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

PERFORMANCE INCENTIVE MECHANISM	Docket No. RM2021-2

COMMENTS OF THE NEWS/MEDIA ALLIANCE AND
THE NATIONAL NEWSPAPER ASSOCIATION
(September 15, 2023)

The News/Media Alliance ("N/MA")[1] and the National Newspaper Association ("NNA")[2] respectfully submits these comments in response to Order No. 6537,[3] which revived this proceeding initiated by the Advance Notice of Proposed Rulemaking in Order No. 5816.[4]

N/MA and NNA will confine these comments to addressing the possibility of a performance incentive mechanism ("PIM") to Periodicals class mail. If there is to be a PIM applicable to Periodicals Mail, it should take the form of forfeiture of the 2 percent surcharge for non-compensatory classes (39 C.F.R. §3030.222) unless the Postal

[1] N/MA is the leading voice for the news and magazine media industries that collectively generate more than $40 billion in annual revenue. Our members use all classes of mail, particularly Periodicals and USPS Marketing Mail.

[2] Established in 1885, NNA represents community newspapers across the United States. Primarily weekly publications, they rely heavily upon the Postal Service for distribution to their subscribers.

[3] Order No. 6537 (June 12, 2023) (Order Reactivating Docket and Setting Comment Deadline). Since July 2, 2021, the Commission has held this proceeding in abeyance. *See* Order No. 5928 (July 2, 2021).

[4] Order No. 5816 (Jan. 15, 2021) (Advance Notice of Proposed Rulemaking Regarding Performance Incentive Mechanism) ("*ANPRM*").

Service achieves 95 percent on-time performance for Periodicals, based upon the service standards in place today, including all business and mail preparation rules, and limits any increase in Periodicals unit costs to less than the change in CPI minus 1 percent.

I. THE POSTAL SERVICE HAS CONSISTENTLY FAILED TO CONTROL PERIODICALS COSTS WHILE PERIODICALS SERVICE HAS DECLINED

The stated purpose of this proceeding is to determine whether additional regulations may be necessary to achieve the statutory objectives of maximizing incentives to increase efficiency and reduce costs while maintaining high-quality service standards and assuring financial stability. *ANPRM* at 1. N/MA also believes that improvements in efficiency, cost reductions, and service are essential towards ensuring the financial strength of the Postal Service.

In the case of Periodicals mail, for many years the Postal Service has not met its service standards or targets for the class. Moreover, the Periodicals class has suffered from the Postal Service's long-standing issue with excessive costs in handling flats mail, as Periodicals mail primarily consists of newspapers and magazines. As just one example, the Commission's Annual Compliance Determination for FY2021 presented a lengthy discussion of the Postal Service's cost issues in handling flats.[5] Yet despite this history of poor service and excessive costs, the Postal Service has not faced any regulatory consequences.

Instead, it has been *mailers* who have suffered regulatory consequences. Due to the Postal Service's longstanding cost control issues, Periodicals mailers are now

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[5] *See Annual Compliance Determination, FY 2021,* at 228-277 (Mar. 29 , 2022) ("*FY2021 ACD*").

subject to a two percent surcharge for "non-compensatory" products, authorized by the Commission in Docket No. RM2017-3.[6] The Commission has authorized that surcharge in its last three Annual Compliance Determinations and the Postal Service has used that surcharge to raise Periodicals rates in all three years.[7] As a result Periodicals mailers are paying rates that are more than 6 percent higher than they would be under the already-well-above CPI price cap for compensatory products.[8]

Moreover, the two percent surcharge imposes no conditions on the Postal Service other than that costs for Periodicals exceed revenues from Periodicals. The Commission need only find in an Annual Compliance Determination that the Periodicals class attributable costs exceeded revenues. There is no requirement that the Postal Service take any actions to control, reduce or otherwise limit its Periodicals costs to be eligible for the two percent surcharge. Although the Commission has added numerous reporting requirements regarding flats operations and costs and Congress has directed the Postal Service to remedy its inefficiencies in the handling of flats, the Commission does not require any condition for eligibility for the additional 2 percent. Nor does the Postal Service face any other regulatory consequences.

In fact, the surcharge creates an incentive for the Postal Service *not* to bring Periodicals costs under control, because if it did so successfully it would lose the extra

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[6] *See* Order No. 5763, Docket No. RM2017-3, at 194-196 (Nov. 30, 2020), *codified at* 39 C.F.R. §3030.222. The Postal Service has the option not to use that surcharge in any given year.

[7] *See United States Postal Service Notice of Market-Dominant Price Change*, Docket No. R2021-2, at 4-5 & 21 (May 28, 2021); *United States Postal Service Notice of Market-Dominant Price Change*, Docket No. R2022-1, at 3-5 & 219 (April 6, 2022); *United States Postal Service Notice of Market-Dominant Price Change*, Docket No. R2023-2, at 4-5 & 26 (April 10, 2023).

[8] That is in addition to the higher rates caused by the density and retirement authorities applicable to all Market-Dominant classes.

revenue from the two percent surcharge. As long as the Service has excessive Periodicals costs, it can raise prices even higher.

Yet rates alone will not and should not solve the Postal Service's problems in Periodicals mail or in other classes. In the same order that adopted the non-compensatory surcharge, the Commission also told the Postal Service not "to address its financial challenges solely by raising rates." Order No. 5763 at 186.

One way for a regulated entity to try to reduce costs is to reduce service, which itself is a *de facto* rate increase. Three times in the past eleven years the Postal Service has formally reduced service standards for the Periodicals class.[9] Despite these repeated service standard reductions, the service performance provided to Periodicals has been even worse. The Postal Service sets the service performance targets for Periodicals lower than for any other Market-Dominant class but has not met those hurdles in any year since FY 2009.[10] Periodicals today still receive the poorest quality service of any Market-Dominant products. *See Annual Compliance Determination Report, Fiscal Year 2022*, at 159-160 (Mar. 29, 2023).

While the Periodicals class is a small volume class, it is no less important than other classes to the publishers and subscribers across the nation who depend upon it

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[9] *See* Advisory *Opinion on Mail Processing Network Rationalization Service Changes*, Docket No. N2012-1, at 52 (Sept. 28, 2012) (summarizing reduced service standards implemented for Periodicals); A*dvisory Opinion on Service Changes Associated With First-Class Mail and Periodicals*, Docket No. N2021-1, at 66 (July 20, 2021) (concluding that extending expected time to delivery of some Periodicals should improve performance at the lengthier standard); summarizing reduced service standards implemented for Periodicals); A*dvisory Opinion on Changes to the Critical Entry Times for Certain Categories of Periodicals,* Docket No. N2022-1, at 3 (Nov. 30, 2022) (noting that Periodicals unable to meet earlier Critical Entry Times will receive slower service).

[10] United States Postal Service *Quarterly Performance for Periodicals, Quarter III FY2023*, https://about.usps.com/what/performance/service-performance/fy2023-q3-periodicals-quarterly-performance.pdf (visited September 1, 2023).

for critical timely news and information. Poor service, high costs, and soaring rates are causing significant harm to both national and local publications. N/MA members have lost subscribers due to the Postal Service's service failures, which are far beyond publishers' control. And the sharply increasing Periodicals rates have forced publishers to charge higher subscription prices, which unfortunately has caused a segment of subscribers to cancel their subscriptions. It is imperative that the Postal Service improve service performance and bring Periodicals costs under control. The Periodicals class is a candidate for a PIM which forcefully imposes more accountability than under current regulations and would help ensure compliance with Congress's directive.

II. A PERFORMANCE INCENTIVE MECHANISM FOR PERIODICALS SHOULD TAKE INTO ACCOUNT THE STATUTORY FORM OF REGULATION AND TARGET AREAS OF PRIMARY CONCERN

If there is to be a PIM affecting Periodicals Mail, it should comport with both the statutory scheme and the economic principles presented in the literature cited in the *ANPRM*. Furthermore, it must prevent still more deterioration of service quality and encourage cost efficiency.

A. The Price Cap System Provides A Strong Incentive To Increase Overall Efficiency By Allowing the Postal Service To Retain Financial Benefits Resulting From Efficiency Improvements

The current statutory system created by Congress for regulating the rates of Market-Dominant products gives the Postal Service a strong incentive – it retains every cent that it can save. If it can reduce costs, the savings go directly to its bottom line.

This mechanism "provides optimal incentives for inducing managerial effort and eliminates the costs associated with managerial…moral hazard."[11]

For that reason, the Postal Service has a more favorable position than most entities subject to price caps. Most price cap systems require the regulated entity to share cost savings with customers. *E.g., Expert Declaration of Robert D. Willig*, Docket No. RM2017-3, at 8 (Feb. 3, 2020).

The Postal Service recognizes this strong incentive, and its actions demonstrate that it can perform without a PIM. It argued in Docket No. RM2017-3 that the "current market environment already supplies maximum incentives for the Postal Service to reduce costs, increase efficiency, maintain high-quality service standards, and restrain price increases" and thus there is no need for a PIM.[12]

The Postal Service's more recent adoption and implementation to date of the Delivering for America Plan demonstrates its response to its incentive. The Plan foresees transforming the organization "to one that is self-sustaining and high performing." *See* https://about.usps.com/what/strategic-plans/delivering-for-america/ (visited Aug. 28, 2023). The Plan presents a broad slate of initiatives designed to transform the network and "further improve our service performance within the existing standards, while reducing costs." *Responses of the United States Postal Service To Questions 1-6 of Chairman's Information Request No. 2*, Q1, Docket No. PI2023-4 (Aug. 22, 2023). Whether the many and wide-ranging initiatives outlined in the Plan will

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[11] Joskow, Paul L, *Incentive Regulation in Theory and Practice Electric Transmission and Distribution Networks*, at 6 (January 21, 2006).

[12] *Initial Comments of the United States Postal Service in Response to Order No 4258*, Docket No, RM2017-3, at 44-45 (Mar. 1, 2018).

achieve the intended results will not be known for years. But what is important for this proceeding is that the Postal Service has sufficient incentive today – without a PIM – to make these changes.

What is missing from the current system is not incentives, but a means of ensuring accountability. Given that the PAEA has already given the Postal Service the strongest incentive, one that is recognized in economic literature, and one that the Service is acting upon, there is no need for a PIM that would generate still more upward rate authority, which would be redundant with existing incentives.[13] Yet even with its incentive, the Postal Service has not improved the cost or service for the Periodicals class. Past initiatives directed at Periodicals unit costs have either proven unsuccessful, such as the Flats Sequencing System, or the Service has been unable to track whether a particular initiative has produced positive results.[14] Regardless of the causes, the net result is the same: Periodicals mailers have experienced reductions in service, excessive unit costs, and soaring rates. Yet the Postal Service has faced no sanction or accountability, other than criticism in the ACR process, for these failures.

The economic literature cited by the *ANPRM* states that a PIM can usefully exert pressure on a regulated entity to improve targeted problem areas of activity.[15] A PIM

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[13] *See Utility Performance Incentive Mechanisms, A Handbook for Regulators*, Synapse Energy Economics, Inc., Prepared for the Western Interstate Energy Board, at 2 (March 9, 2015) ("*PIM Handbook*"); *Willig Declaration* at 15-16.

[14] N/MA recognizes that the Commission observed that unit attributable costs for Outside County Periodicals declined in FY 2022. However, the Commission noted that was "primarily due to the elimination of the requirement to pre-fund retiree health benefits" which in previous years were piggybacked onto labor costs, not due to improved performance by the Postal Service. Postal Regulatory Commission, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement*, at 62-63 (May 17, 2023).

[15] *See PIM Handbook*, at 7 (stating "[w]here utilities are subject to economic and regulatory cost-cutting pressures, [PIs] can encourage utilities to maintain, or even improve, customer service, customer

that reduces rate authority is consistent with the need to target areas requiring improved accountability. While retaining the incentive built into the price cap system, a properly-designed negative PIM would also align the system more closely with the standard economic theory of price caps, which require the regulated entity to share cost savings with its customers.[16]

B. A Performance Incentive Mechanism Would Deter Further Periodicals Service Degradations

As mentioned above, Periodicals mailers have seen the Postal Service reduce the applicable service standards or related business rules three times in the past eleven years. The Postal Service has generally justified these reductions as necessary to reduce costs or improve "measured" – albeit slower -- service. However, notwithstanding these repeated service reductions, the Postal Service's service *performance* continues to fall short.

Reducing service to cut costs is a well-recognized risk in a price cap system. As the Commission has recognized, a decline in service standards or service performance is "tantamount to a decline in the overall value of the mail." Order No. 4257, Docket No. RM2017-3, at 256 (Dec. 1, 2017). It is the Commission's responsibility to deter the Postal Service from doing so. As the *PIM Handbook* cited in the *ANPRM* states, "[W]ith performance-based regulation, performance metrics and incentives might be especially important to prevent the degradation of service as a result of pressures to reduce

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satisfaction, and other relevant performance areas"); William Zarakas, *A New Face for PBR: Aligning Incentives in the Electric Utility Ecosystem*, PUB. UTILS. FORT., at 3 (December 2017).

16 *Willig Declaration* at 16 (stating "[i]t is important that some of the benefits of a price cap system be passed on to consumers").

costs." *PIM Handbook* at 3. PIMs are applied "in order to ensure that utilities do not allow service to degrade in their pursuit of reduced costs and greater efficiencies." *Id.* at 13.

The Postal Service needs to improve the actual service performance received by Periodicals Mail. Yet the recent history of reducing Periodicals service standards, including business rules, does not provide assurance that it will not again reduce standards instead of improving performance. Establishing a PIM that focuses on improving actual performance could guard against the Postal Service trying to reduce service standards.[17] And to the extent that the Service does not plan to reduce Periodicals service again, such a PIM should not affect its plans.

C. A Performance Incentive Mechanism Would Also Help To Focus The Postal Service On Reducing Periodicals Costs

While PIMs generally focus on aspects of service performance, a PIM targeting Periodicals costs would help ensure compliance with the statutory and regulatory direction to the Postal Service to address longstanding flats costs trends while, at the same time, not interfering with the Postal Service's authority over day-to-day operations.

The Postal Service's long-term issues with flats costs generally and Periodicals flats specifically is well-documented. The Commission found in the *FY2021 ACD* that the Postal Service's poor performance was not limited to a small set of operations, but rather pervaded mail processing, transportation, delivery, and even pricing efficiency.

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[17] It is important to isolate true service performance from illusory improvement that could occur if the Postal Service were to meet its "targets" better but only because the standards were reduced. *See* Postal Regulatory Commission, *Analysis of United States Postal Service's FY 2022 Annual Performance Report and FY 2023 Performance Plan*, at 29-30 (June 28, 2023) (noting that Postal Service is unable to identify how much change in service performance results was due to service standards changes).

Unfortunately, despite years of attention from the Commission in the annual compliance review process and in other proceedings,[18] and attention from the Office of the Inspector General,[19] the Postal Service's inability to restrain flats costs has persisted.

Indeed, matters deteriorated to such degree that Congress in 2022 directed the Commission to identify and quantify the Postal Service's inefficiencies in handling Flats, and to quantify the effects of those inefficiencies on postal costs, and for the Postal Service to develop and implement an operational plan to address the inefficiencies. Postal Service Reform Act, Section 206(c). In response, the Commission, after conducting a proceeding,[20] issued extensive findings in the *Flats Operations Study Report* in April 2023. Among its conclusions were that if flats volumes continue to decline, "[c]ost reduction programs must be established that at least match the rate of decline in order to stabilize marginal costs." *Id*. at 152.[21]

A PIM that, in addition to preserving and improving service, also holds the Postal Service accountable for reducing its costs for handling Flats would be appropriate. The next Section discusses the form such a PIM could take.

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18 *See Special Study on Issues Related to Flats Operations*, Docket No. SS2022-1.

19 *E.g.,* Office of the Inspector General, *Flats Cost Coverage*, Audit Report Number 22-166-R23 (June 29, 2023); Office of the Inspector General, *Cost Reduction Initiatives for Mail Products*, Audit Report Number 20-0888-R20 (Aug. 3, 2020).

20 N/MA submitted comments in that proceeding. *See Comments of N/MA – The News/Media Alliance*, Docket No. SS2022-1 (Jan. 18, 2023).

21 The Postal Service recently released a draft of the required plan. *See Postal Service Flats Plan Pursuant to Section 206 of the Postal Service Reform Act of 2022* (Aug. 15, 2023).

III. THE PERFORMANCE INCENTIVE MECHANISM FOR PERIODICALS SHOULD BE THE LOSS OF THE NON-COMPENSATORY SURCHARGE IF PERIODICALS-SPECIFIC METRICS ARE NOT MET

The *PIM Handbook* cited in the *ANPRM* recommends that metrics for a performance incentive mechanism should be:

1. Tied to the policy goal;
2. Clearly defined and unambiguous;
3. Able to be quantified using reasonably available data;
4. Sufficiently objective and free from external influences;
5. Easily interpreted; and
6. Verifiable.

PIM Handbook at 28-31. These are reasonable criteria that can readily be applied to the Postal Service. The appropriate metrics and mechanism for Periodicals are quite clear and derive directly from the discussion above.

A. Metrics For Service Performance And For Costs

A PIM for Periodicals should have two metrics – one linked to service and a second linked to operational improvements and efficiency.

First, for service, the Commission should bear in mind that by the time a PIM will be implemented, the Postal Service will have had several years to meet its Delivering For America goal of achieving 95 percent on-time performance for mail in measurement. *Delivering for America Plan* at 38. Accordingly, the metric for Periodicals service performance should be:

> 95 percent on-time performance, based upon the service standards in place today, including all business and mail preparation rules.

This metric for service performance ties directly to the goal of not cutting service to save money, and is objective and verifiable through the annual compliance review process.

Although existing data provides some measurement for Periodicals, the only sure way to determine whether service is maintained is for the Postal Service to substantially increase the coverage of its service performance measurement system for Periodicals. Today, barely half of Periodicals Mail is measured.[22] The Postal Service measures *less than 10 percent* of Within County mail.[23] It measures only about 62 percent of Outside County. How can there be accountability for service performance when service is not measured? As part of the metric, the Postal Service should directly measure Within County mail (instead of using a proxy as at present), and measure more Outside County mail than merely the volume currently in measurement.

Second, for the cost metric, the Postal Service should be held accountable for:

> holding increases in Periodicals per-unit attributable costs to less than the Consumer Price Index minus 1 percent.

This is consistent with the Commission's call, in the *Flats Operations Study Report*, for the establishment of cost reduction programs "that at least match the rate of decline" in volume to stabilize marginal costs. Restraining Periodicals unit attributable costs to CPI minus 1 percent sets a reasonable and appropriate target for the Service to improve the longstanding cost trends.

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22 In the third quarter of this year, of 766,875,360 total Periodicals pieces, only 417,865,833 were measured. *See* United States Postal Service, *FY 2023 Q3 Measured and Unmeasured Volumes report, Audit, Audit Response Pursuant to 39 CFR 3055.31(h)(3-4) and (i)* (Aug. 29, 2023).

23 *Id.* The only Within County mail measured were the few pieces that applied IMbs.

B. The Penalty Mechanism Should Be The Unavailability Of The Non-Compensatory Surcharge

In Periodicals Mail, the form of the financial PIM is clear and straightforward. If the Postal Service (1) fails to achieve 95 percent on-time service performance based upon current standards and (2) fails to hold increases in Periodicals costs to less than CPI minus 1 percent, the Commission should not allow the Service the additional two percent pricing authority for non-compensatory products for Periodicals for the following fiscal year. That would provide a financial incentive for the Postal Service to maintain or improve service and handle Periodicals mail more efficiently. It also would eliminate the disincentive for it to do so inadvertently created by the current rule. Finally, it would be consistent with the Commission's admonition to the Postal Service not to solve its problems by rates alone, as well as its conclusion in the *Flats Cost Study Report* that the Service must set a firm target for reducing Periodicals costs.

The two percent non-compensatory surcharge is a concerning amount of money to publishers, particularly because it is applied in addition to the other above-inflation rate authorities. The July 2023 increase, which included the surcharge plus the other new rate authorities, exceeded 8.1 percent, which followed an increase of more than 3.4 percent earlier in the year. The cumulative more-than-ten-percent increase has caused significant harm to newspapers and magazines. And while eliminating the two percent should be enough to get the Postal Service's attention (as 2 percent of approximately $1 billion in Periodicals revenue is about $20 million), it will not have a material effect on the Service.

Removal of the two percent non-compensatory class authority satisfies the criteria set forth in the *PIM Handbook*. It is tied directly to the policy goal of achieving high quality service while reducing costs and improving efficiency. It is clearly defined; it can be quantified using data that the Postal Service already must report annually; it is as objective as possible given that the data is within the Service's control; it is easily interpreted; and it can be verified through the normal Annual Compliance Review process.

To be effective, the costs should be based on an apples-to-apples comparison. That means that the underlying costing methodologies should, as much as possible, be consistent from year to year. If Periodicals unit costs decline due to a change in costing methodology or, as in FY 2022, due to an Act of Congress, instead of by any new efficiencies adopted by the Postal Service, such a change should not bear on whether the Service in fact reduced its costs.

III. CONCLUSION

For the foregoing reasons, the News/Media Alliance and the National Newspaper Association respectfully submit these comments in response to the *ANPRM* regarding an appropriate performance incentive mechanism applicable to Periodicals Mail.

Respectfully submitted,

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