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

ANNUAL COMPLIANCE REVIEW, 2016	Docket No. ACR2016

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
(February 13, 2017)

In Order No. 3717, the Postal Regulatory Commission solicited comments on the United States Postal Service's Annual Compliance Report ("ACR") for Fiscal Year ("FY") 2017.[1] On February 2, 2017, the Public Representative ("PR") and nine private parties filed comments.[2] The Postal Service hereby submits its reply comments.

I. Scope of ACR Proceeding

As in past ACR dockets, it has become necessary to reiterate the scope of the instant proceeding under the Postal Accountability and Enhancement Act (PAEA). Section 3653 of title 39 directs the Commission to do four things in this docket, two of which relate to compliance and two of which do not. As to compliance, the Commission is charged with determining: (1) whether any rates or fees in effect during the preceding year were not in compliance with chapter 36 and its accompanying regulations; and (2) whether any service standards in effect during the preceding year were not met.[3] Separate from these compliance determinations, the Commission: (3) is directed to

[1] Order No. 3717, Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments, Docket No. ACR2016 (Dec. 30, 2016); United States Postal Service FY 2016 Annual Compliance Report, Docket No. ACR2016 (Dec. 29, 2016) (hereinafter "FY 2016 ACR").
[2] Beyond the Public Representative, parties filing comments (individually or jointly) on February 2, 2017, included the Association of Postal Commerce, American Catalog Mailers Association, National Postal Policy Council (NPPC), Valpak, UPS, Pitney Bowes, National Association of Presort Mailers, Greeting Card Association (GCA), and Major Mailers Association.
[3] 39 U.S.C. § 3653(b).

review whether the Postal Service has met its performance goals; and (4) may advise the Postal Service as to the protection or promotion of the public policy objectives of title 39.[4] While fewer comments fall outside the scope of the ACR this year than in years past, the tendency to stray remains.

It may also be useful to reiterate that the wide scope of comments submitted precludes response to each and every assertion made by the parties. The mere fact that the Postal Service in these reply comments does not address a claim, argument, or opinion expressed in an initial comment should not be construed to suggest that the Postal Service agrees with that claim, argument, or opinion.

II. Pricing and Costing

A. The 2017 Price Differential between Metered and Stamped Letters, Which the Commission Approved in Docket No. R2017-1, Is Outside the Scope of this ACR Proceeding

On January 22, 2017, the Postal Service implemented new rates, which set the price differential between First-Class Mail Stamped Letters and Metered Letters at 3 cents. The Greeting Card Association (GCA) filed comments in this docket requesting that the Commission require the Postal Service to provide additional information justifying that differential.

In general, the Metered Letters rate is intended to encourage small and medium-sized businesses to use meters instead of stamps, with the goals of promoting continued or increased use of First-Class Mail and other meter-eligible products, and reducing Postal Service costs.[5] For example, metered mail saves the Postal Service cancellation costs for Metered letters that bypass the facer canceler process. The

[4] 39 U.S.C. § 3653(d).
[5] United States Postal Service Notice of Market Dominant Price Adjustment, Docket No. R2017-1 (Oct. 12, 2016), at 16-17.

Postal Service also avoids costs associated with stamp production and distribution.

The 2017 price differential between Stamped and Metered Letters is consistent with the provisions of chapter 36 of title 39. The Postal Service provided a rational justification for the Stamped/Metered differential in Docket No. R2017-1, in which GCA raised the same arguments it raises in the present docket.[6] Based on that justification, the Commission approved the Stamped and Metered Letters prices.[7]

Ultimately, however, the 2017 price differential between Metered and Stamped Letters is beyond the scope of the FY 2016 ACR. Section 3653 of title 39 clearly directs the Commission to review rates and fees in effect during the preceding year. GCA has acknowledged as much.[8] The Postal Service and the Commission will be in a better position to analyze the differential in the FY 2017 ACR, when data reflecting the impact of the differential will be available.

B. The Cost Coverage for First-Class Mail Presort Letters/Cards Reflects Cost Reductions Rather than Price Increases

Both Pitney Bowes and the First-Class Business Mailers (Major Mailers Association, National Association of Presort Mailers and National Postal Policy Council) are critical of the cost coverage for First-Class Mail Presort Letters. Pitney Bowes notes that the "FY2016 ACR data confirm that First-Class Mail Presort Letters/Cards remain much more profitable than Single-Piece First-Class Mail Letters/Card,"[9] while the First-Class Business Mailers observe that "First-Class Mail Letters/Cards once again

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[6] United States Postal Service Notice of Market Dominant Price Adjustment, Docket No. R2017-1 (Oct. 12, 2016), at 16-17; Comments of the Greeting Card Association, Docket No. R2017-1 (Nov. 1, 2016).
[7] Order No. 3610, Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, Docket No. R2017-1 (Nov. 15, 2016), at 20.
[8] Initial Comments of the Greeting Card Association, Docket No. ACR2013 (Jan. 31, 2014), at 1.
[9] Comments of Pitney Bowes Inc., PRC Docket No. ACR2016 (Feb. 2, 2017), at 5.

contributed a grossly disproportionate share of institutional costs."[10] Both Pitney Bowes and the First-Class Business Mailers comments fail to address the true reasons for the higher cost coverage for Presort Letters/Cards. The cost coverage is higher for Presort Letters/Cards than Single-Piece Letters/Cards because the Postal Service has had more success in reducing costs and slowing cost growth for Presort Letters/Cards than for the Single-Piece First-Class Mail product. Although Pitney Bowes praised the Postal Service for lowering Presort prices in its most recent price adjustment, this praise implies that pricing is driving the high cost coverage when in reality, low cost growth is the main driver of the high cost coverage for Presort Letters/Cards.

Since FY 2008, revenue per piece has increased by almost the same amount for Presort Letters/Cards as Single-Piece Letters/Cards (See table below). In other words, the Postal Service has not increased Presort prices by substantially more than Single-Piece prices. Moreover, in Docket No. R2017-1, the Postal Service increased Single-Piece prices while decreasing Presort prices. Order No. 3610 at 18, Table III-1 (November 15, 2016).

	FY2008 Revenue Per Piece	FY2016 Revenue Per Piece	% Change	FY2008 Cost Per Piece	FY2016 Cost Per Piece	% Change
First-Class Mail:						
Single-Piece Letters..............................	$0.428	$0.500	16.8%	$0.252	$0.281	11.5%
Single-Piece Cards................................	$0.271	$0.355	31.0%	$0.242	$0.292	20.7%
Total Single-Piece Letters and Cards	$0.420	$0.494	**17.6%**	$0.251	$0.282	**12.4%**
Presort Letters......................................	$0.337	$0.393	16.6%	$0.112	$0.117	4.5%
Presort Cards...	$0.206	$0.262	27.2%	$0.079	$0.079	0.0%
Total Presort Letters and Cards.........	$0.328	$0.386	**17.7%**	$0.110	$0.115	**4.5%**

Source: FY2008 and FY2016 Public Cost and Revenue Analysis

Between FY 2008 and FY 2016, unit costs for Presort First-Class Mail have grown at a much slower rate compared to the rate for Single-Piece First-Class or for First-Class Mail generally. This table shows that Presort First-Class Mail unit costs grew by 4.5

[10] Comments of the Major Mailers Association, National Association of Presort Mailers, and the National Postal Policy Council, PRC Docket No. ACR2016 (Feb. 2, 2017), at 1 [hereinafter "First-Class Business Mailers' Comments"].

percent between FY 2008 and FY 2016 while unit costs for Single-Piece First-Class Mail grew by 12.4 percent during the same time period. It is worth noting that, although Single-Piece First-Class Mail grew more than twice as fast as Presort Mail Costs, the 12.4 percent growth rate of unit costs for Single-Piece First-Class Mail is less than the price cap over the same time period.

The Postal Service believes that Congress enacted the PAEA to encourage the Postal Service to reduce costs and provide the Postal Service financial incentives to do so. The Postal Service has achieved this objective for Presort Letters/Cards, and is enjoying higher cost coverage in this category because of its success in controlling these costs. Rather than being criticized, the Postal Service should be praised, and encouraged to have as much success in controlling costs in other areas as it has achieved in First-Class Mail Presort Letters and Cards.

C. The Postal Service is Addressing Passthrough Concerns

Averaging Cost Avoidance Over Three Years Has Drawbacks

First-Class Business Mailers propose that "the Commission should consider changing its practice to evaluating compliance with Section 3622(e) using the average of the past three years' cost avoidance estimates and not merely the most recent year."[11] While the Postal Service is concerned about the volatility of cost avoidance estimates for some workshare categories, the use of a three-year average has significant drawbacks. The most recent year generally has the most accurate information about In-Office Cost System ("IOCS") tallies, mail flows, productivities, labor wage rates, and piggyback factors. Moreover, cost avoidance figures that were filed with ACRs for prior years may be based on outdated cost models that the Commission

[11] First-Class Business Mailers' Comments at 8.

has decided to change based on the carwash process.

First-Class Mail 5-Digit Letters

The First-Class Business Mailers (Major Mailers Association, National Association of Presort Mailers and National Postal Policy Council) fail to acknowledge that the 5-Digit Letters passthrough increased from 67.6 percent in FY 2016 to 88 percent on January 22, 2017. Pitney Bowes, on the other hand, recognizes this fact and lauds the Postal Service for the progress it has made on this passthrough. The 67.6 percent passthrough reflected a discount set in Docket No. R2015-4, which relied on the FY 2014 cost avoidance for the passthrough calculation.

First-Class Mail 5-Digit Automation Flats

As the Postal Service has described in Docket Nos. R2017-1 and ACR2016, the First-Class Mail 5-Digit Automation Flats cost avoidance has changed significantly from fiscal year to fiscal year. Contrary to the PR's assertion that "[t]here is no evidence of any attempt to phase out the excessive discount in this time period," the Postal Service lowered the 5-Digit Flats discount from 19.2 cents to 18.4 cents in Docket No. R2017-1, the Postal Service's first market-dominant annual price change for nearly two years. Due to the January 22, 2017 price change, the passthrough decreased from 161.6 percent to 154.6 percent. Furthermore, in response to ChIR No. 4 in this docket, the Postal Service announced its intent to lower the passthrough by at least five percentage points in each subsequent market dominant price adjustment.[12] In sum, the Postal Service has not only demonstrated efforts to lower the passthrough in its only market dominant rate adjustment since FY 2016, it has committed to a schedule of passthrough

[12] Responses of the United States Postal Service to Chairman's Information Request No. 4, PRC Docket No. ACR2016 (Jan. 19, 2017), at Question 7.

improvements that will eventually result in a passthrough below 100 percent.

First-Class Mail AADC Letters

Pitney Bowes incorrectly asserts that the Docket No. R2017-1 price change, which took effect on January 22, 2017, lowered the First-Class Mail AADC Letters passthrough such that it now complies with section 3622(e)(2). In Docket No. R2015-4, the Postal Service aligned the discount with the FY 2014 avoided cost of 2 cents. In Docket No. R2017-1, the Postal Service maintained the discount at 2 cents, which equaled the FY 2015 cost avoidance. Because the FY 2016 cost avoidance dropped to 1.8 cents, however, the passthrough has increased to 111.1 percent. In the ACR, the Postal Service committed to either fixing the discount in its next market-dominant price change or justifying it pursuant to a statutory exception at that time, taking into consideration other business needs at the time of the price change.

USPS Marketing Mail

To address the PR's concern that the Postal Service does not have a plan to lower excessive USPS Marketing Mail passthroughs, the Postal Service reiterates its commitment to lowering the Automation AADC Letters passthrough, Nonautomation 5-Digit Nonmachinable Letters passthrough, DNDC Carrier Route Letters passthrough, DSCF Carrier Route Letters passthrough, DNDC High Density and Saturation Letters passthrough, and DSCF High Density Saturation Letters passthrough by a minimum of 10 percentage points each in every subsequent market dominant price change until the passthroughs reach 100 percent or lower.[13] Moreover, the Postal Service stresses that

[13] Responses of the United States Postal Service to Chairman's Information Request No. 4, PRC Docket No. ACR2016 (Jan. 19, 2017), at Question 9.

it improved the majority of high USPS Marketing Mail passthroughs in the January 22, 2017 price change.

D. The Commission Should Reject Valpak's Arguments Concerning The Need For Significant Price Increases For Standard Mail Flats

Valpak's comments regarding the pricing of Standard Mail Flats continue in the vein of the past several ACR proceedings, clinging to the phantom notion that the Postal Service has failed to comply with the Commission FY 2010 directive, and recommending that the Commission order large price increases to eliminate negative contribution. Once again, Valpak's pricing claims are fundamentally unsound and are marred by key factual omissions.

First, while Valpak notes that Standard Mail Flats "lost $602 million in FY 2016,"[14] and that the loss increased by "a remarkable $80 million,"[15] over FY 2015, it downplays the completely unremarkable cause of this increase: additional volume. As the Public Representative acknowledges in his comments, "[t]his [loss] is not surprising considering a significant (by more than 1 [b]illion pieces) increase in Standard Mail [Flats] volume from 5,260 million pieces in FY 2015 to 6,307 million pieces in FY 2016."[16] Thus, Valpak's claim that the absolute value of the FY 2016 loss indicates that "the [Standard Mail Flats] product is headed in the wrong direction"[17] is unfounded. In fact, the loss increased by 15.3 percent, well below the volume increase of 16.6

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[14] Docket No. ACR2016, Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. Initial Comments on The United States Postal Service FY 2015 Annual Compliance Report, at 2 (February 2, 2017) [hereinafter "Valpak Comments"].
[15] *Id*.
[16] Docket No. ACR2016, Public Representative Comments, at 31-32 (February 2, 2017). The Public Representative inadvertently states that Standard Mail volume increased by 1 million pieces in his comments. However, a comparison of the public CRAs from FY 2015 (USPS-FY15-1) and FY 2016 (USPS-FY16-1) clearly shows that Standard Mail Flats volume increased from just over 5.26 billion pieces to 6.30 billion pieces.
[17] Valpak Comments, *supra* note 13, at 2.

percent.

Second, in an unusual omission, Valpak fails to even mention the FY 2016 cost coverage for Standard Mail Flats, which declined from 80.15 percent to 79.73 percent.[18] As the Postal Service explained in its Annual Compliance Report filing, the most likely cause of this small 0.42 percentage point decline was the involuntary rollback of the exigent surcharge prices midway through FY 2016.[19] Indeed, had the exigent surcharge remained in place for the final 5+ months of the fiscal year, the Postal Service estimates that Standard Mail Flats' cost coverage would have at least remained stable, but most likely increased. This conclusion is bolstered by the fact that, despite the reported decrease in revenue per piece, both unit contribution and unit cost improved in FY 2016. In particular, unit contribution improved from ($0.099) in FY 2015 to ($0.095) in FY 2016.[20] Similarly, unit cost improved from $0.501 in FY 2015 to $0.471 in FY 2016.[21] By omitting these critical facts, Valpak reaches the conclusion that "[Standard Mail Flats] is no closer to 100 percent cost coverage than in FY 2010."[22] However, as shown above, it is quite possible that, had the exigent surcharge not been rolled back in the middle of FY 2016, Standard Mail Flats' cost coverage would have exceeded its FY 2010 level.

Third, Valpak attacks the Postal Service's recent Standard Mail Flats price adjustments as being "barely above-average price increases"[23] and as demonstrating

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[18] Docket No. ACR2016, USPS-FY16-1, file "Public_F16CRAReport.xls", tab 'Cost1'; Docket No. ACR2015, USPS-FY15-1, file "Public-FY15CRA.xls", tab 'Cost1.'
[19] Docket No. ACR2016, United States Postal Service FY 2016 Annual Compliance Report, at 25-26 (December 29, 2016) [hereinafter "ACR2016" or "FY 2016 ACR"].
[20] Docket No. ACR2016, USPS-FY16-1, file "Public_F16CRAReport.xls", tab 'Cost1'; Docket No. ACR2015, USPS-FY15-1, file "Public-FY15CRA.xls", tab 'Cost1.'
[21] *Id*.
[22] Valpak Comments, *supra* note 13, at 15.
[23] *Id*.

"clear defiance of Commission pricing directives."[24] However, as the Postal Service explained in its Annual Compliance Report, its recent Standard Mail Flats price adjustments have exceeded the Commission approved price adjustment schedule.[25] Indeed, since the Commission first approved the Standard Mail Flats price adjustment schedule in the ACD for FY 2013 (which called for above average price increases of 1.05*CPI),[26] the Postal Service has implemented three general market-dominant price increases. In Docket No. R2013-10 the Postal Service increased Standard Mail Flats prices by 1.810 percent, which was 107 percent of the available CPI price adjustment authority (1.696 percent).[27] In Docket No. R2015-4, the Postal Service increased Standard Mail prices by 2.549 percent, which was 130 percent of the available CPI price adjustment authority (1.966 percent).[28] Finally, in Docket No. R2017-1, the Postal Service increased Standard Mail Flats prices by 2.522 percent, which was 280 percent of the available CPI price adjustment authority (0.900 percent).[29] In contrast, during those same price adjustments, the High Density and Saturation Letter price increases were only 78 percent of CPI, 101 percent of CPI, and 246 percent of CPI, respectively.

What's more, the price increases for the two dominant rate categories within High

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[24] *Id*. at 2.
[25] ACR2016, *supra* note 18, at 26.
[26] Docket No. ACR2013, Annual Compliance Determination Report, Fiscal Year 2013, at 52-54 (March 27, 2013). In Docket No. R2017-1, the Postal Service presented, and the Commission approved, an updated three-year schedule of above average price increases for Standard Mail Flats price. *See* Docket No. R2017-1, Response of United States Postal Service to Questions 2-8 of Chairman's Information Request No. 4, Question 4 (October 26, 2016); Docket No. R2017-1, Order No. 3610 - Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, at 31-32 (November 15, 2016).
[27] Docket No. R2013-10, Order No. 1890 - Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, at 66-67 (November 21, 2013).
[28] Docket No. R2015-4, Order No. 2472 - Order on Revised Price Adjustments for Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, at 3, 33 (May 7, 2015).
[29] Docket No. R2017-1, Order No. 3610 - Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, at 29 (November 15, 2016).

Density and Saturation Letters (Saturation DSCF and High Density DSCF) have increased *by less than CPI* since the PAEA was implemented. In particular, the Commercial Saturation DSCF price has increased from 13.5 cents to 15.5 cents (14.8 percent) and the Commercial High Density DSCF price has increased from 14.4 cents to 16.8 cents (16.7 percent).[30] In comparison, CPI has increased by 18.4 percent over the same time period.[31] Thus, far from being "barely above-average" or demonstrating "clear defiance" of the Commission's directives, the above demonstrates the Postal Service's commitment to complying with, and usually exceeding, the Commission approved price adjustment schedule.

Finally, as mentioned previously, Valpak's ultimate aim is to have the Commission impose "Significant price increases" on Standard Mail Flats.[32] However, Valpak also requests that the Commission direct the Postal Service to apply "corresponding price decreases for HD/Saturation Letters."[33] The second half of this request is notable, as it would seem to direct any benefit of any above average Standard Mail Flats price increase to Valpak at the expense of other mailers. Indeed, without a separate Commission order specifically directing the Postal Service to decrease High Density and Saturation Letter prices, the class-wide price cap permits the Postal Service to implement above average Standard Mail Flats price increases by reducing any combination of Standard Mail prices. Thus, if Valpak's only goal is to raise the cost coverage of Standard Mail Flats, it would not have requested that High Density

[30] United States Postal Service, Domestic Mail Manual, Notice 123 (Effective July 15, 2007), at 5; United States Postal Service, Domestic Mail Manual, Notice 123 (Effective January 22, 2017) at 16.
[31] This represents the compounded CPI pricing authority over the eight price adjustments since PAEA was implemented. The eight price adjustments are +2.9 percent, +3.8 percent, +1.164 percent, +2.133 percent, +2.570 percent, +1.696 percent, +1.966 percent, and +0.871 percent.
[32] Valpak Comments, *supra* note 13, at 19.
[33] *Id*.

and Saturation Letter prices be reduced for the specific purpose of increasing Standard Mail Flats prices. There can be little doubt that Valpak's requested relief in this case is little more than a self-serving attempt at lowering its own prices – prices that have increased by less than CPI since the PAEA was enacted. Accordingly, it should be rejected.

In sum, given the significant increase in Standard Mail Flats volume in FY 2016, and the rollback of the exigent surcharge midway through the fiscal year, the Postal Service cannot help but agree with the ACMA, that "FY 2016 was a stressful year," and that it should not be used as a measure of future success in improving Standard Mail Flats' cost coverage.[34] Moreover, when considering Valpak's request for significant Standard Mail Flats price increases and corresponding High Density and Saturation Letter price decreases, the Commission must be mindful of the ripple effects that such directives could have on other Commission priorities[35] and on other mailers. Based on the above, the Postal Service respectfully requests that the Commission reject Valpak's requested relief.

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[34] Docket No. ACR2016, Initial Comments of the American Catalog Mailers Association (ACMA), at 17 (February 2, 2017).

[35] *See* Docket No. ACR2015, Annual Compliance Determination Report: Fiscal Year 2015, at 27 (March 28, 2016) (directing the Postal Service to set the DNDC and DSCF dropship discounts "at avoided costs in the next general Market Dominant price adjustment," or to "file a plan to align discounts with avoided costs" at that time). The associated dropship passthroughs, for letters, ranged between 160.0 percent (Basic Carrier Route, High Density, High Density+ and Saturation DNDC Letters) and 191.3 percent (Regular DSCF Letters) in the FY 2016 ACR. Altogether, DNDC Letters and DSCF Letters accounted for 52.9 percent of all Standard Mail revenue in FY 2016. Consequently, the alignment of these dropship passthroughs, using DNDC and DSCF price increases, could significantly limit the scope of other price increases under the price cap. Vice-versa, dedicating limited cap space to a substantial price increase for Standard Mail Flats would constrain the Postal Service's ability to address the DNDC and DSCF Letters dropship-passthrough priority using DNDC and DSCF price increases.

E. The Postal Service is Adequately Addressing the Financial Performance of International Products

The Postal Service submits that it has adequately addressed the PR's observations about the following international products: Inbound Letter Post, International Money Transfer Service ("IMTS"), International Ancillary Services, Inbound Air Parcel Post at non-UPU Rates, Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1, and Outbound International Insurance. In general, the PR's observations appear to align with the Postal Service's analysis of these six products.

First, with respect to Inbound Letter Post, in the ACR, the Postal Service acknowledged that Inbound Letter Post did not cover its attributable costs as a result of the product's unique pricing regime. In addition, the Postal Service noted that graduated increases are scheduled for calendar year 2017 terminal dues for Inbound Letter Post as set forth in Articles 30 and 31 of the current Universal Postal Convention; also, significant increases in Inbound Letter Post terminal dues revenues are expected as a result of the new Universal Postal Convention cycle effective in January 2018.[36] The PR acknowledged the above statements and stated "[g]iven the unique pricing regime of the Inbound Letter Post, the Public Representative cannot conclude that First-Class Mail rates were out of compliance in FY 2016 within the provisions of chapter 36 of title 39.[37] Following up on the Postal Service's statements in the ACR, the Postal Service reiterates that calendar year 2017 Inbound Letter Post terminal dues increases as well as the significant increases expected to result from the Universal Postal Convention cycle commencing in January 2018 should improve cost coverage for the

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[36] FY2016 ACR at 13-14; *see also* Notice of the United States Postal Service of Filing of Revised Annual Compliance Report Pages – Errata, Docket No. ACR2016, January 25, 2017.
[37] PR comments at 28.

Inbound Letter Post product.

Second, as for IMTS, in the ACR, the Postal Service explained the measures that the Postal Service has taken to improve cost coverage, including price increases, such as the over 73 percent increase in International Postal Money Order fees in the January 22, 2017 published price change. In the ACR, the Postal Service noted the following statement of the Commission in its order concerning that price change: "'[a]ll else remaining equal, this price increase should generate sufficient revenue to cover the attributable costs for Outbound IMTS.'"[38] In addition, that price change also included changes to the rates for Dinero Seguro (Vendor Assisted Electronic Money Transfer), which is also part of Outbound IMTS.[39] The PR, in his comments, summarizes actions that the Postal Service has recently taken to improve cost coverage for IMTS, and concludes by stating that the "price increase effective January 22, 2017, should have a positive impact" on IMTS cost coverage in FY 2017.[40] In response to ChIR No. 9 filed under seal in this docket, the Postal Service provided additional information concerning Outbound IMTS, which should aid the Commission in its evaluation of this product.[41]

Third, with respect to International Ancillary Services, the Postal Service explained in the ACR that International Ancillary Services did not cover costs because of costing changes approved in Docket No. RM2016-10, which reassigned delivery costs from Inbound Letter Post to Inbound Registered Mail. The Postal Service stated that additional revenue for inbound registered items might be generated as a result of

[38] FY2016 ACR at 88.
[39] PRC Order No. 3622, Order Approving Price Adjustments for Competitive Products, Docket No. CP2017-20 (November 18, 2016), Revised MCS Pages, at 103 of 108.
[40] PR comments at 54-55.
[41] Response of the United States Postal Service to Questions 1-2 of Chairman's Information Request No. 9, Docket No. ACR2016, February 6, 2017.

the graduated increase for registered items in 2017 under the Universal Postal Convention, a significant increase in Registered Mail terminal dues rates scheduled for 2018, the Postal Service's participation in the voluntary supplementary remuneration program for inbound registered items as well as the Inbound Market Dominant Registered Service Agreement 1 multilateral agreement.[42] The PR notes that "the cost coverage for market dominant International Ancillary Services was slightly (less than one percent) below 100 percent." The PR acknowledges that "[a]s the Postal Service explains, the situation was due to the failure of Inbound Registered Mail to cover its costs…. The Postal Service, however, anticipates that in 2017-2018, the cost coverage for Inbound Registered Mail will exceed 100 percent after implementation of a number of currently proposed measures" and suggests "close monitoring of the impact of the anticipated measures on the cost coverage for Inbound Registered Mail.[43] The Postal Service provided additional information concerning reporting for Inbound Registered Mail in response to ChIR No. 3, Questions 27 in this docket,[44] and plans to monitor the impact of the measures described above on cost coverage for Inbound Registered Mail.

Fourth, concerning Inbound Air Parcel Post (at non-UPU rates), in the ACR, the Postal Service explained that the Postal Service exited the EPG agreement, effective June 30, 2016.[45] The PR acknowledges that "the Postal Service confirms that it exited the EPG agreement as intended" and states that the only remaining agreement (the CP2009-28 agreement with Royal Mail) "covered its costs in FY 2016." The PR

[42] FY2016 ACR at 62-63.
[43] PR comments at 43-44.
[44] Responses of the United States Postal Service to Questions 3, 24-27 of Chairman's Information Request No. 3, Docket No. ACR2016, January 23, 2017, Response to Question 27.
[45] FY2016 ACR at 87.

concludes that "the performed action was appropriate."[46] The Postal Service expects that, as a result of the Postal Service's exit from the EPG agreement, the cost coverage for Inbound Air Parcel Post (at non-UPU rates) should improve in FY 2017.

Fifth, as for Inbound Competitive Multi-Service Agreements with Foreign Postal Operators 1, the Postal Service acknowledged in the ACR that one competitive bilateral agreement did not cover costs and that the Postal Service intends to replace that agreement with a successor agreement, which if negotiated and executed, would provide adequate cost coverage at the product level.[47] The PR notes that just one of the nine bilaterals in this product failed to cover its costs in FY2016, and that "[t]he Postal Service intends to replace the rates for the agreement so that they 'provide adequate cost coverage.'" The PR, noting that "the FY 2016 cost coverage was just slightly below 100 percent," "expresses hope that the rate change will allow the agreement to cover its costs."[48] That successor agreement has recently been executed, and the Postal Service plans on filing the inbound competitive rates in that agreement with the PRC in the near future.[49]

Sixth, with respect to Outbound International Insurance, in the ACR, the Postal Service stated that the difference between costs and revenues for international insurance is small, and that Priority Mail Express International insurance fees and Priority Mail International Insurance fees were raised in the January 22, 2017 price change. The Postal Service also stated that management will propose further remedial

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[46] PR comments at 55.
[47] FY2016 ACR at 89.
[48] PR comments at 56.
[49] The inbound market dominant rates in the successor agreement were recently filed with the Commission in Docket No. R2017-4. *See* Notice of United States Postal Service of Type 2 Rate Adjustment, and Notice of Filing Functionally Equivalent Agreement, Docket No. R2017-4, February 9, 2017.

measures for consideration if the product continues to underperform.[50] The PR acknowledges these comments, concluding that "the proposed approach is reasonable."[51] In response to ChIR No. 8, Question 2, the Postal Service identified factors that contributed to a decrease in cost coverage, unit cost, and unit revenue, and a substantial increase in volume, for Competitive Outbound International Insurance from FY 2015 to FY 2016. In that response, the Postal Service stated that it is considering options to address the impact of the recent changes to competitive Outbound International Insurance and to Priority Mail International on cost coverage for both products, and intends to study whether the Postal Service can separate the costs of Priority Mail International insurance for which no fee is paid, in order to assign those costs to the Priority Mail International product.[52]

F. The Comments Provided By UPS Have Virtually No Relevance to the FY 2016 Compliance Determinations Now Pending Before the Commission, and Lack Merit in Other Respects as Well

UPS purports to acknowledge on page 3 of its comments that "the ACR process is a narrow proceeding with a limited time frame." Yet, as it has done in previous years, UPS once again raises a litany of costing issues that it admits it is not even asking the Commission to resolve in the course of making the annual compliance determinations that are the exclusive focus of this proceeding. Nonetheless, UPS asks that the Commission submit information requests along the lines it has suggested in two separate motions. The Commission has already done so, and the Postal Service has responded. But UPS uses its comments to continue to harp on ill-defined complaints

[50] FY2016 ACR at 89.
[51] PR comments at 56.
[52] Responses of the United States Postal Service to Questions 1-8 of Chairman's Information Request No. 8, Docket No. ACR2016, February 6, 2017, Response to Question 2.

about costing and the transparency of the costing methodologies. Many of these claims are extremely misleading, because they are based upon convenient narratives, rather than actual analysis of the Postal Service's submission. In many respects, the UPS comments seem to be more an exercise in casting aspersions than identifying actual issues.

For example, on pages 11-12 of its comments, UPS notes the growing importance of mail dropshipped at Destination Delivery Units (DDUs). UPS then alleges:

> Despite this increase in use and importance, the cost model for mail volume drop-shipped at DDUs remains a black box.

Id. at 11. It is simply unclear which "cost model" UPS considers to be a black box, and why. For purposes of estimating worksharing cost avoidances, the mail processing operations at DDUs that UPS discusses are "modeled" in USPS-FY16-NP15 (Parcel Select/Parcel Return Service Mail Processing Cost Model).[53] Without specific reference to that folder or any other part of the ACR documentation, UPS alleges that "[d]elivery of drop-shipped products at DDUs follows an extended process." *Id.* The reality, however, is that dropshipped containers of parcels are essentially unloaded from the trucks and moved to the parcel sorting area where they are sorted. UPS seems to be implying that there are a lot more tasks that must be performed at delivery units for dropshipped parcels. There are not. While there may be other tasks performed after the parcels have been sorted in the delivery units, those would be considered part of the delivery costs of parcels, and would be no different whether the parcels were

[53] While that model is filed as part of the nonpublic annex, when requesting and obtaining access to other parts of the nonpublic annex early in this proceeding, UPS did not request access to USPS-FY16-NP15.

dropshipped or not. But perhaps most importantly, UPS never even hints at a reason why the activities at the DDU (whether accurately considered "extended" or not) and the mail types processed therein are not appropriately handled through the normal data collection system sampling systems established for purposes of cost attribution and distribution. Those systems have been well-documented for decades in extensive public materials, and if there has recently been increased activity in DDUs, those systems are designed to reflect that, and indeed have done so. Why UPS feels all of this is appropriate for discussion within the "narrow proceeding" of the ACR is distinctly unclear, as these matters should be generally understood, and UPS is not raising any material compliance issues.

Many of the UPS allegations are of the same ilk, and their apparent substance evaporates in the light of publicly available information and data. First, UPS claims at pages 2-3 and 7-9 that the Postal Service is not appropriately attributing increased peak season costs to packages. UPS further asserts at pages 2-3 that the Postal Service's costs associated with peak season are massive. As is typical of its comments, UPS fails to provide any actual data or results to substantiate its unfounded claim that peak season costs are "massive," despite the fact that the necessary data are readily available. As the following table illustrates, the publicly filed unaudited National Trial Balance data for FY 2016 shows that city carrier labor costs for PQ 1 FY 2016 were just 26 percent of the annual labor costs for city carriers, only marginally above the exactly proportional value of 25 percent. The Postal Service acknowledges that the PQ 1 were higher than for the other quarters, but the assertion by UPS that peak season costs were “massive” certainly requires a spike in costs for PQ 1 greater than 1.3 percent actual increase. (The mean proportion of costs in PQ 2-PQ 4 is 24.7 percent).

	Q1 FY 2016	**Q2 FY 2016**	**Q3 FY 2016**	**Q4 FY 2016**	**FY 2016**
	($000)	($000)	($000)	($000)	($000)
	(1)	(2)	(3)	(4)	(5)
City Carrier Labor	$ 4,127,654	$ 3,958,232	$ 3,898,658	$ 3,918,116	$ 15,902,660
Percentage by Quarter	26.0%	24.9%	24.5%	24.6%	100%

UPS does not isolate its narrative about peak season costs to city carrier labor. It also asserts that the Postal Service is misattributing the “massive” costs associated with the peak season in purchased highway transportation, particularly regarding the Postal Service’s use of Christmas Routes. However, as it did with city carrier labor, UPS fails to present any facts or data to substantiate this claim. To account for the seasonal spike in purchased transportation costs, the established methodology uses <u>quarterly</u> accrued costs and distribution factors. This means the volumes that are carried during the peak season will receive the extra costs associated with transportation during that season. Costs associated with “Christmas” routes are separately identified in the publicly-filed purchased transportation cost model (USPS-FY16-32, workbook CS14, tab 14.3). In PQ 1, Inter-SCF accrued costs were $420 M of which $113 M (27 percent) were associated with Christmas Routes.[54] Of the $376 M in volume variable costs, $206 M (55 percent) are assigned to competitive products. In contrast, in PQ 2-PQ 4 only 35 percent of relevant Inter-SCF costs are assigned to competitive products. While it is correct that stated costs associated with Christmas routes are a substantial portion of PQ 1 Inter-SCF purchased transportation costs, UPS

[54] Costs associated with Christmas routes on other modes are essentially insignificant.

conveniently failed to acknowledge that the Postal Service explicitly accounts for the seasonality of these costs by using quarterly costs and distribution factors to assign costs to products.

Second, on pages 4 and 12-13, UPS also requests that the Postal Service explain what UPS characterizes as “financial inconsistencies” and “unexpected” and “anomalous” competitive product cost trends. Specifically, UPS professes not to understand why, on a unit basis, costs for market dominant products would be trending up while costs for competitive products are trending down. UPS admits, however, that this matter was being addressed in Information Requests, and its concerns could be satisfied by responses to those requests. Indeed, the Postal Service’s responses to ChIR Nos. 11 and 13 resolve the so-called anomalies to which UPS refers, thoroughly explaining the reasons behind the observed trends in product costs across years. For example, a change in the mix of competitive products toward more drop-shipped volume understandably caused a reduction in the calculated unit cost for competitive products. Such a cost movement is neither inconsistent nor unexpected.

Third, UPS complains that the Postal Service only provides basic information about the methods used to assign costs to the three types of Special Purpose Routes. UPS at page 6 goes further to assert that the information provided is needlessly opaque and substantially greater transparency is warranted. The UPS assertions ignore the fact that the established methodology was primarily developed in a public rate case (Docket No. R97-1) in which UPS was an active participant, and that the methodology has been in place since before PAEA. Thus, the Postal Service strongly disagrees with these UPS assertions. The costs are assigned to the route types based on readings from the In-Office Cost System ("IOCS") as has been done for many cost components, for many years. Not only is this methodology clearly identified in the cost model (USPS-FY16-32, workbook CS06&7, tab Inputs IOCS) where the costs by route type are separately identified under the header "IOCS," but also the series of IOCS survey questions that lead to these costs are quite clearly illustrated in the In-Office Cost System documentation filed annually with the ACR.[55] The existence of these two long-standing sources of public information about the assignment of Special Purpose Routes demonstrates the mischaracterization of the UPS claim.

Fourth, UPS requests that the Commission expand its directive in Order No. 3506 regarding the Summary Description to include competitive and market dominant cost data in separate columns in the annual Segment and Component group cost tables. UPS claims at page 17 that such reporting will not burden the Postal Service and will make the data more accessible and transparent. The Postal Service is puzzled by this request, as this information is <u>already available and easy to find</u> in the ACR in the Cost Segments and Components folder, USPS-FY16-2. In contrast to the presentation of cost figures, which is done in the ACR filing, the purpose of the Summary Description is to explain the sources and nature of the accrued costs (i.e., which accounts in the General Ledger are mapped to which cost segments, components and elements) and the conceptual basis upon which they are attributed and distributed. It is not intended to be a reference for the amount or relative shares of market dominant and competitive products assigned by component. In fact, that information is presented six months earlier, in the Cost Segments and Components report. UPS also fails to acknowledge that the Postal Service in FY 2016 significantly

[55] USPS-FY16-37, workbook IOCS Data Entry Flowchart, tab Q16.

expanded the level of detail in the Cost Segments and Components component so that it includes costs by product, by individual component, rather than by component group. Thus, the information requested by UPS is already available in a user-friendly Excel spreadsheet more than six months prior the filing of the Summary Description. There is no reason to confound the basic purpose of the Summary Description by including unnecessary and previously reported cost data. The Postal Service urges the Commission to reject this unnecessary and ill-considered proposal by UPS.

Fifth, UPS criticizes the established method for assigning special purpose route costs to products. UPS notes that costs associated with “Exclusive Parcel Post” routes increased from 17 percent in FY 2013 to 35 percent in FY 2016, but that the costing methodology does not appear to reflect the changing composition of Special Routes. UPS Comments at 6. Once again, UPS makes a frivolous claim without supporting data. The unstated implication is that, despite the growth in Exclusive Parcel Post route costs, the same amount of costs were assigned to competitive products in FY 2016 as in FY 2013. This is false. In fact, in FY 2016, $118 M in special purpose route costs were assigned to competitive products, compared to $91 M in FY 2013. Over the same period of time, the relative share of accrued SPR street costs assigned to competitive products has also increased from 21 to 24 percent.

Also on page 6, UPS asserts that it is notable that more than 40 percent of SPR costs are treated as network travel costs, while only 2 percent of letter costs are treated as such. As in other places in its comments, UPS correctly quotes individual figures out of context, but fails to include the important details behind the figures. UPS is implying that the Postal Service is assigning too much SPR costs to network travel, which by the established method is treated as an institutional cost. But, UPS fails to account for the fact that network travel time is very different for SPR carriers than it is for letter carriers. This difference quite logically leads to different proportions, and has for decades. For letter carriers, network travel is just the time spent driving between delivery sections and possibly to a few fixed collection points.[56] In contrast, for SPR carriers, network travel time is driving time associated with collection and inter-facility activities which are not related to <u>delivery</u> activities.[57]

UPS fails to recognize that SPR costs arise primarily in two different activities: 1) the delivery of parcels and accountable mail and 2) the collection of mail from street letter boxes and other mail collection points.[58] As explained in the recent response to ChIR No. 13, question 6, the established methodology aggregates SPR costs across the three route types (delivery, collection, and combination) before the attribution and distribution processes are applied. Thus, the network travel costs cited by UPS include those associated with collection activities, which are substantial for SPR carriers but extremely minor for letter carriers. By its nature, a substantial portion of collection activity is servicing street letter boxes and other collection points every single day, regardless of the amount of volume collected. The costs associated with these activities represent a significant amount of SPR network travel costs, very little of which would be associated with servicing competitive products.

Sixth, UPS also stresses that the low level of attribution of SPR costs raises ”questions” about how those costs are attributed to products. Apparently the estimated

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[56] Summary Description at 7-2.
[57] Summary Description of USPS Development of Costs by Segments and Components, Fiscal Year 2015 at 7-2 (filed July 6, 2016).
[58] Docket No. RM2015-7, Response of the United States Postal Service to Commission Order No. 2792 (February 16, 2016) at 16.

variabilities do not conform to UPS's preferred preconceived notion that virtually all SPR cost should be attributed to packages. Indeed, UPS falsely claims that these costs are largely driven by parcel delivery. UPS at 7. But this is factually wrong. The variabilities to which UPS refers are the variabilities for *both* collection and delivery activities. In FY 2016, only 34 percent of accrued SPR street costs were on Parcel Post routes, while 29 and 37 percent of costs were incurred on Collection, and Combination/Other routes.[59] Only about one-third of SPR street costs are accrued on parcel post routes. This explains the estimated cost elasticities associated with SPR. In FY 2016, the overall variability for all SPR street costs, including collection, was 41 percent. But the variability for SPR costs associated with delivery (excluding collection and network travel) was 95 percent.

When SPR costs are studied at even a cursory level, the complaint by UPS about the low level of attribution is not convincing. It is based upon a casual predisposition for "high" variabilities. As a result, UPS fails to recognize that a significant portion of SPR costs are not related to delivering parcels, and neglects to mention the 95 percent elasticity associated with direct parcel delivery activities.

Seventh, UPS also criticizes the treatment of vehicle depreciation costs, asserting that, in FY 2016, 30.5 and 5.2 percent of accrued vehicle depreciation costs were attributed to all products and competitive products respectively. UPS appears to find surprising the result that 5.2 percent of these costs are assigned to competitive products. But UPS ignores the fact 17 percent of attributable vehicle costs (5.2/30.5) are attributed to competitive products, despite the fact they are less than three percent

[59] *See* United States Postal Service Response to ChIR No.13, Question 6 (February 10, 2017) for more discussion about the activities associated with each route type.

of volume delivered on city letter routes. Based on its false premise, UPS requests that the Commission review the cost models that generate this low level of attribution. UPS at 10-11. But no such review is necessary as the established treatment of vehicle depreciation costs is simple. Vehicle depreciation costs are attributed and distributed in accordance with respect to the labor that uses the vehicles. In city delivery, vehicle depreciation costs are attributed and distributed by route type in accordance with the street time costs for labor. The same treatment is applied to vehicle maintenance (parts and labor) costs in segment 12. This treatment is based upon the clear, causal relationship between city carrier direct labor costs and the associated vehicle maintenance and depreciation costs. As city carriers work more street hours, vehicle use hours and associated vehicle costs rise.[60]

In addition, UPS failed to mention that the Postal Service initiated a costing method change in Docket No. RM2016-3, Proposal Twelve that raised the attribution of vehicle depreciation costs by 1) using total street time as the baseline for calculating the variability and 2) creating a new component that separately attributes costs associated with vehicles used on SPR. These two changes resulted in $11 million in additional city carrier vehicle depreciation costs assigned to products based on FY 2014 data. At page 10 of its Comments, UPS states that “The Postal Service, in its FY 2016 Annual Report to Congress, discussed recent investments made in its delivery fleet…Many of these costs do not appear to be adequately attributed to competitive products.” The implication is that the Postal Service spent an enormous sum on new vehicles and neglected to attribute the costs thereof. But, in fact, accounting rules and attribution

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[60] *See* Response of the United States Postal Service to Commission Order 2915 at 3, Docket No.RM2016-3, February 29, 2016.

convention contravene UPS's assertions. The expense of the new vehicles would be depreciated over time (the service life of the vehicles), and would not commence until the vehicles are actually deployed. The Postal Service has already responded (on February 3, 2017) to the Information Request on this topic (ChIR No. 11, Question 5). As the vehicles about which UPS inquired have not even been purchased, there is as of yet no depreciation to attribute, to competitive products or market dominant products.

Eight, UPS requests that the Commission follow up on what it claims is an unresolved issue from Order No. 2792 from Docket No. RM2015-7 (Commission approval of Proposal Thirteen, a new city carrier letter route street model). Specifically, UPS requests that the Commission convene a technical conference to consider the availability of Postal Service data for use in the top-down model proposed by UPS in Docket No. RM2015-7. No such technical conference is necessary, as the Postal Service is proceeding apace on this issue and will report to the Commission when sufficiently reliable operational data are available to estimate the top-down model.

In its response to Order No. 2792, the Postal Service stated that a single equation approach relies on capturing accurate daily volumes for the items captured through special studies in Docket No. RM2015-7. Specifically, the top-down model needs reliable measures of collection mail, in-receptacle parcels, deviation parcels, and accountables. Response at 6. The Postal Service suggested that after full deployment of the Mobile Delivery Devices (MDDs), more reliable estimates of in-receptacle parcels, deviation parcels, and accountables might be available from the Product Tracking and Reporting (PTR) system. The Postal Service has done investigation into this PTR data and has compared it with corresponding information from City Carrier Cost System tests. The results of this experiment were encouraging, but clearly indicated that additional analysis of the PTR data is required to establish its reliability. For example, there were several route-days, with serious mismatches between the two data sources in both total recorded parcel volume and in parcel volume by type.

Since the deployment of the MDDs and the initial investigation, PTR has undergone several changes in an effort to improve the quality of information for internal and external use regarding the status of their packages and accountables. These improvements will likely result in more accurate data, and the Postal Service will continue its analysis of the PTR data. As for collection mail, the availability of regularly collected data has not changed since the filing of the response to Order No. 2792. It is very likely that an update to the city carrier letter route street cost model will require an expensive data collection effort similar to the City Carrier Collection Mail Volume and Source Study (CCCMVSS) done in 2013.

Regarding Order No 3506, UPS offers comments on the acknowledgement made within the ACR that, in the relatively short time since the Commission issued that Order and identified the inframarginal costs estimated as part of a product's incremental cost as an additional component of the product's attributable costs, obstacles surfaced which prevented immediate implementation of the new costing regime in its entirety. UPS Comments at 14-16. UPS erroneously claims that many of these obstacles appear to be "of the Postal Service's own creation." *Id.* at 14. Instead, UPS's comments relating to the calculation of incremental cost contain factual errors and betray a lack of understanding of how incremental costs should be calculated.[61] For example, UPS

[61] Apart from not appreciating the complexities of implementing Order No. 3506, UPS neglects to acknowledge that the Postal Service did provide, in USPS-FY16-43, the incremental costs for each

asserts that the difficulty experienced with regard to NSAs "only arises because the Postal Service is trying to treat NSAs as separate products for the incremental cost calculation." *Id.* UPS characterizes this treatment as "artificially granular," and decrees by mere proclamation that "there is neither a need nor a justification for treating NSAs as separate products" when computing incremental costs. *Id.* at 15. These assertions by UPS are erroneous. As clearly explained on page 6 of the ACR, the determination that each NSA has to be treated as a separate product was made in 2007 *by the Commission.* The Postal Service was simply following the Commission's determination when attempting to implement Order No. 3506.

UPS also offers an alternative approach to computing incremental costs that is obviously in error and ambiguous. UPS first claims that incremental costs need not be calculated for individual products, but only for product "types." *Id.* at 15. By this reasoning, in implementing Order No. 3506, the Postal Service could call all competitive products, as a group, a "product type" and simply calculate the incremental cost of the group as it always had. Obviously this is not what was intended by Order No. 3506. Then, UPS suggests that incremental costs of NSAs that fall within a particular "product type" first be computed for the "product type" as a whole, and then distributed to individual NSAs on the basis of volume or weight. But, of course, UPS does not indicate whether volume or weight should be used for the distribution, and does not provide a scintilla of evidence or argument that either of these allocations schemes

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Market Dominant product or "product type," with comparable information for competitive products in USPS-FY16-NP10. The Postal Service, given the short time between the issuance of Order No. 3506 and the preparation of the Annual Compliance Report material, made a good faith effort to comply with the Order to the extent that it could, providing new material that UPS is happy to ignore.

would provide accurate incremental costs. In fact, there is no discussion why volume or weight would be better than any other arbitrary allocation basis.

Given its willingness to encourage arbitrary cost allocations in the three proposals it advanced in Docket No. RM2016-2, it is not surprising to find UPS here encouraging, yet again, arbitrary cost allocations. However, UPS also ignores the distinct possibility that the Postal Service, in keeping with the Commission's rules regarding the calculation of costs for individual NSAs, might actually be endeavoring to compute conceptually valid incremental costs for NSAs in a manner that appropriately reflects the cost-causing characteristics of mail from NSA partners. The NSA partners often utilize or avoid different parts of the Postal Service processing or delivery system and/or have distinct characteristics along multiple product characteristics. Thus, they can have different costs than do the "average" pieces in the "product type," and simplistic cost allocators may be expected to produce inaccurate costs.

Moreover, the UPS proposal is fatally flawed in that it does not correctly recognize the differences between product-level and group-level incremental costs. The error in UPS' proposed approach arises from the circumstance duly noted in the Preface to USPS-FY16-43 (as well as the Preface to USPS-FY16-NP10) – when incremental costs of a set of products are estimated individually, their sum does not equal the group incremental costs of the same set of products. Generally, the incremental costs of the group are <u>higher</u> than the sum of the individual product incremental costs because they include costs not caused by the individual products. Under UPS's proposed approach, the incremental cost for a group of products is necessarily the sum of the individual products' incremental costs. But this approach does not supply a unique answer. One could calculate the individual product incremental costs and sum them to get the group incremental cost, or one could calculate the group incremental cost and arbitrarily assign them to products. But these two methods would produce different group and individual product incremental costs. This is an example of why it is important to calculate incremental costs correctly.

The justification UPS offers for this misguided approach dissolves under even minimal scrutiny. The premise appears to be that, if the individual NSA products did not exist, essentially the same aggregate volume would be handled as pieces within the non-NSA product, using or avoiding the same parts of the postal network as they do now. UPS Comments at 15, note 26. Yet for that to be true, the NSA program would have to be a complete waste of time and money, as without it the Postal Service would still receive the same volume with the same characteristics at (presumably higher) published rates. Moreover, the efforts of UPS to improve its competitive position by forcing postal rates higher would also be fruitless, as the Postal Service would apparently get the same volume regardless of price. In reality, of course, volume would respond to changes in price, which is why UPS is pursuing the strategy it has adopted, and why it is critical not to incorrectly calculate incremental costs for NSA products by including costs that they do not cause.

With respect to final adjustments, UPS is equally off-base with the claim on page 15 that the Postal Service "gives no reason why it could not make the final adjustments to incremental costs rather than attributable costs." In fact, as explained in both the text of the ACR and the Prefaces (to folders 43 and NP10), the Postal Service did apply the final adjustments to the incremental cost estimates presented in those folders.

Moreover, UPS seems aware of that, when suggesting in the very next sentence that it is unclear "why the calculations in NP-10 are based on an intermediate pre-adjustment estimate of volume variable and product specific costs instead of the final calculation." Contrary to this assertion, the reason for this procedure is clear:

> Note that the circumstances which cause a situation to have to be handled by a final adjustment (normally the lack of data at a cost pool level) also preclude using the adjusted volume variable costs as the inputs into the incremental cost estimation model.

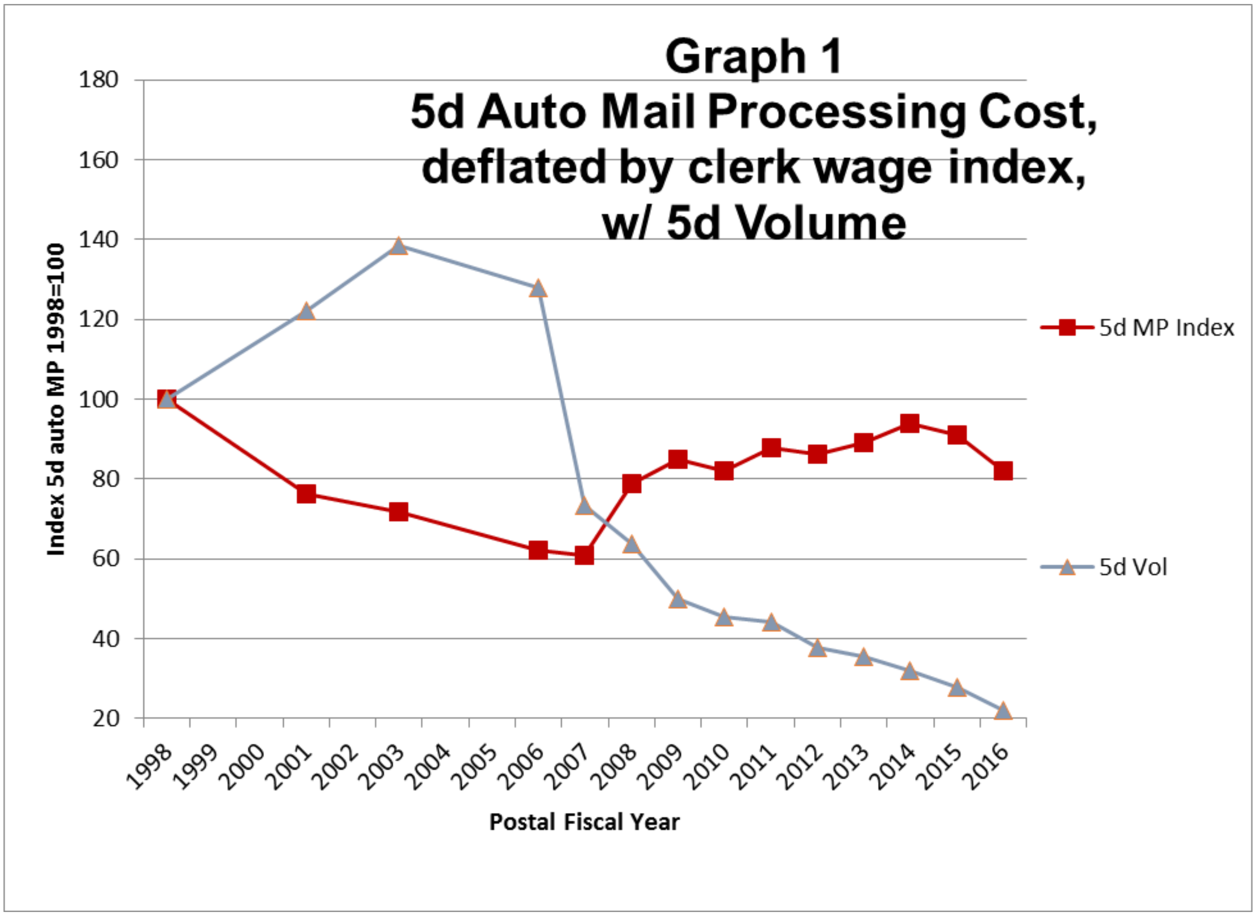
ACR at 5. The Postal Service also acknowledged, however, that having to resort to this procedure yields less than precise estimates of incremental costs. *Id.* at 6.

As explained in the ACR, the Postal Service intends to address the identified challenges regarding more comprehensive incremental cost estimates moving forward. Moreover, the Postal Service likewise intends to supplement the FY 2016 Summary Description to be filed in July as directed in Order No. 3506. The concerns raised by UPS regarding these efforts are premature and do nothing other than create consternation and raise doubts that are unrelated to the Annual Compliance Report under review at this time. It would be counterproductive to compel the Postal Service to be distracted by intermediate proceedings rather than to be able to focus its efforts on the tasks at hand.

G. ACMA's Claims Concerning the Accuracy of Established Costing Methods are Based on Unsound Analyses.

In its comments, the American Catalog Mailers Association (ACMA) made several claims disputing the accuracy of established methods for assigning both mail processing costs and city in-office and street costs. The analysis behind these claims, however, is not sound. The Commission should not rely on ACMA's claims as a basis to question the reported FY 2016 costs for Standard Mail, or any other class. Moreover, AMCA's unsupported comments regarding stand-alone costs fail to add anything constructive to the ACR dialogue.

With respect to mail processing, ACMA asserts on page 7 of its comments that "[c]ertain cost behaviors suggests that the associated costs cannot be relied on as meaningful." This conclusion was reached by ACMA based on an erroneous analysis of historical data. The Standard Mail Flats models in USPS-11 (Folder 11 models) disaggregate the mail processing costs of Standard Mail Flats by presort level. As part of the analysis, the Folder 11 models separate the USPS-26 Costs by Shape into costs that are associated with workshare activities (activities like direct piece distribution and direct bundle distribution) and costs that are invariant to workshare (activities like acceptance, PO Box distribution, forwarding). In its analysis, ACMA uses 5-Digit costs that include the "Fixed Costs" (workshare invariant) for years 2007 through 2016, and costs that exclude these "Fixed Costs" for 2006 and prior years. Given this egregious error, it is not surprising that ACMA is puzzled by the pattern of costs they present. Correction of this error shows that 5-Digit automation flats costs behave as expected over the specified time period. From 1998 to 2006, 5-Digit automation unit costs declined as the AFSM100 was deployed and Incoming Secondary moved from manual to automation. From 2006 to 2009, costs increased slightly due to significant volume decline. From 2009 to 2016, costs have remained stable relative to wages and are not significantly different from what they were 16 years ago.



With respect to city carriers, ACMA artificially constructs (but does not measure) possible trends for marginal street times, by individual product, for city carrier direct labor from FY 2004 – FY 2016. The calculations depend upon a series of assumptions and approximations that undermine the trend's potential accuracy. As constructed by ACMA, the trend tor Standard Mail flats (SF) purports to show that the marginal street time increased from 2.4 seconds in 2004 to 5.8 seconds in FY 2016. ACMA contends that the 2.4 seconds covers picking through an additional flats case at a stop and handling an additional tray when the volume change is large. Moreover, on pages 8 and 9 of its comments, ACMA wonders if analysts of carrier operations believe these more-recent outcomes to be reasonable.

The Postal Service does not accept that the constructed trend figures presented by ACMA are accurate. Even if they were, however, the recent results ACMA has generated would not necessarily be unreasonable. Increases in the marginal times for SF could occur because of: 1) sharp volume declines over the period FY 2004 – FY 2016; 2) the presence of Flats Sequencing System (FSS) bundles at many locations; or 3) ACMA's mischaracterization of the cited marginal times. First, the city carrier volume of SF has declined by approximately 5.5 billion pieces since FY 2004 (8 billion in FY 2004 and 2.5 billion in FY 2016) and, given the known economies of density in delivery, one would expect a corresponding increase in marginal time. Second, Professor Bradley extensively discussed the street cost implications of FSS bundles in Docket No. RM2015-7.[62] Third, ACMA appears to associate marginal times solely with time at stops. Under the current city carrier street model, marginal times are associated with the entire additional amount of regular delivery time caused by an additional piece. This includes time that may be required to access a new delivery point due to the additional piece. ACMA erroneously appears to believe that the marginal times calculated in its analysis only include the additional time at a stop entailed in delivering the additional piece, which neglects the additional access time that may also be required. Additional access time could increase for Standard Mail due to a sharp decline in the amount of First-Class mail being delivered by city carriers, making it more likely that Standard Mail necessitated the access.

ACMA also compares the city carrier street costs of SF with Carrier Route (CR) and High Density (HD) flats. ACMA compares the marginal street times of a CR (3.4

[62] Docket No. RM2015-7, City Carrier Street Time Study Report, at Section III.

seconds) and a HD piece (2.6 seconds), and notes that these marginal times are far lower than the corresponding time for SF (5.8 seconds). ACMA further asserts that it is not clear that a carrier on the street can distinguish between a SF, CR, or HD. They claim that these results suggest that something, presumably the costing methods, appears to be terribly wrong. ACMA Comments at 10.

The Postal Service fails to see how a carrier's ability to distinguish among the three types of flats cited is relevant to costing. Rather, the line of argument appears to show a general misunderstanding of the ways costs are incurred on the street.[63] Moreover, the Postal Service disagrees with the ACMA's claim that the disparate results in marginal times suggests that something is terribly wrong with the costing methods.

The econometric model that underlies the city carrier letter route street costs reflects the fact that marginal times per piece are incurred by bundle *type (DPS letters, cased letters and flats, etc.)* not by individual *product*. Consequently, the differences in marginal times by product (cited by ACMA) only reflect the weighted proportions each product consumes of each bundle type. The different marginal times estimated from the econometric model are 2.8, 2.6, and 5.2 seconds for cased mail, sequenced mail, and FSS mail respectively. Hence, the simple reason SF mail has a higher marginal time than CR and HD mail is that a higher proportion of those pieces are processed by FSS.

ACMA also questions the city carrier in-office direct casing costs. As was done with street costs, ACMA indirectly calculates measures of marginal casing seconds using a series of assumptions and approximations. Based on its calculations and the results of a Postal Service study of relative casing times from Docket No. R2000-1, ACMA concludes that the casing time for SF in FY 2016 was too high. ACMA goes

[63] Docket No. RM2015-7, City Carrier Street Time Study Report, at Section III.

further and suggests that the CR casing time may be too high relative to the corresponding time in FY 2007 (3.2 seconds). Lastly, assuming that HD provided the correct baseline, ACMA concluded that the direct casing times for CR and SF were biased upward. ACMA Comments at 12.

As with its street analysis, the Postal Service contends that the ACMA city carrier in-office cost analysis has method and assumption flaws, which lead to unfounded conclusions. First, ACMA referenced the long-standing city carrier casing standards of 18 letters and 8 flats per minute as evidence that the city carrier in-office direct casing costs were overstated. This conclusion illustrates ACMA's clear misunderstanding of the differences between activities included with direct casing costs as measured by the In-Office Cost System (IOCS). The operational casing rates cited for letters and flats only relate to the direct activity of sequencing mail (*i.e.*, taking mail from bundles and sequencing it in the carrier case). However, direct casing costs captured by IOCS include several additional activities that do not involve direct sequencing of mail. These other activities include, but are not limited to, the following: 1) moving a letter tray or flat tub from the ground to the shelf at the base of a carrier's case, 2) handling undeliverable as addressed (UAA) mail; 3) collating FSS mail with cased mail on walking routes due to bundle restrictions; and 4) pulldown of cased mail. Thus, comparing marginal casing times based on direct casing costs (as measured by IOCS) to the long-standing operational standards used for city carriers is meaningless, because the times based on operational standards are a subset of the costs ACMA used to calculate its marginal times. The in-office costs are not developed by estimating a casing time and then multiplying by volume to obtain the in-office time. As ACMA should perhaps be aware, IOCS develops the picture of in-office activity through use of questions pursuing a broad range of activities, both the expected and unexpected.

Second, the ratio of casing times of non-LOT to LOT flats of 1.52 (found in the R2000-1 study) is <u>not</u> applicable today given the presence of one vertical case, which rarely existed when the previous study was litigated in Docket No. R2000-1. At the time the study was litigated, carriers generally sequenced mail into two cases, one for letters and flats. Moreover, ACMA not only fails to acknowledge the operational change, it also fails to provide any supporting evidence for why the same ratio should currently hold. In sum, the Postal Service stands by its long-standing method of calculating direct casing costs measured by IOCS.

As a final matter, ACMA also claims that its comments last year "explained why it is reasonable to believe" that rates for flats "are likely above their stand-alone costs." ACMA Comments at 13. The Postal Service does not agree that last year's discussion came remotely close to supporting any such belief. Even if it did, however, merely *believing* that it is likely that rates exceed stand-alone costs is no substitute for providing a meaningful empirical estimate of stand-alone costs in an attempt to actually prove that assertion. ACMA has not done so. Accordingly, its unsubstantiated beliefs should be ignored.

III. Customer Satisfaction

A. Customer Access to Postal Services

1. Number of Post Offices

With regard to the customer access as reflected in the number of post offices, the Public Representative noted that "the slight reduction in facilities (if any) does not appear to be cause for concern in FY 2016," but suggested that the Postal Service clarify whether there were in fact "actual closings or just accounting adjustments."[64] The Postal Service recognizes the important role that Contract Postal Units (CPUs), Village Post Offices (VPOs) and Community Post Offices (CPOs) serve in providing access to its products and services. Despite a net increase in VPOs in FY 2016 (as noted in the Postal Service's response to ChIR No. 11, Question 13), the Postal Service has seen an overall decrease in the number of non-postal-managed facilities in recent years. There are a number of reasons for this decline, which include the following:

- The owner/establishment that runs the CPU/CPO decides to no longer participate in the program.
- The owner/establishment that runs the CPU/CPO is sold and the new owner decides not to participate in the program.
- The owner/establishment is not administering the program correctly and the contract is terminated by the Postal Service.

2. Suspensions

As noted in the FY 2015 ACR, the Postal Service shares the Public Representative's concern regarding the number of suspended post offices.[65] In FY 2017, the Postal Service has been working diligently to reduce the number of suspended post offices. Of the 655 offices that were suspended at the end of FY 2016, 22 of the offices have since reopened and are no longer in suspension status. 264 sites were then identified as having completed the discontinuance process, up to the final step of posting in the Postal Bulletin. The Postal Service has been validating these 264

[64] PR Comments at 19.
[65] PR Comments at 19-20.

sites, to ensure that all steps were followed in compliance with 39 CFR 241.3 and Handbook PO-101. During the validation process, personnel identified 4 of the 264 offices that did not post the Final Determination for the time frame required, which brings the total number of offices that have completed the process, up to the Postal Bulletin posting, to 260. As stated in the ACR, the Postal Service plans to complete the discontinuance process for these offices by publishing formal notice in the Postal Bulletin. The Postal Service will continue its efforts in FY 2017 to further reduce the number of suspended post offices.

3. Number of Collection Boxes

The Public Representative notes that the number of collection boxes has declined by more than 15,800 over a four year period.[66] While the overall number of Collection Boxes has declined, a significant but potentially overlooked factor is the diminishing need for locations with multiple collection boxes. Previously, many locations used multiple boxes (one for stamped mail, one for metered mail, local mail, Priority Mail etc.), deployed to facilitate the expeditious sorting of mail when emptying the boxes. However, with the continued decline in single-piece First-Class Mail volume, the need for these sites has decreased. To improve service, the Postal Operations Manual (POM) Chapter 3 (Collection Service – National Service Standards), republished in December 2015, encourages the relocation of low volume-generating collection boxes to sites with potential volume opportunities before removal. Such relocations require Area Office Level approval from the Manager of Delivery Programs

[66] PR Comments at 20.

Support (MDPS) before collection boxes may be removed.[67] Previously this decision was at the sole discretion of the local Postmaster.

B. Wait-Time-In-Line

The PR notes that although the FY 2016 national average for Wait-Time-In-Line (WTIL) has increased by 12 seconds as compared to the previous years' WTIL measurement, the WTIL "still appears reasonable, and the year-to-year changes do not appear significant given the high level of aggregation at which the data are presented."[68] The PR also noted again that analyzing peak WTIL disaggregated by a variety of factors might provide additional insight.[69] However, as the Postal Service noted in its Reply Comments for FY 2015, the WTIL measurement was developed as part of the Mystery Shopper program, now known as Retail Customer Experience (RCE), as a national average for WTIL. This system is not designed to capture WTIL data in a more disaggregated form, which results in any such disaggregated data being not statistically quantifiable. Moreover, it would not be possible to develop such metrics as a national "peak time" measurement, since peak times vary in different areas of the country. Therefore, the Postal Service continues to believe that national reporting is the correct metric for measuring WTIL.

C. Results of Customer Experience Surveys

The Public Representative notes that even though the Postal Service appears to be improving service performance, this improvement has not yet been reflected in customer satisfaction scores.[70] The Postal Service continues to strive to meet customer

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[67] *See* Postal Bulletin No. 22431, December 24, 2015.
[68] *Id.*
[69] *Id.* at 22.
[70] *Id.* at 23.

needs in every service sector. As noted in the Postal Service's ACR discussion of the market dominant survey, the Postal Service takes customer satisfaction very seriously. It continues to analyze all available data to determine the root causes of any lack of satisfaction and uses a variety of initiatives to identify concerns and to implement solutions.[71]

IV. The Postal Service is Committed to Improving Service and Has Deployed All Available Resources to Achieve Results and Engage the Public in its Efforts

A. Broad Service Performance Improvement

The Postal Service appreciates the PR's acknowledgment that most service categories have recovered from FY2015 performance levels.[72] As quantified in the ACR (at 68-70 & supporting data), the Postal Service made tremendous strides in 2016, improving its performance in almost all service categories.[73] At the same time, the Postal Service understands the concerns relative to those which remain below established targets.[74] However, the Postal Service is confident that the service improvement strategies which were first instituted in FY2015, and which continued to be refined throughout FY2016, are significantly responsible for the remarkable recovery which was realized in FY2016.

As a threshold matter, the PR's suggestion that "the Commission should require the Postal Service to include comprehensive service performance improvement plans in future ACRs"[75] would be counterproductive. In determining the content and form of reports that the Postal Service must file, the Commission is required by statute to "give

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[71] FY 2016 ACR at 72-78.
[72] PR comments at 1, 4.
[73] FY2016 ACR at 68-70.
[74] PR comments at 4.
[75] PR comments at 8.

due consideration to … avoiding unnecessary or unwarranted administrative effort and expense on the part of the Postal Service ….”[76] To require such detailed plans across the board with respect to all market dominant products in all ACRs every year, regardless of the current individual or relative performances, is not giving any consideration to this requisite statutory factor. It also would waste precious resources on reporting plans for products at times when performance has been successful, while diverting resources away from other products and areas of performance that may need special attention at such times.

In any event, the Postal Service disagrees that it has not provided detailed plans or visibility into how it will continue to pursue the achievement of high-quality service targets going forward. In the 2015 Annual Compliance Report, the Postal Service outlined key strategies which were implemented to mitigate the temporary, one-time adverse effects on service performance resulting from the operating window change. Although the impact of the operating window change continued into the early part of FY2016, the Postal Service continued to pursue several of the original seven strategies into FY2016. Specifically, the Postal Service continued to develop analytical reports and tools to provide a better understanding and visibility of factors contributing to service failures; continued to adjust surface and air transportation routings to improve on-time performance; and continued to employ Lean management principles throughout the organization. In addition, the Postal Service continued to leverage the additional parcel and bundle sorting capacity which was added in FY2015 in the form of APPS and APBS bin extensions, as well as the additional SPSS machines that were added to the network. The deferment of facility consolidations remained in place throughout FY2016,

[76] 39 U.S.C. § 3652(e)(1)(B).

providing an extended period for operating conditions and service to stabilize. The aforementioned strategies and activities serve as integral components of the Postal Service plans which have helped the Postal Service improve service in most categories, including record-setting Standard Mail performance. It is important to note that service performance for the last two quarters of FY2016 was significantly better than that of the first half of the year, which is reflective of the fact that the initiatives employed during the previous year were sound, and indicative of the momentum generated as the Postal Service prepared to enter FY2017.

Recognizing that the improvements gained in FY2016 are still short of the high-quality service performance targets set by the Postal Service, it will refine, as necessary, many of the same FY2015-16 strategies in its service improvement plans for FY2017. As evidenced by the momentum generated during the second half of FY2016, the Postal Service is confident that service performance will continue to improve in FY2017. Additional strategies being developed for FY2017 include the development of specific root cause analysis tools more narrowly focused on the 24-Hour Clock (operating plan) metrics, improvement in late departing long-haul surface transportation trips and recently activation of Area and National Operations Control Centers. In addition, a limited and yet-to-be determined quantity of additional parcel and bundle sorting machines will be purchased and deployed in Calendar Year 2017.

The Postal Service also disagrees with the PR’s comments that it has not provided visibility into its plans to improve service. As noted previously, the Postal Service outlined seven improvement strategies in the FY2015 ACR for the Commission’s and public’s benefit. In FY2016, the Postal Service welcomed the opportunity to work with the Commission on several requests to provide visibility into service performance plans and activities. These have included the Postal Service's 36-page First-Class Mail Single-Piece Letters/Postcards Service Improvement Plan – FY 2016 that the Postal Service publicly filed in the ACR2015 docket in June 2016.[77] They have also consisted of the Postal Service's multiple sets of detailed plans to address the six pinch points for Flat Mail performance. Those plans have included its 75-page Report Regarding Information About Flats Data Systems filed in July 2016,[78] its October 2016 live presentation at the Commission of how the Postal Service uses data analytics and visibility tools to identify and correct service issues affecting flats,[79] and its 97-page supplemental response to the Commission's flats directive filed in November 2016.[80]

By stark contrast to the PR's comment that the Postal Service has provided "sparse detail" of its service performance plans,[81] Valpak inexplicably faults the Postal Service for being "almost overly responsive" in providing the Commission with "exquisite detail" about its data systems for flats.[82] Valpak's criticism is that the Postal Service's abundant details are allegedly irrelevant because the data systems either would not improve flats performance or would be too expensive to implement. To the contrary, any such limitations in the data systems are, indeed, relevant. The Postal Service responded honestly and extensively to the Commission's directives to examine in detail

[77] Second Response of the United States Postal Service to Commission Requests for Additional Information in the FY 2015 Annual Compliance Determination, PRC Docket No. ACR2015, June 27, 2016.
[78] Third Response of the United States Postal Service to Commission Requests for Additional Information in the FY 2015 Annual Compliance Determination, PRC Docket No. ACR2015, July 26, 2016.
[79] Although the October 21, 2016 Technical Conference itself was off the record, it was open to the public, and the Postal Service's Power Point deck from its presentation was made part of the record when the Postal Service filed it in PRC Docket No. ACR2015 on November 28, 2016.
[80] Response of the United States Postal Service to Commission Information Request No. 1, PRC Docket No. ACR2015, November 28, 2016.
[81] PR comments at 8.
[82] Valpak comments at 10.

those data systems. That such an examination would expose limitations to the various systems is not a weakness, but instead is part of its value to help the Commission help the Postal Service improve performance.

At the same time that it has criticized the Postal Service's "overly responsive" diligence, Valpak has also mistakenly claimed that the Postal Service failed to respond at all to the Commission's directive last year in Commission Information Request (CIR) No. 1, Docket No. ACR 2015, in which the Commission on September 27, 2016, sought methodologies for each of the six flats "pinch points" to be filed within 60 days (i.e., filed by Monday, November 28, 2016). Valpak laments that (supposedly) nothing has been provided to date, now several months later, even though the Commission afforded the Postal Service that 60-day period:

> [The 60 days] brings us to Thanksgiving. Then we passed Christmas. Now it is the New Year. Noncompliance with the FY 2010 ACD directive is still the order of the day. Sixteen months after the end of FY 2015, still no action has begun to deal effectively with the problems.[83]

Valpak has apparently not considered the Postal Service's timely filing on November 28, 2016. That timely response to CIR No. 1 is posted publicly on the Commission's website in Docket No. ACR 2015 and consists of a 97-page primary response document, accompanied by a Power Point presented at the Commission's technical conference and two Excel spreadsheets of data. The Commission should reject Valpak's blanket assertion that the Postal Service has failed to comply with the Commission's directive.[84]

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[83] Valpak comments at 12.

[84] By contrast, the Postal Service acknowledges that PostCom is correct in its comments that the Postal Service has not yet submitted its new audit plan on service performance measurement. PostCom comments at 5. The Postal Service has been actively engaged in generating that new audit plan. The Postal Service expects to file it with the Commission in the near future.

B. First-Class Mail

As noted in the introduction, the Postal Service recognizes that gaps remain between the improved service performance of FY2016 and the high-quality targets established by the Postal Service. The 3-5 Day service standard is the highest-opportunity gap among all the First-Class Mail products.

Going forward, the Postal Service will continue to use the tools and strategies that produced the improvements in FY2016. In FY2017, the Postal Service is pursuing several additional initiatives. First, the development of specific root cause analysis tools will help to pinpoint where, in the processing and transportation cycles, failures are occurring. Additionally, from the tools which are currently available the Postal Service is focusing on the 24-Hour Clock metrics of Outgoing (OG) Primary operations cleared by 2330 hours (2300 hours for First-Class Mail Parcels), Long-Haul Trips departing late between the hours of midnight and 0700 hours and Managed Mail Program (MMP) cleared after 1500 hours. Analytical tools recently developed in FY2017 allow the Postal Service to determine average pieces of mail processed after the target clearance time, enabling site- and lane-specific improvement opportunities. The Area and National Operations Control Centers (NOCCs), which were activated just prior to Peak Season, provide near real-time monitoring of key equipment, operations and transportation performance metrics, enabling quick intervention to help prevent or quickly mitigate potential service failures.

The Postal Service is also driving the advancement of destinating 3-Day First-Class Mail into a Two-Day processing and delivery window. This strategy is helping to reduce the volume of mail that is at risk of failing service on any given day. Although the largest gap in performance to target is with the 3-5 Day service standard, some of these tools and strategies should help to drive improvements in Overnight and Two-Day First-Class Mail service standards as well.

C. Standard Mail

As the PR observed (at 10), Standard Mail (now known as Marketing Mail) has improved, and, as the Postal Service has noted, the performance of this product achieved record performance levels in FY2016. Even with the record performance of Composite Standard Mail, the Flat shaped product remains an opportunity for improvement.

In FY2017, the Postal Service is continuing its efforts to reduce Work in Process (WIP) cycle time from point of entry (mail acceptance) to Bundle Sort operations, and from Bundle Sort operations to single piece distribution. In addition, the Postal Service is continuing to advance Standard Mail Flats into the processing window by at least one day where feasible. With the addition of new Small Parcel Sorting System (SPSS) equipment at high volume locations in Calendar Year 2017, additional bundle sorting capacity will be available. The additional capacity will help to improve the WIP cycle time from entry to bundle sort operations.

Building on the improvements realized for Standard Mail service in FY2016, the strategies outlined above will help the Postal Service in its pursuit of continuous improvement for the Standard Mail Flats product in FY2017.

D. Other Comments

Although Periodicals Service performance stabilized in FY2016, performance remained below target. In FY2017, the Postal Service will continue its efforts to work with the mailing industry to resolve specific concerns, while pursuing process and cycle time reduction strategies similar to those outlined for Standard Mail Flats.

The Postal Service acknowledges the gap in performance to target for Bound Printed Matter (BPM) Flats. As indicated in the 2016 ACR, the Postal Service is committed to building upon the incremental improvement realized in 2016, including through a constant effort of identifying constraints, reducing WIP cycle times and advancing machineable BPM Flats where feasible.

As described in past comments,[85] the Postal Service continues to disagree with the PR's renewed proposal from the PR comments in FY 2015 to report calendar days-to-delivery as an alternative reporting metric. The Commission did not adopt this proposal when it was raised last year, and no new justification has been demonstrated. Instead, the Postal Service's substantial service performance improvements in FY 2016 indicate that current measures are working.

The Postal Service appreciates the opportunity to respond to the PR's and others' comments and to work with the Commission in improving the service performance for the American public. As outlined throughout these reply comments, the Postal Service has continued to pursue the development of modern analytical tools and of foundational service improvement initiatives, as well as the opportunity to provide visibility into these efforts from an internal perspective and to its external stakeholders. The Postal Service is confident that these efforts have contributed significantly to the remarkable service improvements of FY2016 and will continue to yield improvements as we pursue high-quality service performance in FY2017.

[85] Reply Comments of the United States Postal Service, PRC Docket No. ACR2015, February 12, 2016, at 26.

V. Conclusion

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

Respectfully submitted,

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