

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

Annual Compliance Report, 2016

Docket No. ACR2016

REPLY COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE

(February 13, 2017)

Pursuant to Order No. 3027, the Association for Postal Commerce (“PostCom”) submits these reply comments on the Annual Compliance Report (“ACR”) for Fiscal Year 2016 filed by the United States Postal Service (“Postal Service”) on December 29, 2016. These reply comments build on PostCom’s initial comments on the ACR and incorporate information that the Postal Service has provided in information request responses since those comments were filed.

I. The Comments Reinforce Concerns Regarding the Postal Service’s Ability to Comply With Applicable Service Standards

PostCom shares the concern expressed by the Public Representative that the overwhelming majority of the Postal Service’s products are not in compliance with the relevant service standards. None of the Postal Service’s First-Class Mail products achieved their performance targets; a condition that – despite improvements relative to FY 2015 – is a persistent feature of the annual compliance report. The Public Representative notes with disappointment that the Postal Service has “provided sparse detail of its efforts to improve service performance in its FY2016 ACR filings. Because the Postal Service’s filings lack detail, and really say nothing new compared with previous years, it gives the appearance that service performance issues are not being taken seriously.” Public Representative Comments at 8.

In response to Chairman's Information Request No. 10, the Postal Service provides the equations used to calculate the composite performance indicators. In using composite indicators, the Postal Service is making the task of understanding service performance more difficult at a time when technology – and the Postal Service's regulations – ought to be enabling greater transparency and granularity with respect to service performance measurement. The Postal Service has invested heavily in equipment designed to enable tracking of individual pieces through its network via passive collection of data enabled by the intelligent mail barcode. In its comments on the FY 2015 ACR, PostCom urged the Commission to direct the Postal Service to make use of the voluminous tracking information it is collecting to improve cost measurement. The same recommendation applies with respect to measuring service performance. The composite indicators as designed obscure service performance on flats products because they account for significantly less volume than letters. When the Postal Service is actively trying to track all pieces through its network there is no legitimate reason to aggregate service performance in this way.

Within Standard Mail, the Public Representative notes that “only High Density and Saturation Letters, and Parcels, exceeded service performance targets” and that while in some respects service has improved relative to FY2015, service for many products – Standard Mail Carrier Route, Flats, and Every Door Direct – performance is substantially below targeted levels. Public Representative Comments at 4.

Unfortunately the story for Periodicals and Bound Printed Matter Flats is largely the same. Actual service performance continues to be well below targeted levels and plausible plans for improvement are sorely lacking. Throughout its comments, the Public Representative reprises recommendations from previous proceedings that the Commission continue – and perhaps

increase – its oversight efforts viz a viz service. PostCom agrees with this sentiment but notes that with previous remonstrations having yielded unsatisfying results, there is limited optimism that the needed improvements in performance and transparency will result.

II. The Commission Should Reject Price Increases for Standard Mail Flats and Should be Cautious About Reducing Workshare Discounts

ValPak argues for significant increases in prices for Standard Mail Flats – and not surprisingly for price reductions for high density/saturation letters - in order to address what it views as inequities in the relative cost coverages of different Standard Mail products. The dramatic price increases that ValPak appears to be advocating are entirely unwarranted, for at least two reasons. First, as ValPak itself addresses in its extensive comments, the substantial inefficiencies in the manner in which flats mail is processed persist. Despite Commission efforts to prod the Postal Service into providing a meaningful plan to address chronic inefficiencies, none is yet forthcoming. PostCom shares ValPak’s concern that the Postal Service’s response to Commission efforts to identify and resolve flats cost problems have been dilatory and unproductive. Indeed the pendency of the outstanding 2015 ACD casts a shadow over the current proceeding; to the extent that USPS might have provided helpful information that would guide participants in the current proceeding, such information is unavailable.

That is one of the reasons ValPak’s explicit call for the Commission to demand significant price increases on Standard Mail flats is premature and ill advised. The R2017-1 price increase will lead to a migration of flats to carrier route presortation, which may improve the efficiency of flats handling. Moreover, efficiency could be further improved if the Postal Service were to take stronger steps toward better leveraging the efforts of the mailing industry and sending appropriate pricing signals regarding where and how mail is entered into the Postal

Service network. It is premature to consider any dramatic price increases until these tools for improving efficient processing have been fully leveraged.

Furthermore, the price increase that ValPak seeks for Standard Mail Flats is unwarranted because it would contravene the core pricing objectives reflected in the Postal Accountability and Enhancement Act (“PAEA”). *See* 39 U.S.C. Section 3622. Among the core objectives of the PAEA are to “maximize incentives to reduce costs and increase efficiency” and to “create predictability and stability in rates.” These objectives necessarily color and inform efforts to ensure that each mail class bear the costs associated with the Postal Service’s processing and delivery of that class of mail. A rate increase of the type advocated by ValPak would cause a substantial amount of rate shock, contravening the goal of predictability and stability in postal rates. To allow such a rate increase would be particularly anomalous given the fact that the Postal Service has ample opportunity to capture efficiency gains through better price signals. Indeed, PostCom submits that such a rate increase would contravene the directive in the PAEA to maximize incentives to reduce costs and increase efficiency. Accordingly, PostCom submits that the Commission should reject ValPak’s demand for a rate hike for Standard Mail Flats.

The Public Representative’s recommendations on worksharing passthroughs should be disregarded for similar, albeit slightly different reasons. Proceeding from the premise that consideration of such exceptions as efficiency and rate shock are temporary in nature, the public representative advocates reducing passthroughs to 100 percent more aggressively. Public Representative Comments at 45. In fact, where price changes necessary to attain the necessary reductions are relatively small, *e.g.* 0.3 cents/piece, the Public Representative suggests a complete “correction” in the next rate adjustment cycle. *Id.* at 49. This suggestion is ill considered for a number of reasons, including one that the Public Representative singles out: the

lag between cost development and price adjustment requires the Postal Service to address non-compliant passthroughs that are based on stale cost information. PostCom agrees that this problem should be addressed, for instance, by basing the ACR on the most recent four quarters of cost data rather than the most recently completed fiscal year.

But there is a more fundamental problem with the Public Representative's recommendation. A too rigid adherence to the 100 percent standard – especially where it would send disruptive price signals – would place strict adherence to a numerical standard above other, more important considerations. Given the volatility in some of the cost avoidance estimates, a lock-step approach to conformity with the 100 percent standard could see prices increasing in one year, decreasing in the following year, only to increase again in the year after that. The Postal Service rightly recognizes the need to take rate shock into account as a statutorily authorized exception that mitigates against potentially harmful price volatility. Further, contrary to the Public Representative's contention, there is nothing in the statute that suggests concerns about rate shock or efficiency to be temporary. Rate shock concerns counsel for a gradual shift in discounts to align passthroughs, such as the Postal Service has generally undertaken. And efficiency concerns could well be long-term or permanent—the true operational cost of processing mail at a certain level may not be reflected in recorded costs, or there may be system needs that dictate mail be entered differently than a strict passthrough analysis would identify as the most efficient manner. These discrepancies may be systemic, not temporary deviations from the norm.

Furthermore, the changing nature of the Postal Service's cost structure is having incentive effects on worksharing that are not yet well understood. Since the passage of PAEA, the proportion of institutional costs has increased significantly. One consequence of this change

is that the total “avoidable” costs on which to base worksharing incentives is reduced.

Remember, the private sector companies who provide transportation, presortation, palletization and other services must respond to price signals based on incremental costs without the luxury of ignoring their own overhead. A too-rapid rush to attain 100 percent passthroughs could have negative efficiency effects that would harm the entire postal system.

Incentivizing the entry of mail farther from its eventual destination or less finely prepared could have important unintended consequences. Moreover, the Postal Service’s service performance is generally better on mail that is entered deeper into the distribution network (it is unlikely that the superior performance for HD/saturation letters is a coincidence). Arguably, the true value of dropship workshare is underestimated based on the relative service performance of products entered at different entry points. Consider that if the Postal Service incurred the costs necessary to attain its service targets irrespective of entry point, cost avoidances from drop ship entry would likely be greater. Sudden and dramatic changes in worksharing incentives could have the unfortunate effect of reducing overall efficiency while simultaneously causing service performance to worsen.

III. Improved Transparency and Clarity in Costing is an Important Output Of the ACR Process

In replying to comments offered by the Public Representative and ValPak, PostCom shares the frustration wrought by the Postal Service’s inability and/or unwillingness to properly respond to the directives and admonitions issued by the Commission in previous proceedings. On the other hand, we recognize that the Commission’s authority is limited and that in balancing the interests of multiple parties, every party to the annual ACR proceeding is likely to feel thwarted at some point. However, with respect to requiring transparency, exhaustiveness, and accuracy in

Postal Service's cost information there appears to be near unanimity that the Commission should continue efforts to require the Postal Service to be more forthcoming in providing cost information and in responding to the Commission's efforts to require the same. With that in mind, PostCom supports UPS efforts to shed light on cost trends that could impact all users of the Postal Service's network.

As UPS points out, on a "per-piece" basis, market-dominant mail attributable costs are trending upwards while competitive mail attributable costs are trending downwards. While the current proceeding is still ongoing, thus far the CHIRs and relevant responses on this issue have not yet satisfactorily explained these trends. For example, total attributable transportation costs for market dominant products increased by more than \$100M in FY 16 despite declines in total pieces and weight for market dominant products. The Commission should continue its efforts to secure satisfactory explanations of these phenomena. As with ValPak, UPS also cites a number of instances where the USPS has thus far either failed to provide requested information or done so in an incomplete manner. PostCom agrees with UPS' suggestion that a technical conference would be a constructive forum for exploring the Postal Service's difficulties in complying with Order No. 3506. PostCom believes that technical conferences of this kind – for example the October 21 technical conference arising from ACR2015 - offer promise as an efficient way to allow parties to interact to resolve technical issues that might otherwise require protractive and costly exchange of written pleadings.

CONCLUSION

As many participants have pointed out, the Postal Service's 2016 ACR is distressingly familiar: exhaustive detail, presented grudgingly, with minimal effort toward meaningful insight

that could enable the Commission to more effectively hold the Postal Service accountable. As many commenters have pointed out, the Commission's pursuit of clarity and transparency in costing and service performance is a vital effort that the Postal Service sometimes appears to attempt to thwart at every turn. As the Postal Service has recently disclosed its intent to pursue elimination of the CPI price cap, the importance of the annual ACD process is arguably greater than ever. PostCom requests that the Commission direct the Postal Service to continue to work closely and in a transparent, collaborative process with the mailing industry to develop processes and incentives that maximize efficiency for the Postal Service and the entire mailing industry.

Respectfully submitted,

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