources to explore, in any meaningful depth, issues relating to methods of cost attribution and allocation. Several commenters . . . make broad statements about the adequacy of the cost models used in the ACR and ACD, without any suggestion for improvement.
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> Such broad-based criticisms are not actionable; further, the cost models at issue have been developed under robust litigated proceedings and continually improved and updated over the ensuing decades. Should any party have actionable improvements for costing models and methodologies, the Commission stands ready to evaluate and work to improve the models. *See* Docket No. RM2016-13, Order Adopting Final Rules on Changes Concerning Attributable Costing, December 1, 2016 (Order No. 3641).[46]

In short, the Commission should reject ACI's unsupported arguments relating to cross-subsidization and cost allocation methodologies.

Competitive products with its 'monopoly dollars,' in violation of 39 U.S.C. § 3633(a)(1)") [hereinafter "FY 2015 ACD"].

[45] PR Comments at 65-66; Pitney Bowes Comments at 4 (citing FY 2018 ACR at 68, Table 20); *see also* Notice of the United States Postal Service of Revisions to Certain Pages of the FY 2018 Annual Compliance Report – Errata, Docket No. ACR2018 (Feb. 11, 2019) (adjusting the group incremental cost reported on p. 68 and Table 20, but showing that group incremental costs remained well below total competitive products revenue).

[46] FY 2017 ACD at 94. *See also* FY 2015 ACD at 93 (rejecting arguments by ACI that the Postal Service "circumvents the requirement that Competitive products cover their attributable costs by attributing only a limited portion of costs to Competitive products" rather than "accurately and completely allocat[ing] all of its costs").

C. The Critiques Offered by the Taxpayers Protection Alliance Have No Bearing on Competitive Products' Compliance with Section 3633

TPA refers to language it claims the Commission included on "page 29 of the ACR," defining Negotiated Service Agreements (NSAs) and reciting the requirements of 39 U.S.C. Section 3622(c)(10).[47] It is unclear where the Commission actually made these statements, since of course the ACR is prepared by the Postal Service, and the referenced language does not appear anywhere on page 29 of the Postal Service's submission.[48] In any event, the requirements of Section 3622(c)(10) apply only to NSAs for market dominant products. Competitive product NSAs are governed instead by the provisions of Section 3633. Although it questions the wisdom of the Postal Service's overall strategy for competitive NSAs and other contracts, TPA does not contend that those agreements violate Section 3633 or any other relevant provisions. As a result, TPA's arguments concern matters of pricing strategy that are simply irrelevant to this proceeding.[49] The Commission's role in the ACR docket is to determine whether competitive products, including NSAs, comply with the PAEA and associated regulations. It should not speculate as to whether the Postal Service could have entered into a different set of contracts with terms TPA believes would have been more beneficial.

[47] TPA Comments at 1.

[48] The Commission did refer to Section 3622(c)(10) on page 30 of the FY 2018 Annual Report to the President and Congress, where it discussed the now-terminated market dominant NSA with PHI Acquisitions, Inc. Annual Report to the President and Congress, Fiscal Year 2018 (Jan. 10, 2019), at 30.

[49] TPA's critiques of the Postal Service's reselling program and associated contracts with PC Postage providers, *see* TPA Comments at 2-3, similarly raise issues of business judgment and channel partner strategy that are outside the scope of this compliance review.

IV. International Competitive Products

With respect to International Ancillary Services and Outbound International Insurance, the Public Representative "agrees that 'precipitous' price increases should help improve cost coverage, but suggests they may still be insufficient to bring Outbound International Insurance into compliance with the 39 U.S.C. 3633(a)(2), considering the current level of the product's cost coverage."[50] The cost coverage for Outbound International Insurance increased from 55 percent in FY 2017 to 66 percent in FY 2018, which reduced the corresponding shortfall from $2.1 million to $1.2 million. This was largely the result of two actions taken by the Postal Service.

One, the Postal Service proposed, and the Commission approved, a new treatment of indemnities in Docket No. RM2018-9 (Proposal Six), which largely explains the 30 percent reduction ($1.1) million of indemnities assigned to Outbound International Insurance. Two, price increases for insurance fees for Priority Mail Express International (PMEI) and Priority Mail International (PMI) of 4.0 and 3.9 percent, respectively, were established on January 21, 2018. The revenue impact of these increases were mitigated by the fact that they were only in effect for roughly two-thirds of FY 2018. In FY 2019, however, prices for insurance fees for PMEI and PMI have recently risen precipitously, in excess of 20 percent. The Postal Service believes that the change in treatment of indemnities, in conjunction with the sharp increases in insurance fee prices for PMEI and PMI, provides a reasonable prospect that the cost coverage for Outbound International Insurance will be greater than 100 percent in FY 2019.

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[50] PR comments at 69-70.

The Public Representative states, as she did previously in Docket No. ACR2017, "that relatively high volatility of IOCS-based unit cost estimates could be another major cause of insufficient cost coverage," and goes on to suggest that "the Postal Service provide additional information regarding the reliability of the cost coverage estimates for Outbound International Insurance."[51] The Postal Service is in the process of responding to Chairman's Information Request No. 17, Question 4, which concerns "the total number of In-Office Cost System (IOCS) tallies, the coefficient of variation for the IOCS-based cost estimate, and the 95 percent confidence interval for the cost coverage of Outbound International Insurance."[52] In the ACR, the Postal Service noted that prices in the first quarter of FY 2018 predate the January 21, 2018 price change, which included price increases for PMEI and PMI insurance fees of 4.0 percent and 3.9 percent, respectively, and noted that "prices are set to rise precipitously in January 2019, in excess of 20 percent."[53]

V. Service Performance, Customer Satisfaction, and Consumer Access

A. The Postal Service Has Provided Detailed Plans for Improving Service

Several parties observe that service performance in FY 2018 fell short of most targets and, in some cases, declined from prior levels.[54] The Postal Service

[51] PR comments at 69.

[52] Chairman's Information Request No. 17, Docket No. ACR2018 (Feb. 22, 2019).

[53] FY 2018 ACR at 72.

[54] *See, e.g.*, ACI Comments at 1 ("… USPS fell short of objectives for all segments of First-Class Mail.""); NPPC Comments at 2 ("The Postal Service admittedly did not achieve its performance targets for any category of First-Class Mail."); NAPM/Idealliance Comments at 6 ("Although service performance in some FCM categories has improved since FY2015, service performance for all categories is still below FY2014 levels."). ACI's Comments (at 1) acknowledge that operational window changes have affected service

acknowledged this itself in the ACR.[55] Notably, this followed on two consecutive years of improvements in service performance, and more importantly, the Postal Service has outlined specific steps it is taking to reverse the declines.[56] In this regard, the Public Representative finds that the Postal Service complied with the Commission's directives to provide with its ACR detailed and product-specific plans for improving service performance.[57]

Further, to the extent that parties seek additional data to diagnose service performance issues, the Commission in its FY 2017 ACD already directed the Postal Service to produce granular and disaggregated statistics on separate causes and effects impacting its First-Class Mail performance,[58] and the Postal Service has done so.[59]

NAPM and Idealliance's suggestion of a methodology change to exclude performance data from measurement in subregions affected by natural disasters, if such a general methodology can be developed, may indeed eventually allow more usable

performance in the past, but the Postal Service disputes the characterization that any known cost savings initiatives have been conducted with an "intentional" purpose of "service deterioration." *Id*.

[55] FY 2018 ACR at 47.

[56] *See, e.g.*, ACR at 47-48 ("This will include improved software to generate better daily operational plans, the development and deployment of more precise tools, such as Informed Visibility, to scan and track mail at each step of the delivery process, and augmented use of visualization tools, such as the Run Plan Generator ("RPG"), the freight house visualization tool, and huddle boards. These tools should also promote and enhance open team communication. Other operational changes will include increasing the amount of advanced mail (mail processed ahead of schedule – *e.g.,* making 3-day delivery into 2-day delivery and 2-day delivery into 1-day delivery), improving cycle time, and scheduling additional audits and reviews. Increased emphasis is being placed on dispatch discipline in FY 2019"); *see also* USPS-FY18-29, "Annual Report on Service Performance for Market Dominant Products" (detailing specific initiatives).

[57] PR Comments at 13.

[58] FY 2017 ACD at 147-49.

[59] USPS-FY18-29.

year-over-year comparisons.[60] The Postal Service will be working on an initiative in FY 2019 to identify mail impacted by unforeseen events outside of its control. This initiative will utilize a data driven approach to identify and flag mailpieces impacted by unexpected events such as weather or other events outside of the Postal Service's control. Using this intelligence, the Postal Service will be able to more accurately quantify impacts from these events and diagnose service failures. Furthermore, the ability to categorize the impacted mailpieces will enable the Postal Service to report on service performance – with impacted pieces included, and with impacted pieces excluded.

B. The Postal Service Continues to Seek Higher Customer Satisfaction

The Postal Service takes seriously the need to listen to its customers and provide them with the highest levels of service and satisfaction across all classes of mail. Accordingly, it carefully reviews the results of its customer surveys, and is also considering the customer satisfaction-related comments made by outside parties in this docket.

NPPC notes specific concerns with Large Business (LB) customers as reflected in the LB Panel survey, and also alleges that the Postal Service has eliminated that survey for FY 2019.[61] In fact, the Postal Service made the decision to continue fielding

[60] NAPM/Idealliance Comments at 7.

[61] Comments of the National Postal Policy Council, Docket No. ACR2018 (Feb. 14, 2019), at 7-9 [hereinafter "NPPC Comments"].

the LB Survey to large business customers in FY 2019; there are no plans to eliminate the fielding of this survey.[62]

NAPM and Idealliance observe the reported decline in customer satisfaction with Market Dominant products by various customer groups, and claim the Postal Service has not identified the factors impacting satisfaction for LB mailers. They urge a change in future surveys to examine satisfaction by product type and measure for satisfaction with mail delivery times.[63] In response, the Postal Service notes that it performed a preliminary analysis of factors driving customer satisfaction among large business customers, which includes (but is not specific to) mailers; these factors are listed as drivers of overall satisfaction in the ACR.[64] Further, the Postal Service tracks customer satisfaction by product type by asking LB customers questions about product satisfaction for each product they use; this information appears at Table 19 in the ACR.[65]

The Postal Service seeks to continuously improve its understanding of customer sentiment among large business customers and will take NAPM and Idealliance's feedback into consideration. Although the Postal Service recognizes that it must perform further research to understand large business customers' experience, there are

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[62] NPPC also raises a number of complaints about decisions that the Postal Service has made, but none of these are relevant to the Commission's task in this docket. As noted above, the Postal Service takes seriously its commitment to listen to its customers, and will continue to work to ensure that processes exist that enable robust and open dialogue with mailers. As one example, the Move Update change from 2017 that NPPC raises concerns about was implemented following an extensive notice and comment process (as well as review by the Commission). In addition, while NPPC raises concerns about the shifting of costs to mailers through changes to mail preparation requirements, that is the subject of a separate proceeding (RM2018-11), and in any event the Postal Service has no incentive to impose onerous or unreasonable mail preparation requirements on mailers.

[63] NAPM/Idealliance Comments at 7-8.

[64] FY 2018 ACR at 59.

[65] FY 2018 ACR at 57.

currently other tools in place that help gain insight as to how major customers view their customer experience with the Postal Service and how to enhance products and services. These tools include direct interaction with mailing and shipping associations, use of the Business Service Network (BSN) and Sales organization to obtain relevant feedback directly from customers, and the leveraging of other outreach channels (for example, the Postal Customer Council (PCC) network and the National Postal Forum (NPF)). The Postal Service utilizes this information to develop actionable insight to improve product performance, develop training, and monitor effectiveness.

In addition, the Postal Service uses numerous communication channels to inform mailers about changes in regulations and service updates, including information about software releases and other data or technical matters. The Postal Service also works closely with the mailing industry to identify opportunities for optimization and simplification, including those related to mail preparation and entry requirements.

The Public Representative states that it is now “less feasible” to compare FY 2018 customer satisfaction scores with those for FY 2017. The Postal Service is committed to measuring customer sentiment across all customer touchpoints, and in doing so making necessary updates to survey language or methodologies to reflect best practices. While this may make year-over-year comparisons inexact, the alternative would be a survey that is not up to date. In addition, as noted in the Postal Service’s recently-filed reply to the Public Representative’s comments on the FY 2018

Performance Report and FY 2109 Performance Plan, survey results at the Composite Index level are comparable for the years FY 2015 – FY 2019.[66]

The Public Representative is encouraged that many scores were close to target, but is still disappointed that customer satisfaction has generally declined, including a "noticeable decline" in customer satisfaction for delivery of market dominant products.[67] With respect to the Delivery survey, the Postal Service is dedicated to improving on-time delivery and delivery to the correct address, which are top drivers to improving customer experience. The Postal Service is also committed to improving the customer experience through customer feedback and will continue to closely monitor customer satisfaction scores across the survey portfolio.

The Postal Service appreciates the Public Representative's recognition that wait time in line decreased in FY 2018, as well as wait time in line's importance for both customer satisfaction and customer access.[68] The Postal Service plans to build on this improvement in FY 2019.

C. Adjustments to Maintain the Proper Level of Customer Access Remains a Priority for the Postal Service

The Postal Service recognizes that customer access to its services and products, in all forms (including brick and mortar retail facilities, rural carrier assistance, *usps.com*, Informed Delivery, etc.), is critical to ensuring that mail remains a vital, economical

[66] *See* Docket No. ACR2018, United States Postal Service Reply Comments Regarding FY 2018 Performance Report and FY 2019 Performance Plan (February 22, 2019), at 6.

[67] PR Comments at 23-27.

[68] *Id.* at 20-21.

means of communication. This requires careful attention to and evaluation of all mail channels to maintain an efficient, useful postal network.

The Greeting Card Association notes its concern with the continued decrease in the number of street collection boxes (aka “blue boxes”) in FY 2018, claiming this decrease may violate 39 U.S.C. § 403(b)(3).[69] GCA also cites to three Postal Service Office of Inspector General (OIG) reports criticizing a general lack of posted advance notice required when a blue box is being considered for removal.[70] GCA suggests the Commission insist that the Postal Service explain in more detail how its blue boxes are managed and removed, how to improve customer access to boxes, how it is addressing issues raised by the OIG, and how it considers customer concerns in this area.[71] The Public Representative notes the smaller decrease in blue boxes and commends the Postal Service’s continued density testing of boxes.[72]

In response, the Postal Service notes that sections 303 through 315 of the Postal Operations Manual (POM) explain the general rule that collection boxes averaging fewer than 25 pieces of mail per day should be relocated or removed. For decades, the installation and removal of the Postal Service’s blue collection mail boxes from streets across the country has been based on mail volume received in those boxes. Historically, mail boxes have been removed for lack of use and installed in growth areas. When a collection box consistently receives very small amounts of mail, efficiency suffers in the form of fuel and workhours for carriers to service the mailbox. It

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[69] GCA Comments at 1-2.

[70] *Id.* at 3-4.

[71] *Id.* at 4-5.

[72] PR Comments at 19-20.

is also important to note that all customers with a residential or business mailbox can use it as a vehicle to send outgoing mail.

In the past few years, greater emphasis has been placed on stabilizing the number of collection boxes in use and relocating low-use boxes to high traffic areas such as shopping centers, business parks, and grocery stores, for increased customer convenience. Routine density tests are conducted at least annually to determine if a collection box is being utilized effectively. The decision to remove a mailbox is made on a case-by-case basis: if, for example, that mailbox is the only means for sending a letter or other correspondence in a neighborhood, business center, or senior citizen complex, the Postal Service would likely decide to keep it there. Density tests are aimed at sampling a time frame where a normal, average mail volume would be received (not low or high volume but typical volume).

When the decision is made to remove a collection box, a sign is posted on the box for a period of 30 days prior to the date of removal to notify prospective customers. The sign also directs customers to the nearest collection box location. In addition, POM 313.23 advises the Postal Service to determine customer preference for blue box locations. One significant contributor to the reduction in total counts of collection boxes is that in prior years, the Postal Service often staged multiple boxes at select high volume addresses to assist with sorting: one box specified stamped letters only, another metered letters, and a third flats. In today's mailing environment this sort of configuration is rarely needed.

Collection Boxes are managed via the Collection Point Management System (CPMS). The version of CPMS that was in effect during the mentioned OIG audits had no means of tracking collection points from creation to deletion. Collection point removals from the application could be made with little accountability, and the application provided no methodology for managing and addressing collection points marked as “out of service” (OOS). CPMS has since been upgraded and enhanced. The application now provides the means to track collection points from creation to deletion. Phase 1 of the CPMS enhancement was implemented in August 2018; phase 2 went live in October 2018. These changes have brought full accountability and visibility to vital CPMS processes, in particular collection point deletions as well as the managing of the OOS designation in CPMS.

In addition, the Postal Service’s City Delivery department developed and implemented a National Standard Operating Procedure (SOP) for Collection Boxes that requires the Area Manager Delivery Programs Support (MDPS), Area CPMS Coordinator, Manager, Operations Programs & Support (MOPS), Manager Post Office Operations (MPOO), District CPMS Coordinator, and the Postmaster/Station Manager to periodically review collection points listed as out of service and, as appropriate, take action to ensure that this designation is used for collection points that are out of service temporarily.

The Public Representative notes that the largest recent decrease in retail facilities was in non-postal-managed properties, such as Village Post Offices (VPOs) and Contract Postal Units (CPUs), which she asserts have experienced a decline of 679 since FY 2015. Because of the Commission’s stated concerns about alternative retail access, the Public Representative has asked about the impact of these decreases on customer access. The Postal Service would note in response that, while VPO and CPU numbers have admittedly decreased in recent years, it continues to develop and promote the use of alternative access channels, including *usps.com*, a new generation of improved and enhanced Self Service Kiosks (SSKs), Click & Ship, and PC Postage.

In addition, while acknowledging the Postal Service's recent information request responses, the Public Representative urges the Postal Service to resolve discrepancies in reporting the numbers of these non-postal-managed retail facilities.[73] In its response to Chairman's Information Request No. 9, Question 1, the Postal Service explained that it uses a facilities database that allows for updates beyond the end of the fiscal year. This allows for more accuracy in tracking of the status of non-postal-managed retail facilities like VPOs and CPUs, but can result in changed numbers over time, as new updates are input to the database.

Finally, the Public Representative comments on the "marked improvement" in the decrease in the number of suspended Post Offices, noting a 43 percent reduction since the beginning of FY 2017. While the Public Representative also observes that the Postal Service fell short of its suspension reduction goal from the FY 2017 ACR, she describes the staffing and related changes the Postal Service plans to implement to better address suspensions as reasonable.[74]

VI. Conclusion

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

[73] *Id.* at 16-17.

[74] *Id.* at 17-19.