

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Annual Compliance Report, 2016

Docket No. ACR2016

**INITIAL COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE**

(February 2, 2017)

Pursuant to Order No. 3027, the Association for Postal Commerce (“PostCom”) submits these comments on the Annual Compliance Report (“ACR”) for Fiscal Year 2016 filed by the United States Postal Service (“Postal Service”) on December 29, 2016. While PostCom does not contest the Postal Service’s compliance with its statutory responsibilities in FY 2016, the information presented in the ACR nevertheless raises several concerns of which the Commission should be aware. In short, the concerns PostCom expressed in its comments on the FY 2014 and FY 2015 ACRs have not been addressed—the Postal Service continues to make decisions that impose additional costs on mailers without creating corresponding efficiencies in the postal network, causing costs to both the Postal Service and the industry to continue to rise. Moreover, as indicated in its reporting on service, the Postal Service – while achieving improvements in service over FY 2015 – is still below target levels in nearly every category. PostCom urges the Commission to remain cognizant of this dynamic as it evaluates and makes recommendations regarding cost coverage and workshare discounts reported in the ACR.

**I. THE IMPORTANCE OF TRANSPARENCY IN REPORTING**

The circumstances of this year’s compliance review are somewhat unusual as issues raised during the FY 2015 ACD still await resolution. While that need not preclude the

participants in this year's review from commenting on the Postal Service's report – or prevent the Commission from performing its review – the ongoing pendency of the 2015 ACR raises issues that should be addressed. For instance, in 2015 PostCom pointed out that:

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

Initial Comments of the Association for Postal Commerce, Docket No. ACR2015, at 1. As workshare incentives continue to erode, PostCom reiterates this point and calls attention to the fact that a proposed methodological change under consideration in RM2016-12 would possibly exacerbate this problem.

PostCom appreciates the efforts of the Commission to increase the quantity and quality of cost information provided by the Postal Service as well as to consider new approaches to resolving open issues. For example, the October 21 technical conference was a welcome effort to improve the exchange of relevant technical information on service and costs. In the event that written comments and reply comments identify similar issues in the 2016 data, PostCom endorses a similar approach.

PostCom notes the continued issuance of Chairman's Information Requests (CHIR) in this proceeding as helpful in identifying missing and potentially helpful contextual information. As a general principle, PostCom endorses all efforts to increase the transparency of the ACR process with regard to identifying relevant cost and cost avoidance estimates, operational performance data, and service information.

## **II. VOLATILITY IN COST ESTIMATES HAS IMPORTANT MARKET IMPLICATIONS**

In addressing workshare incentives that exceed 100 percent passthroughs, the Postal Service identifies a number of instances where cost avoidance estimates exhibit a troubling

pattern. For example, when discussing the First-Class Mixed AADC Automation Letters passthrough, the Postal Service notes that “[i]n FY 2016, the cost avoidance increased by 75 percent to 5.8 cents, up from 3.3 cents in FY 2015; between FY 2014 and FY 2015, the cost avoidance decreased by 28 percent, from 4.6 cents to 3.3 cents.” ACR at 14. Without additional information, it is unclear what is behind such fluctuations. While the Postal Service helpfully acknowledges that inefficient price signals would be sent by blindly tying price incentives to wild cost swings, they stop short of attempting to explain how and why these swings occur.

PostCom suggests that, when presenting estimates of cost avoidance, the Postal Service could provide standard errors or confidence intervals to help participants better understand the reliability of the cost estimates used in setting and analyzing workshare incentives. This is especially important to customers who have to plan capital investments over a multi-year time horizon. The Postal Service’s commitment to take into account rate shock helps to some extent, but if the CPI were to increase as is expected, the observed volatility in cost estimates would negatively impact the Postal Service’s customers’ ability to plan on future price movements and thereby undermine the predictability envisioned in PAEA.

### **III. PROMISED FLATS EFFICIENCIES HAVE FAILED TO MATERIALIZE**

The shortfall from Standard Mail flats grew to \$620M in FY 2016. While the Postal Service helpfully points out that this is less than the peak shortfall, it fails to properly explain why Standard Mail flats costs grew at 15.7 percent when volume increased by only 10 percent. In addressing FSS performance the Postal Service touts three key operational indicators that will comprise an FSS scorecard intended to identify opportunities for improvement. Tellingly, performance on all three indicators (Throughput per hour, delivery point sequence percentage, and mail pieces at risk) worsened in 2016 when compared against 2015 performance despite

increases in volume. The flats sequencing system can no longer be considered new technology, so it is unlikely that significant productivity improvements should be anticipated from learning curve or experience curve effects. As PostCom pointed out in the still ongoing 2015 ACR proceeding, “The Postal Service, whether intended or not, has altered rate relationships in a way that discourages efficient mail entry. PostCom contends that these inefficiencies manifest themselves in the reduced cost coverage of Flats mail reported in the ACR.” Initial Comments of the Association for Postal Commerce, Docket No. ACR2015, at 1-2.

The inability of the Postal Service to articulate how FSS performance relates to costs is particularly alarming when one considers that while the Postal Service freely commits to above average price increases for flats products (ACR at 26), it makes no such commitment to reductions in flats processing costs. To its credit, the Postal Service acknowledges that “the information generated by the Postal Service’s existing data systems does not support reliable estimates of the impact of operational initiatives on flats costs.” ACR at 28. But now that we are ten years beyond the passage of PAEA, this raises the obvious question, “why not?” It is unclear how the Postal Service expects to make operational decisions that will improve product cost efficiencies when they are unable to measure the causal effects of such decisions. It is truly disappointing that the Postal Service remains largely indifferent to the importance of understanding how its operational decisions impact the costs that it is able to pass directly onto its customers due to its monopoly status.

#### **IV. SERVICE PERFORMANCE CONTINUES TO DISAPPOINT**

As the Commission has noted in CHIR-10, the Postal Service has failed to attain its service targets in most categories. While the Postal Service is able to tout improvements in service relative to FY 2015, it should be noted that FY 2015 saw significant network and operating window changes that resulted in substandard performance. This is one of the inherent

challenges of the ACD: the Postal Service presents its performance results without consideration of context or benchmarks beyond historical comparisons or internally imposed standards. While direct comparisons with other industries might be imperfect, PostCom would argue that consideration of the Postal Service's service performance could be improved by identifying appropriate external standards against which the Postal Service's performance could be measured. As the users of the Postal Service's market dominant products are largely without alternatives, allowing the Postal Service to set achievable targets – and to continually fail to achieve them - puts customers of the Postal Service in an untenable position. With regard to specific shortcomings in the Postal Service's ACR, PostCom notes that:

- The USPS has yet to submit its “audit plan” to the PRC around service performance measurement, which it told the PRC it would provide by end of calendar year 2016.
- The USPS in its ACR highlights select service performance data where performance improvements were made, but does not discuss or recognize the products/areas where performance did not show improvement, or talk about how it plans to improve service for those product groups.
- The USPS' move toward using “composite” performance scores muddies the water in terms of product categories whose scores declined or remained at unsatisfactory levels. We urge the Commission and USPS to reject the use of broad aggregate composite performance scores for reporting purposes. For instance, in its report the USPS says its composite FCM score exceeded that of pre-OWC change while ignoring the fact that very few product categories had that experience.
- The USPS refers to “stretch” performance targets in its ACR (ACR at 70) but does not define what this means or what purposes these targets will have.

- The USPS reduced its goal for MD Package Services (91% to 90%), and added a new performance goal category within Standard Mail called “DDU Entry (Weekly),” with no explanation of what this category is, why it is shown separately (has the same 91% goal as other Standard Mail), and how it will be measured.
- While the USPS mentions improvements in flats service performance, it talks only about FCM flats improvements. PostCom notes that flats service performance overall lags letter service performance by a significant margin.

## **V. CONCLUSION**

PostCom respectfully offers the foregoing comments on the FY 2016 ACR. As noted above, the cost information provided by the Postal Service exhibits inherent volatility that creates the potential for negative customer impact and undermines confidence in the estimates themselves. More fundamentally, PostCom notes that with regard to improving efficiency or service, or understanding the cost implications of operations decisions on costs, the Postal Service continues to exhibit a tendency to do “just enough” to avoid a determination of non-compliance. PostCom respectfully requests that the PRC encourage the Postal Service to improve the transparency of its cost and service information and to commit to work with industry to understand, not just what the estimated costs are, but how operations information can be used to enable better management of product costs.

Respectfully submitted,

*/s/ Matthew D. Field*

Matthew D. Field

Ian D. Volner

VENABLE LLP

575 7<sup>th</sup> Street NW

Washington DC 20004

(202) 344-8281

[mfield@venable.com](mailto:mfield@venable.com)

[idvolner@venable.com](mailto:idvolner@venable.com)

*Counsel for Association for Postal Commerce*