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

Section 701 Report | Docket No. PI2016-3

COMMENTS OF THE
NATIONAL ASSOCIATION OF PRESORT MAILERS
(June 14, 2016)

Pursuant to Order No. 3238, the National Association of Presort Mailers (NAPM) respectfully submits these comments to inform the Postal Regulatory Commission's second report to Congress under section 701 of the Postal Accountability and Enhancement Act (PAEA).

Order No. 3238 invited comments on a number of different issues, including: (1) the Postal Service's financial situation, (2) rate and service issues for market dominant products, (3) nonpostal services, and (4) the postal monopoly. NAPM's specific comments on each of these topics are detailed below. As a general matter, the PAEA is working and has achieved its objectives. While there is room for refinement and improvement in certain areas, the core elements of the PAEA and the modern rate system should be preserved to ensure the continued viability of affordable mail service and an efficient and effective U.S. postal system.

NAPM's membership includes 90 company members representing 136 mailing sites mailing in 36 states. NAPM represents mail owners preparing their own mail and mail service providers that commingle client mailings, as well as vendors to the mailing industry. Our members interact with, and collect mail from, tens of thousands of mail consumers and combine their mail together to present it as a single mailing to the Postal Service so that the client can receive the benefits of workshare postage discounts with minimal involvement with the complex mailing standards required by the Postal Service. Collectively, NAPM represents approximately 40 percent of the total presorted First-Class Letter Mail volume.

The members of NAPM have been valued partners with the Postal Service, delivering high quality mail to the Postal Service with accurate addresses, high quality barcodes, and high density preparation levels, transported and entered where the Postal Service wants it, bypassing many initial processing functions. NAPM members are committed to ensuring this mail remains profitable and in the postal system. We are true partners with the Postal Service: we sell its products, our customers are its customers, and just like the Postal Service, without mail we don’t have a business.

I. Postal Service Financial Condition

The Postal Service’s financial situation has recovered significantly since the last 701 Report. Net operating income has improved. The Postal Service has experienced successive years of positive operating income and cumulative controllable operating income in the ten years since the PAEA was passed is positive. The Postal Service’s cash position is also the strongest it’s been in nearly 10 years. The Postal Service’s business is healthier. Volume declines for First-Class Mail Presort Letters have leveled off and, in some cases, have shown small volume growth. Standard Mail Letters volume also has stabilized. The Postal Service’s competitive shipping business has demonstrated sustained double-digit volume growth and is gaining market share. And the Postal Service’s digital integration strategies are beginning to take root; additional innovation around its core postal products is likely to yield new volume growth.

Despite these improvements, the Postal Service continues to face substantial financial challenges associated with its unfunded liabilities for pension and retiree health benefits. These challenges stem from Congressional requirements that impose unrealistic prefunding requirements for retiree health benefits, prevent the Postal Service from integrating its health benefits program with Medicare, prevent the Postal Service from prudently investing its pension fund assets, and prevent the Postal Service from calculating its liabilities on the basis of postal-specific actuarial assumptions. Legislative proposals to address each of these issues have been developed and are widely supported by the Postal Service, the mailing industry (including NAPM), and postal labor. The Commission should recommend in its 2016 report that Congress act on these proposals.

Congressional financial relief is necessary, but not sufficient. The Postal Service must exercise its authority under existing law to drive out costs and improve efficiency. The Postal Service reduced its costs as mail volumes fell, but more is required. NAPM's members are concerned that cost cutting measures have stalled. This concern was recently echoed by the Government Accountability Office when it cited "growing expenses" and "no new major cost savings initiatives are planned" as two of the contributing factors to the Postal Service's financial challenges:

> *Growing Expenses*: While mail volume has declined, USPS's operating expenses have been rising. USPS reported that its key operating expenses grew in fiscal year 2015—notably salary increases for unionized employees, as well as additional work hours, in part due to a 14.1 percent growth in shipping and packages, which are more labor intensive to process. Despite efficiency initiatives such as consolidation of 36 mail-processing facilities in 2015, total employee work hours increased, and the size of USPS's career workforce increased slightly in fiscal year 2015—the first increase in the size of the career workforce since fiscal year 1999. Compensation and benefits comprise close to 80 percent of total USPS expenses. Thus, expenses will further grow if increases in salaries and work hours continue. According to USPS, increases in compensation and benefits costs (primarily from increased wages) will add $1.1 billion in additional costs in fiscal year 2016.
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> *No new major cost-savings initiatives planned*. USPS has no current plans to initiate new major initiatives to achieve cost savings in its operations.[1]

[1] Written statement of Lori Rectanus, Director, Physical Infrastructure Issues, U.S. Government Accountability Office, House Oversight and Government Reform Committee Hearing "Reforming the Postal Service: Finding a Viable Solution," Wednesday, May 11, 2016 at pp. 4 and 8.

The Postal Service must continue to reduce its costs by eliminating excess capacity. As discussed in more detail below, the Postal Service could also improve its financial position by using its pricing authority to reduce costs and drive efficiency.

II. Market Dominant Rate System

A. CPI Price Cap

NAPM is in agreement with the majority industry opinion that the CPI cap, the cornerstone or centerpiece of the modern rate system, is working and has proved effective in achieving the objectives of the PAEA. The CPI cap has provided rate stability and predictability. The CPI price cap has ensured that postage prices for monopoly products remain affordable. The CPI price cap has also functioned as it was intended by imposing much-needed discipline on Postal Service costs and efficiency. Measured against these metrics, the CPI price cap has been effective.

NAPM's members strongly believe that but for the constraint of the CPI price cap, the temptation to raise prices on mailers during the recession would have been overwhelming. But raising prices on mailers would have compounded the negative effects of the recession on mail volume losses because the Postal Service's financial challenges are derivative of the financial challenges facing the mailing industry.

Accordingly, NAPM urges the Commission to reaffirm its finding from the 2011 701 Report that: "the annual rate limitation for market dominant products as expressed by the price cap has kept prices stable and predictable since the passage of the PAEA." 2011 701 Report at 28. And, therefore, to conclude again that: "[b]ased on that experience, the Commission finds that no legislative changes are needed with respect to the price cap." *Id*. at 39.

The 2011 701 Report also addressed issues regarding service impacts and cost shifting under the CPI price cap. NAPM supports the Postal Service's efforts to achieve operational efficiencies and leverage new technologies to improve service and increase the value of mail. However, to the extent Postal Service initiatives increase the costs of mailing (compliance costs, operational costs, development costs), those costs must be balanced with a commensurate increase in value for the mailers and their end customers. Reduced service standards/performance and cost shifting are effective rate increases and can be used to evade the protections of a price cap.

To protect the integrity of the CPI price cap, service standard changes and cost savings programs should be subject to Commission approval. For changes with substantial economic effects on the mailing industry, the Postal Service should be required to:

(1) Develop, and publish in the *Federal Register*, comprehensive strategic and tactical plans;

(2) Provide an effective plan with identified resources (personnel and budgeted funds), including contingency processes that require minimal engagement and “cost” to the mailer;

(3) Conduct and publish a cost / benefit analysis, including estimated compliance and ongoing maintenance costs for mailers; and

(4) Identify a predetermined “bailout” point based on costs to terminate a program.

These are minimum requirements for businesses operating in a dynamic environment where disruptive technologies and changing economic conditions can impact strategic decisions. Ineffective strategic designs and the lack of tactical implementation plans can negatively impact the costs to mailers to implement or support new initiatives and programs. Missed or continued slippage of implementation dates causes mailers to lose confidence in programs and impacts capital investments. Publication of clear, advance standards helps all stakeholders understand the “rules of the road;” and better understanding will drive more efficient adoption and compliance.

To further encourage the Postal Service to drive efficiencies in its operations and improve service performance, the Commission should also revisit the concept it addressed in its 2011 701 Report:

> *Congress should consider allowing the Postal Service to obtain increased pricing flexibility for quality of service enhancements. Congress could legislatively provide additional rate adjustment authority to the Postal Service if it increases the quality of its service performance for a particular class of mail. Such service quality pricing authority would provide an incentive for the Postal Service to increase the service performance of its products. Currently, there are no direct financial incentives for the Postal Service to increase the service performance of its products and services*.

2011 701 Report at 48.

NAPM thinks that concept of additional rate adjustment authority for improvements in service quality should be further explored to incentivize more effective cost cutting initiatives. As the Commission correctly observed, such a change would have to be made by Congress because the PAEA explicitly requires the use of the CPI price cap. 39 U.S.C. 3622(d)(1)(A).

B. Rate Design and Workshare Pricing

The Postal Service should be required to use its existing pricing authority to reduce costs, grow mail volume, and increase operational efficiency. The Postal Service's use of its pricing flexibility under the PAEA has been a disappointment. With the exception of the Intelligent Mail barcode discount and the adoption of a separate meter rate to provide a more accurate presort benchmark rate, there have been few examples of strategic, policy-based pricing differentials designed to grow volume or drive efficiency. There have been too many instances in which the Postal Service has used its pricing flexibility in ways that will decrease the mail volume of its most profitable market dominant products and which frustrate operational efficiency.

Two long-standing and persistent rate design flaws in First-Class Mail illustrate this point: (1) above-average increases imposed on Presort mail, and (2) the failure to passthrough the full value of the workshare-related costs avoided.

First-Class Mail Presort Letters mail volumes have trended more favorably for the Postal Service than Single-Piece volumes; Single-Piece volumes continue to decline, while Presort volumes are holding flat or trending positive. Presort mail is also significantly more profitable, than Single-Piece on a unit contribution basis and delivery standards are better for Presort mail than Single-Piece. Accordingly, the Postal Service should be doing everything it can to grow Presort mail. Yet a pattern of recent disproportionate price increases on Presort relative to Single-Piece discourages the use of Presort mail. The Postal Service should not use its pricing flexibility in a manner that is financially self-defeating.

Workshare pricing is another area that has fallen short. The Postal Service has consistently set workshare passthroughs in First-Class Mail Presort Letters well below the level of avoided costs. As a result, more efficient mailers and mail service providers are excluded from performing work that they could perform at a lower cost than the Postal Service. The result is higher costs for mailers, decreased mail volume, and productive inefficiency.

The Commission notes that the PAEA does not require the USPS to set workshare discounts to pass through 100 percent of the costs of preparing the mail, and states that "[l]egally, workshare discounts are only bound by this ceiling; the Postal Service is not bound by this provision to increase a workshare discount that is less than avoided costs." Order at 6.

This statement ignores the fact that the Commission has the authority to legally require the Postal Service to increase workshare discounts that are less than avoided costs. It also ignores the Commission's responsibility to establish and design a modern rate system that is designed to "maximize incentives to reduce costs and increase efficiency," 39 U.S.C. 3622(b)(1)(the Commission itself has consistently recognized that setting discounts below avoided costs sends inefficient price signals), to "assure adequate revenues," 39 U.S.C.

3622(b)(5)(setting discounts below costs fails to minimize costs; the Postal Service is losing money on every piece of mail it sorts that could have been sorted by a more efficient workshare partner), to "establish and maintain a just and reasonable schedule," 39 U.S.C. 3622(b)(8)(setting discounts below costs is anticompetitive). It also ignores the Commission's responsibility to establish a system that takes into account the "degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service," 39 U.S.C. 3622(c)(5)(setting discounts below costs fails to recognize and reward the degree of preparation performed by the mailer), the "importance of pricing flexibility to encourage increased mail volume and operational efficiency," 39 U.S.C. 3622(c)(7)(setting discounts below costs increases the effective price of mail thus depressing mail volume and it fails to encourage operational efficiency), the "need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services," 39 U.S.C. 3622(c)(12)(setting discounts below costs fails to encourage efficiency or reduce costs, it perpetuates excess infrastructure and labor capacity).

The Commission can and should adopt a rule directing the Postal Service to set a soft floor for workshare discounts. Such a rule would be consistent with the statutory objectives and factors of the PAEA, it would also improve operational efficiency and lower total mailing costs.

III. Nonpostal

Order 3238 requests comments regarding "whether the Postal Service should be permitted to offer [nonpostal services]." Order at 9. NAPM is concerned that commercial initiatives unrelated to the Postal Service's core mission of physical mail delivery will divert scarce management attention and resources and mail service will suffer. The Postal Service's history with commercial nonpostal services has not been positive. Prior commercial ventures were not profitable and frequently raised concerns about the potential abuse of government-sponsored competition in private, commercial markets.

The Postal Service should be encouraged to focus on innovative new postal products. The Commission must, however, ensure fair competition for all new products, especially when the Postal Service offers "no cost" solutions that directly compete with existing industry solutions. Several recent examples include the Every Door Direct Mailing (EDDM) product, the Intelligent Mail Small Business (IMSb) tool, Delivery Visibility, and the recently announced Political Mail Dashboard. Each of these products is being offered at no cost by the Postal Service in competition with existing commercial solutions. This is unfair because: (1) these products are being sold below costs, and (2) mailers and mail service providers are being forced to finance with monopoly rents the development of products that are being sold by the Postal Service below cost in the market.

IV. Postal Monopoly

Order 3238 requests comments on recommended changes to the postal monopoly. Order at 12. NAPM does not recommend any changes to the postal monopoly. The Postal Service continues to operate as a valuable public resource, offering universal, affordable mail service to every household in America. NAPM members and their customers rely on and finance this vital public service. NAPM urges the Commission, however, to reaffirm the importance of the Commission's role as an independent regulator. As long as the Postal Service remains a government entity with a statutory monopoly, a strong, independent regulator is essential.

The NAPM appreciates the Commission’s consideration of these comments.

Respectfully submitted,

National Association of Presort Mailers

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