



Office of Inspector General | United States Postal Service

RARC Report

Assessing the Effectiveness of Domestic Competitive Negotiated Service Agreements

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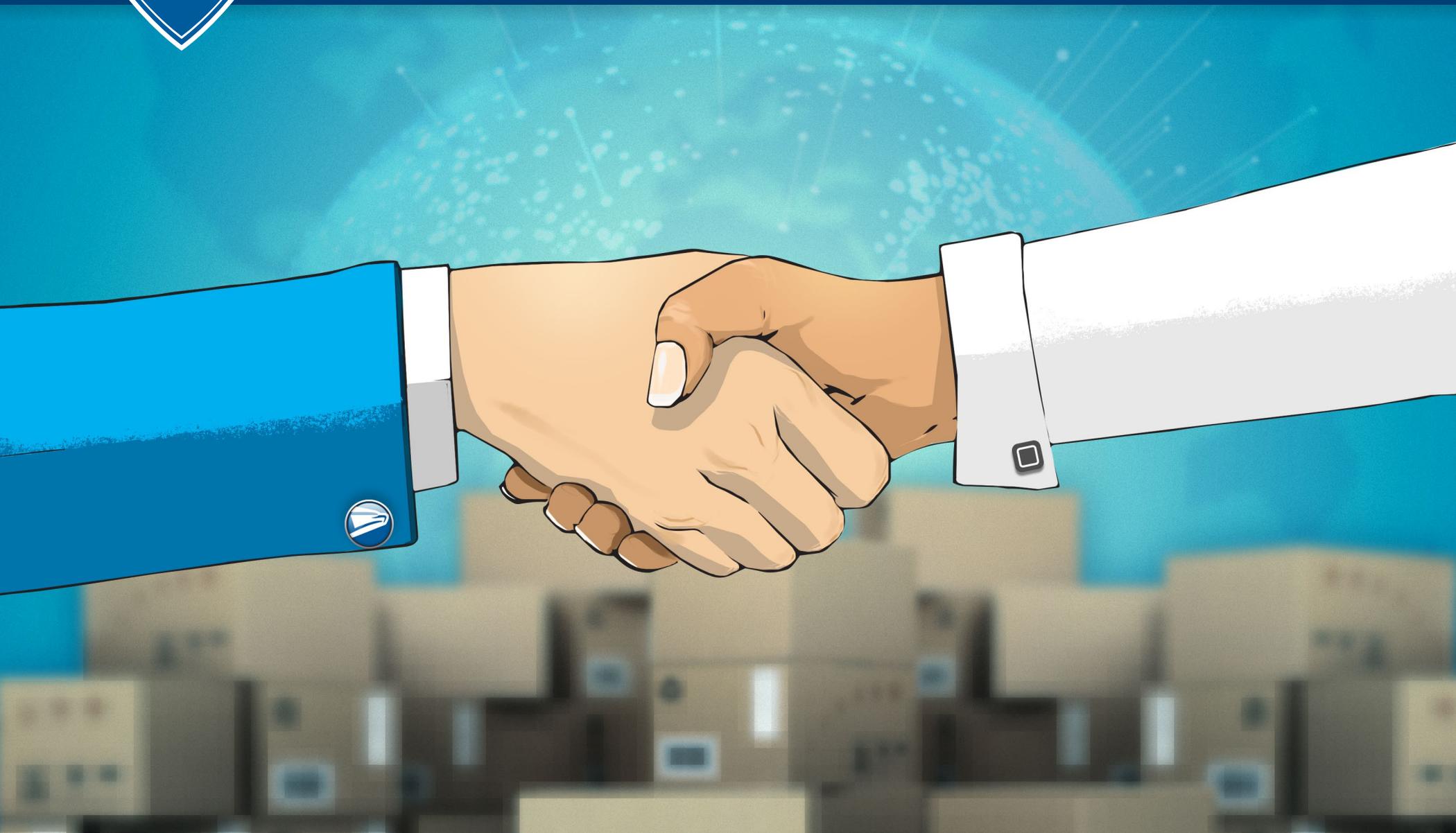


Table of Contents

- Cover
- Executive Summary 1
 - The OIG Recommends that the Postal Service 2
- Observations 3
 - Introduction 3
 - How NSAs Work 3
 - Market Dominant vs. Competitive NSAs 4
 - Use of NSAs Has Grown 5
 - The NSA Approval Process is Complicated 6
 - [REDACTED] 6
 - NSA Results Vary 7
 - The Vast Majority of NSAs Are Profitable 9
 - [REDACTED] 9
 - Do Competitive NSAs Make USPS Better off Financially? 12
 - A Closer Look at a Sample of Individual NSAs 14
 - The Tension Between Meeting Customer Needs and Protecting the Bottom Line 17
- Recommendations 17
- Conclusion 18
- Management’s Comments 18
- Evaluation of Management’s Comments 18
- Appendices 19
 - Appendix A: NSA Financials Over Time 20
 - Appendix B: Management’s Comments 24
- Contact Information 27

Executive Summary

The growth of ecommerce has fueled a boom in the U.S. package delivery industry. As the U.S. Postal Service has sought to grow that business, it has [REDACTED] given individual shippers customized contracts for discounted postage or special terms of service. The number of these “Negotiated Service Agreements” (NSAs) has increased from 66 in fiscal year (FY) 2012 to more than 1,000 in FY 2018. [REDACTED] of USPS domestic package volume.

NSAs are a tool to better meet customer needs when some aspect of the Postal Service’s off-the-shelf offerings does not. [REDACTED] By law, the Postal Regulatory Commission (PRC) approves NSAs, though the regulatory bar for “Competitive” products, which include most packages, is relatively low. The agreements must generate enough revenue to cover the costs directly tied to fulfilling the product or service. In addition, Competitive products as a whole must cover at least 8.8 percent of the Postal Service’s institutional costs. The PRC has approved all of the more than 1,400 domestic package NSA product agreements submitted for review since the program’s inception. USPS also can propose NSAs for “Market Dominant” products, which include First-Class Mail and Marketing Mail. However, there are currently no NSAs of this type. There are multiple reasons for this, including that the regulatory bar for approval is much higher than it is for Competitive NSAs [REDACTED] that is required as part of the process. USPS also has NSAs for international products. Both the Market Dominant and the international NSAs are outside the scope of this white paper.

By law, NSAs also must be approved by the Postal Service’s Board of Governors, which is similar to a corporate board of directors. In 2011, the Governors issued a decision giving approval for all Competitive NSAs that are [REDACTED]. That approval allowed the Postal Service to continue issuing Competitive NSAs, even though there were no presidentially-appointed governors on the board from January 2017 to August 2018. [REDACTED]

Highlights

The number of active NSAs for domestic package products has grown from 66 in FY 2012 to more than 1,000 as of FY 2018. This has strained the processes surrounding NSA approval and oversight.

NSAs are a tool to better meet customer needs in a highly competitive package market.

NSAs overall are solidly profitable for USPS. [REDACTED] by the contracts with the [REDACTED] package customers, which account for [REDACTED] percent of NSA product-level profits.

Three quarters of NSAs [REDACTED]

While the regulatory bar for “Market Dominant” NSAs is high, the bar for new package NSAs is relatively low.

We recommend ways USPS could improve how it manages its NSA program.

[REDACTED] in February 2019 the Governors again issued a decision giving approval for all Competitive NSAs that [REDACTED].

[REDACTED] NSAs overall are solidly profitable, [REDACTED] with the [REDACTED] NSA customers, whose agreements generally perform strongly for the Postal Service. These customers generated [REDACTED] percent of the revenue

and [REDACTED] percent of the product-level profits (known as “contribution” in postal parlance) from NSAs in FY 2017. [REDACTED] percent of the revenue from the [REDACTED] NSA customers comes from agreements for Parcel Select, the Postal Service’s last-mile delivery product, where it has a strong competitive advantage. [REDACTED]

Nearly three quarters of NSAs are [REDACTED] contracts for Priority Mail, where the Postal Service faces strong competition from private carriers [REDACTED]

While the regulatory bar for Competitive NSAs is relatively low, there is still a complex process involved in developing and approving new NSAs and managing ongoing agreements. [REDACTED]

[REDACTED] After the Postal Service’s new Governors took an active interest in NSAs, the Postal Service made significant and important changes, which came as this white paper was nearing publication. [REDACTED]

[REDACTED] This change addressed some concerns that the OIG raised during the discussions surrounding this white paper. As of the publication of this report, the Postal Service continues to explore additional changes and improvements to its NSA process.

The OIG Recommends that the Postal Service:

- [REDACTED]
- [REDACTED]

Observations

Introduction

In recent years, the U.S. Postal Service (USPS) has increased its use of Negotiated Service Agreements (NSAs) in its domestic package business. These agreements are customized contracts with individual shippers and partners for special pricing or terms of service that go beyond the commercial discounts USPS offers to all shippers that qualify.¹ The number of active NSAs grew from 66 in fiscal year (FY) 2012 to more than 1,000 as of FY 2018.²

In this report, the Postal Service Office of Inspector General (OIG) will give a brief history of the expanded use of “Competitive” domestic NSAs, lay out the process behind them, and examine their effect on the Postal Service’s package business. More detailed information is included in [Appendix A](#). The Postal Service also has more than 700 international NSAs, though these are outside the scope of this white paper.⁴

As the OIG was nearing the end of its work on this white paper, the Postal Service made significant changes to its internal NSA approval process. This paper reflects those changes.

This report is a follow up to an OIG white paper issued in July 2018 titled *Postal Partnerships: The Complex Role of Middlemen and Discounts in the USPS Package Business*.⁵

How NSAs Work

The market for shipping packages is highly competitive. Most carriers offer discounts to certain classes of clients, such as new customers or high-volume shippers. As a result, carriers can charge very different prices for delivering the same package to the same destination. The Postal Service is no different from other carriers in this regard and has a variety of prices for its parcel products. USPS publishes its rates and explains how a customer could qualify for each rate tier.⁶ For example, if an individual walks into a post office to ship a package, they will likely pay the Retail rate, which is the highest. If a customer meets certain qualifications, such as using specific payment methods, they could pay the commercial price.⁷ The Postal Service uses NSAs when it wants to enhance some aspect of its standard commercial pricing or services to better meet a customer’s needs.

The Postal Service entered into its first NSA in 2003 with financial services company Capital One.⁸ In the inaugural agreement, Capital One received

The Postal Service’s first NSA was in 2003 with financial services firm Capital One.

1 39 C.F.R. § 3001.5(r).

2 OIG analysis of USPS NSA reports. Note that some NSA contracts include agreements for multiple products, such as Priority Mail and First-Class Package Service. The OIG is counting those as separate agreements, though they are filed with the Postal Regulatory Commission as a single NSA. In addition, the OIG’s figures do not include inactive NSAs, which are still nominally “in effect” but are not utilized by the customer.

4 Postal Regulatory Commission, *Annual Compliance Determination Report Fiscal Year 2017*, March 29, 2018, https://www.prc.gov/docs/104/104398/2017_ACD.pdf, p. 89.

5 U.S. Postal Service Office of Inspector General, *Postal Partnerships: The Complex Role of Middlemen and Discounts in the USPS Package Business*, Report No. RARC-WP-18-010, July 23, 2018, <https://www.uspsoidg.gov/sites/default/files/document-library-files/2018/RARC-WP-18-010.pdf>.

6 U.S. Postal Service, *Price List: Notice 123*, effective January 27, 2019, <https://pe.usps.com/cpim/ftp/manuals/dmm300/notice123.pdf> and U.S. Postal Service, *Commercial Mail: Priority Mail Prices and Eligibility*, January 27, 2019, <https://pe.usps.com/cpim/ftp/manuals/dmm300/223.pdf>.

7 As shown in the Price List referenced in the previous footnote, price tiers and discounts vary by product. For instance, only Priority Mail and Priority Mail Express have the Commercial Plus Pricing tier. In January 2019, the Postal Service made the rates for the Commercial Base and Commercial Plus price tiers identical.

8 Margaret Cigno, Postal Regulatory Commission, *Negotiated Service Agreements*, May 6, 2014, <https://www.gsa.gov/portal/getMediaData?mediaId=191983>, p. 9.

discounts on First-Class Mail in exchange for sending more mail. Capital One also agreed to make changes to its addressing and return practices that would save the Postal Service the time and expense of sorting and returning millions of undeliverable pieces of mail.⁹ Over the first three full years the initial NSA was in place, the Postal Service reaped nearly \$37 million in additional contribution (new revenue plus cost savings) from the agreement.¹⁰

The Postal Service executed eight more NSAs over the next several years, though the approval process was perceived to be arduous, expensive, and time consuming.¹¹ In 2006, Congress passed major postal reform legislation that, in part, made it easier for USPS to enter into some types of NSAs.¹²

Since then, the Postal Service has offered NSA contracts to a wide variety of customers, [REDACTED]

[REDACTED]

The PRC has approved all of the more than 1,400 domestic NSA product agreements submitted for review.

[REDACTED]

Market Dominant vs. Competitive NSAs

The 2006 law created different standards concerning NSAs for “Market Dominant” products, which include First-Class Mail and Marketing Mail, and Competitive products, which include most parcels.¹⁴ For Market Dominant products, the Postal Service must meet a high regulatory bar. The agreements must make the Postal Service better off financially, be available to similarly situated mailers, and must not cause unreasonable harm to the marketplace. The agreements also are subject to a public comment and debate before the Postal Regulatory Commission (PRC), which approves the NSAs.¹⁵ There have been relatively few domestic Market Dominant NSAs, with only one in effect during FY 2017.¹⁶ As of this writing, that contract has ended and there are no NSAs of this type in effect. In addition, the Postal Service’s Board of Governors, which is similar to a corporate board of directors, must approve each Market Dominant NSA. There were no presidentially-appointed governors on the board from January 2017 to August 2018, which also prevented the Postal Service from executing new Market Dominant agreements during that period.¹⁷

Under the law, Competitive product NSAs face few regulatory hurdles. In addition to the requirement that Competitive products collectively cover at least 8.8 percent of institutional costs, the Postal Service must demonstrate that each specific agreement is estimated to cover the costs that can be directly attributed

9 While USPS began the regulatory process for executing the NSA in 2002, the deal did not take effect until 2003. U.S. Postal Service, *Field Information Kit: Capital One Negotiated Service Agreement (NSA)*, Postal Bulletin No. 22109, August 21, 2003, <https://about.usps.com/postal-bulletin/2003/html/pb22109/kit-textx.html>.

10 Analysis of Postal Regulatory Commission periodic reports filed under docket MC-2002-2.

11 Postal Regulatory Commission, *Section 701 Report: Analysis of the Postal Accountability and Enhancement Act of 2006*, September 22, 2011, https://www.prc.gov/sites/default/files/testimonies/701_Report-092211.pdf, p. 52.

12 *Ibid.*, pp. 52-53.

14 Postal Regulatory Commission, *Section 701 Report: Analysis of the Postal Accountability and Enhancement Act of 2006*, p. 7.

15 39 U.S.C. § 3622(c)(10) and 39 C.F.R. § 3010.40.

16 U.S. Postal Service, “FY 2017 Annual Compliance Report,” Postal Regulatory Commission Docket No. ACR2017, December 29, 2017, <https://www.prc.gov/docs/103/103292/FY.17.ACR.pdf>, p. 46.

17 The Board of Governors became vacant December 8, 2016, when James Bilbray’s time on the board ended. Two new Governors were sworn in on September 6, 2018. U.S. Postal Service, *FY 2016 Annual Report to Congress*, The Board of Governors, https://about.usps.com/who-we-are/financials/annual-reports/fy2016/annual_report2016_tech_009.htm and U.S. Department of Treasury, “Two Members of USPS Board of Governors Sworn In,” Press Release, September 6, 2018, <https://home.treasury.gov/news/press-releases/sm475>. For details and context on the Board of Governors, see U.S. Postal Service Office of Inspector General, *Governance of the U.S. Postal Service*, Report No. RARC-WP-17-002, November 10, 2016, <https://www.uspsaig.gov/sites/default/files/document-library-files/2016/RARC-WP-17-002.pdf>.

to providing that product.¹⁸ This is not a high bar. Of the more than 1,400 NSA package product agreements submitted to the PRC since the program's inception, those agreements account for a large portion (40 percent) of USPS package.

Legally, the Board of Governors must also approve the agreements.¹⁹ However, the Governors gave approval in 2011 for all Competitive NSAs that [REDACTED] [REDACTED]²⁰ The Postal Service relied on that approval from FY 2012 until the fall of 2018.

[REDACTED]²¹ [REDACTED] allows the Postal Service to submit all Competitive NSAs that [REDACTED]

The Postal Service has substantial "institutional costs."²⁴ The PRC confirms as part of its annual review that Competitive products collectively generate enough product-level profit to cover at least 8.8 percent of those costs.²⁵ This was increased in January 2019 from 5.5 percent.²⁶ Even with the larger amount, Competitive products have consistently been far above that mark. In FY 2017,

Competitive products covered about 23 percent of institutional costs.²⁷ In other words, collectively, they generated nearly three times the current minimum required profit. Even so, the Postal Service did not have enough product-level profit in FY 2017 from all Competitive and Market Dominant products to cover its \$31 billion in institutional costs.²⁸

Use of NSAs Has Grown

The number of NSAs has grown substantially in recent years. Out of the 6.1 billion packages USPS delivered in FY 2018, [REDACTED] were shipped through NSAs, generating [REDACTED] for the Postal Service.²⁹

Figure 1 shows that a large increase of new NSAs came in FY 2016. Postal Service management [REDACTED] Since then, USPS has continued to issue new agreements at a rapid pace, [REDACTED]

Of the wave of new contracts enacted in FY 2016, [REDACTED]

18 Postal Regulatory Commission, *PRC Adopts Final Rules on Minimum Contribution of Competitive Products to Institutional Costs*, press release, January 3, 2019, <https://www.prc.gov/sites/default/files/pr/Institutional%20Cost%20Final%20Rule%201.3.19.pdf>, p. 1.

19 39 U.S.C. § 3632(b)(3). All NSAs, except for Priority Mail template contracts, are treated for regulatory purposes as individual Competitive products, according to postal officials.

20 U.S. Postal Service Board of Governors, *Decision of the Governors of the United States Postal Service on the Establishment of Prices and Classifications for Domestic Competitive Agreements, Outbound International Competitive Agreements, Inbound International Competitive Agreements, and Other Non-Published Competitive Rates*, Decision No. 11-6, March 22, 2011, <https://www.prc.gov/docs/98/98133/Request%20PM%20Contract%20271.pdf>, Attachment A.

21 [REDACTED] and U.S. Postal Service Board of Governors, Decision No. 18-2, October 25, 2018, <https://www.prc.gov/docs/107/107326/Request%20PM%20Contract%20489.pdf>, Attachment A and [REDACTED]

23 U.S. Postal Service Board of Governors, Decision No. 19-1, February 7, 2019, <https://www.prc.gov/docs/108/108607/Request%20PM%20Contract%20515.pdf>, Attachment A."

24 Institutional costs are items that cannot be directly tied to a particular product or service. This includes items such as headquarters costs. Institutional costs comprised 43 percent of the Postal Service's total costs in FY 2017.

25 39 C.F.R. § 3015.7(c). Officially, the difference between revenue collected and attributable costs is known as "contribution" to institutional costs. For readability, the OIG will use the layman's term "product-level profit" instead of "contribution."

26 Postal Regulatory Commission, *PRC Adopts Final Rules on Minimum Contribution of Competitive Products to Institutional Costs*, p. 1.

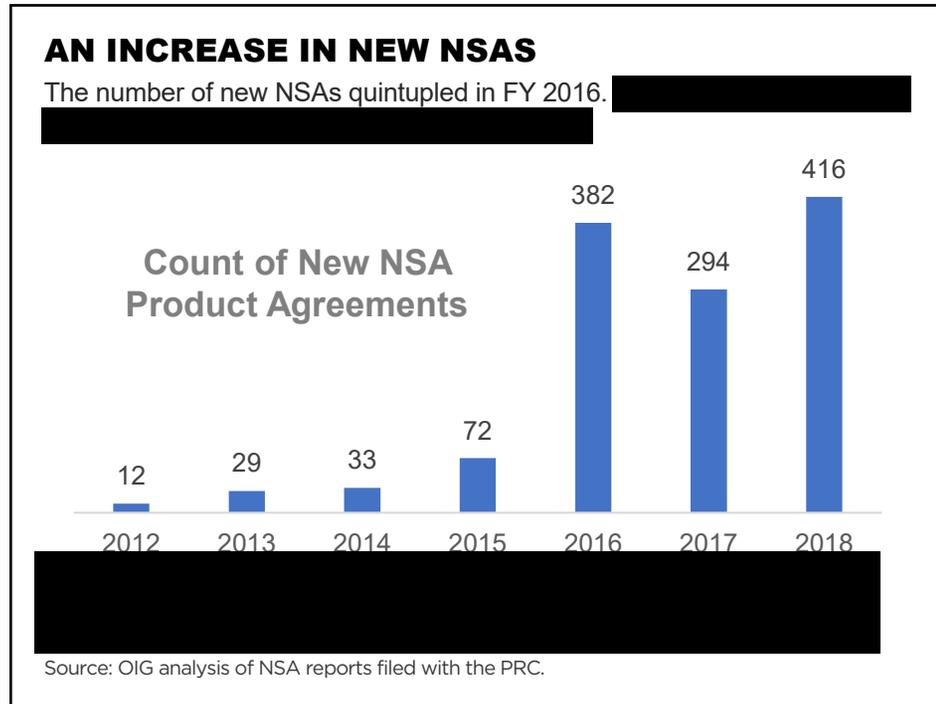
27 Postal Regulatory Commission, *Annual Compliance Determination Report Fiscal Year 2017*, p. 92.

28 This figure includes uncontrollable expenses, such as adjustments to the fair value of workers compensation payments.

29 OIG analysis of the non-public FY 2018 Cost and Revenue Analysis Report.

30 OIG analysis of NSA reports filed with the PRC. This analysis excludes template Priority Mail contracts. Template NSAs automatically expire after one year unless they are renewed.

Figure 1: NSA Growth



The NSA Approval Process is Complicated

While the legal bar for Competitive NSAs is relatively low, the approval process is complex, requiring coordination across many different departments within the Postal Service and external approval by the PRC. The process generally starts when a USPS [REDACTED] identifies a situation in which an NSA with a customer might make business sense. The [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

³³ For template Priority Mail contracts, which are discussed in more detail later, the customer can begin shipping at NSA rates two days after the agreement is signed. The Postal Service then has seven days to notify the PRC of the agreement.

³⁵ The Postal Service must give the PRC at least 15 days to review NSAs for compliance with statutory requirements. 39 U.S.C. § 3632(b)(3); 39 C.F.R. §§ 3015.5-3015.7, 3020.34-3020.35.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

The legal department formally submits the contract to the PRC, which evaluates whether the NSA meets the minimum legal requirement of covering its costs. Once the PRC gives its approval, the customer can begin shipping under the terms of the NSA.³³

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED] with the PRC talked about having to work over weekends at times to keep up with the increased number of NSAs.³⁵ It is unclear how the recent changes to the NSA approval procedures will impact these [REDACTED].

[REDACTED]

NSAs generally have contract terms between [REDACTED] though some [REDACTED] NSAs have frequent amendments. [REDACTED] But amendments that impact the financials of an agreement must go through the

same approval process as new NSAs. [REDACTED]

[REDACTED] Also, the Postal Service worked with the PRC back in 2011 to create an expedited approval process for basic Priority Mail contracts that use a pre-approved contract template and fall within a certain discount threshold.³⁸ These “Contract A” NSAs get automatic PRC approval and face a less burdensome ongoing annual review process compared to other NSAs. They come with a one-year term, but can be extended for an additional year. There were 286 Contract A agreements in FY 2017.³⁹ [REDACTED]

[REDACTED]

NSA Results Vary

Five different categories of parcel products have Competitive NSAs. Each product caters to different customer needs, as explained in Figure 2. Each product also occupies a different space in the broader package delivery market. Priority Mail is the Postal Service’s flagship end-to-end package product, and it had nearly three-times as many NSAs in FY 2018 as all the other domestic package products combined.⁴⁰ Other end-to-end package delivery products include First-Class Package Service, which caters to lightweight packages under 16 ounces, and Priority Mail Express, USPS’ speediest (and most expensive) offering with overnight or two-day delivery and a money-back guarantee.

Parcel Select is generally used by consolidators and large shippers who can presort packages and drop them off by the truckload at postal facilities that are close to the final destination, paying a lower rate based on how close they get the packages to their delivery point.⁴¹ The Postal Service takes the packages the “last mile” and delivers them to their ultimate destination. Many Parcel Select packages originate with other carriers. Since the Postal Service already travels to nearly every address six days per week, it can deliver to many locations in America much more cost effectively. [REDACTED]

[REDACTED]

³⁸ U.S. Postal Regulatory Commission, *Order Approving Addition of Priority Mail—Non-Published Rates 1 to the Competitive Product List*, Docket No. MC2011-15, Order No. 661, February 3, 2011, https://www.prc.gov/docs/71/71807/Order_No_661.pdf, pp. 1-2.

³⁹ OIG analysis of NSA reports filed with the PRC. Note that much of the OIG’s analysis for this white paper was based on FY 2017 data, which were the most current at the time of the analysis. FY 2018 data became available as the OIG was completing its work. Where necessary and feasible, the OIG updated the report with the new data.

⁴⁰ Ibid.

⁴¹ U.S. Postal Service, *Overview – Parcel Select Mail*, accessed April 25, 2018, https://about.usps.com/postal-bulletin/2007/html/pb22219/kit2_002.html.

[REDACTED].⁴² This reflects the sheer size and the core competency of the Postal Service's last-mile delivery operation.

Figure 2: Package Products with NSAs

COMPETITIVE USPS PARCEL PRODUCTS

The Postal Service had Negotiated Service Agreements for five different domestic package products in FY 2018, each of which has different features, as explained below.

Product	Basic Description	NSA Count* FY 2018	NSA Revenue (millions)	NSA Product-Level Profit (millions)
Priority Mail	End-to-end delivery of packages in one to three business days.	775	[REDACTED]	[REDACTED]
Priority Mail Express	End-to-end delivery of packages with money-back guaranteed delivery in one or two days.	98	[REDACTED]	[REDACTED]
First-Class Package Service	End-to-end delivery of lightweight parcels weighing less than one pound in one to three business days.	162	[REDACTED]	[REDACTED]
Parcel Select	Last-mile delivery, requiring shippers to drop off packages close to the delivery point.	24	[REDACTED]	[REDACTED]
Parcel Return Service	First-mile USPS acceptance of returns packages. A reverse logistics provider retrieves the parcels and delivers them to the merchant's returns facility.	12	[REDACTED]	[REDACTED]

*The count of active Negotiated Service Agreements in FY 2018. Note that some NSA contracts include agreements for multiple products. These figures represent the count of individual product agreements. Also, some Parcel Select and Parcel Return Service contracts include separate agreements for different types of drop ship locations. Those are counted as separate agreements in this analysis.

Source: OIG analysis of FY 2018 NSA data filed with the PRC.

Parcel Return Service, on the other hand, services the “first mile” of the ecommerce returns process. Through Parcel Return Service, the Postal Service collects return packages at post offices, from residential addresses, and from collection boxes. It then consolidates the returns packages and hands them off to another company that delivers them to the merchant's returns facility.⁴³

[REDACTED]

[REDACTED]

[REDACTED]

42 OIG analysis of NSA reports filed with the PRC. Parcel Select contracts that include separate agreements for different types of drop ship locations are counted as separate NSAs in this analysis.

43 U.S. Postal Service Office of Inspector General, *Riding the Returns Wave: Reverse Logistics and the U.S. Postal Service*, Report No. RARC-WP-18-008, April 30, 2018, <https://www.uspsoig.gov/sites/default/files/document-library-files/2018/RARC-WP-18-008.pdf>, p. 12.

The Vast Majority of NSAs Are Profitable

As explained earlier, the procedures for creating new NSAs are focused primarily on ensuring that NSAs cover their attributable costs. The Postal Service is mostly successful by that metric. In FY 2017, only five contracts lost money, down from 14 the previous year.⁴⁴ When an NSA fails to cover its costs, the Postal Service explains to the PRC in the Annual Compliance Review how it will remedy the situation to ensure cost coverage on those contracts in the future.

Of the 20 contracts that lost money between FY 2012 and FY 2017, most were terminated, expired, or returned to profitability the following year, though seven sustained losses for multiple years.⁴⁵ One had losses for three consecutive years before finally ending in FY 2018.

Most of the contracts that did not cover their costs have been relatively low-volume NSAs. In FY 2017, the money-losing contracts did not cover their costs by [REDACTED] million, which was slightly less than the previous year's loss.⁴⁶ However, most of the loss in FY 2017 came from a single contract that lost over [REDACTED] million. Some of the contracts that have lost money are small contracts with large companies that also have other, profitable, higher-volume NSAs. In those instances, the customer's contracts with the Postal Service were profitable overall. For more information about the profitability of NSAs over time, please see [Appendix A](#).

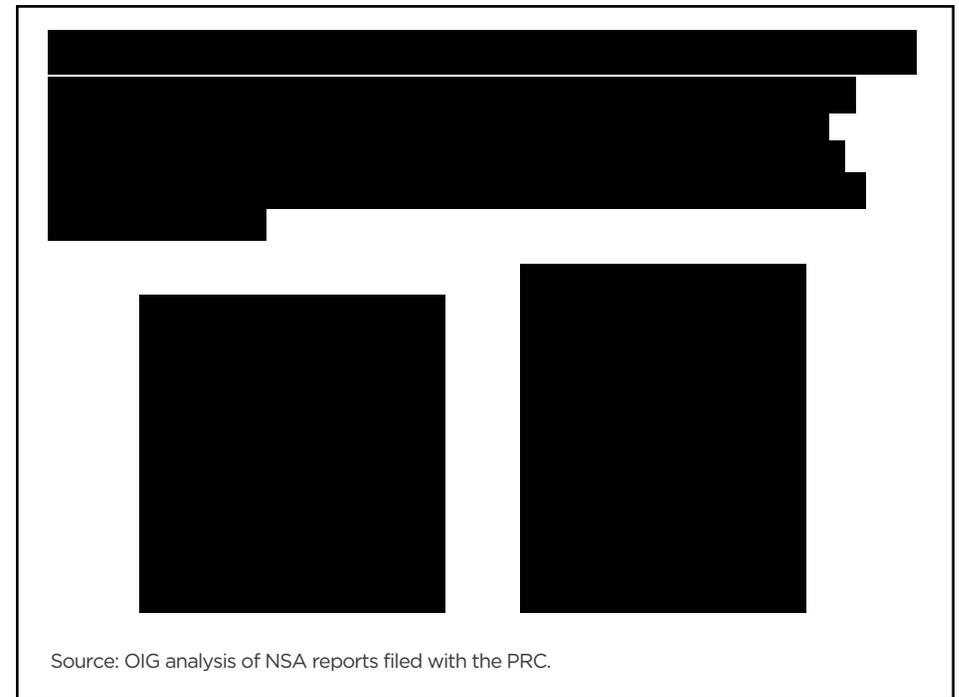
[REDACTED]

The Postal Service's largest NSAs contribute the most financially. Of all NSAs in FY 2017, [REDACTED].⁴⁷ The [REDACTED] [REDACTED] percent of all packages shipped through NSAs. These

Twenty-two NSAs did not cover their costs between FY 2012 and FY 2017.

customers also generated [REDACTED] percent of the revenue and [REDACTED] percent of the product-level profits, as is shown in Figure 3. [REDACTED]

Figure 3: Top 10 NSA Customers by Volume, FY 2017



⁴⁴ OIG analysis of NSA reports filed with the PRC. Note that the PRC also lists NSAs that lost money in its Annual Compliance Determination; however, its count differs from the OIG's because the PRC looks at profitability by NSA contract, rather than product agreement. For example, a single NSA could include agreements for both Priority Mail and Priority Mail Express. If the Priority Mail component lost \$5, but the Priority Mail Express component made \$10, the PRC deems the NSA overall to be profitable by \$5. The OIG's analysis counts this as one money-losing agreement and one profitable agreement.

⁴⁵ OIG analysis of NSA reports filed with the PRC.

⁴⁶ Ibid.

⁴⁷ Ibid.

[Redacted]

[Redacted]

The Government Accountability Office noted a lack of documentation and follow-up in a 2015 audit of Parcel Select NSAs, pointing out that: “the procedures do not require USPS to document some key management decisions, such as USPS’s decision to forego additional revenue when a mailer did not ship a minimum volume of packages, as contractually required.”⁵¹

The Postal Service tracks each NSA’s volume relative to the commitment [Redacted]

[Redacted]

52

USPS officials indicate that other carriers in the package industry have systems in place to automatically enforce volume commitments.⁵³

The smallest NSAs [Redacted]

[Redacted]

[Redacted]

[Redacted]						
[Redacted]						

[Redacted]						
[Redacted]						
[Redacted]						
[Redacted]						

[Redacted]

[Redacted]

51 U.S. Government Accountability Office, *U.S. Postal Service: Improved Management Procedures Needed for Parcel Select Contracts*, Report No. GAO-15-408, April 2015, <https://www.gao.gov/assets/670/669822.pdf>, highlights.

52 The Postal Service also has the right to terminate NSAs, but it is unclear how often this happens, as these terminations are not reported to the PRC.

53 The OIG has validated this through informal conversations with shippers that have described the way other carriers enforce volume commitments. For example, some carriers will adjust a shipper’s price tier based on each month’s volume. If, for example, a customer’s volume fell below a given discount threshold in October, their October invoice would exclude the discount.

NSAs given to existing customers face greater risk of hurting USPS' bottom line

Many NSAs bring in new customers that were previously shipping with another carrier. So long as those deals cover their costs, any product-level profits they generate would improve the Postal Service's bottom line because the profit is based on new volume.

the lower revenue USPS receives through an NSA cuts directly into its product-level profits for those packages. For example, if a customer was paying the Commercial price to ship a two-pound package from Madison, WI, to Washington, DC, USPS would earn an estimated \$2 in profit from that shipment.⁵⁸ If the same customer had an additional 10 percent discount via an NSA, the Postal Service's profit would decline to just \$1.15. The shipper would have to send 74 percent more packages for the Postal Service to maintain the product-level profit it was earning when the customer was paying the Commercial price. If the NSA discount was 15 percent, volume would have to grow by 174 percent to maintain the same level of product-level profit, as is illustrated in Figure 6.

Figure 6: NSA Volume Required to Maintain Profitability

NSAS WITH EXISTING CUSTOMERS REQUIRE LARGE INCREASE IN VOLUME TO MAINTAIN PROFITS

If an existing Priority Mail customer that was paying the Commercial price receives a 10 percent NSA discount, USPS' product-level profit per piece declines from \$2 to \$1.15. For USPS to maintain its profits under the NSA, the customer would have to ship 74 percent more packages. The below table illustrates this, using the price for a two-pound, Zone five package as an example.

	Commercial Price	NSA Discount (-5%)	NSA Discount (-10%)	NSA Discount (-15%)
Revenue/Piece*	\$8.50	\$8.08	\$7.65	\$7.23
Costs/Piece**	\$6.50	\$6.5	\$6.50	\$6.50
Profit/Piece***	\$2.00	\$1.58	\$1.15	\$0.73
Volume	10,000	12,658	17,391	27,397
Total Product-Level Profit***	\$20,000	\$20,000	\$20,000	\$20,000
Volume growth required to maintain profits	0%	27%	74%	174%

*Revenue per piece is rounded to the nearest penny.

**Priority Mail FY 2018 average cost/piece. Actual costs would change as volume changes.

***Product-level profit is officially called "contribution" in postal parlance.

Source: OIG analysis of public Postal Service data.

⁵⁸ Based on the average Priority Mail cost per piece in FY 2018 of \$6.50.

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

A Closer Look at a Sample of Individual NSAs

To get a more nuanced view of NSAs, the OIG looked at a randomly selected sample of 21 NSAs for end-to-end products.⁶³ In addition to the contracts, the OIG reviewed the internal analysis the Postal Service did leading up to the execution of each NSA and the internal tracking documents the USPS Sales team uses to track each NSA on an ongoing basis.

Collectively these contracts accounted for over [REDACTED] in revenue for the Postal Service in FY 2017. They included customers from across the country, including six of the Postal Service’s seven geographic areas. They also included a mix of customized and template contracts. This modest sample provides a window into NSAs that could not be achieved by looking at overall data. There were several key takeaways.

- [REDACTED] In examining the quantity and quality of the customer’s shipping data that the Postal Service evaluated when negotiating each NSA, there was [REDACTED]. Six files were [REDACTED] with [REDACTED] on the customer’s pre-NSA shipments over the previous year. Seven NSAs [REDACTED] or including data that [REDACTED]. For five contracts, the data the Postal Service provided were [REDACTED]. [REDACTED]⁶⁴ For another three agreements, the Postal Service was [REDACTED].

⁶³ The OIG used a random number generator to select the 21 NSAs for this stratified random sample. We requested data on NSAs executed in FY 2016, though in some instances the Postal Service provided data related to more recent NSAs with those customers. As such, some of the data in the sample are for more recent NSAs. Also, this sample is too small to be statistically representative of all NSAs. A statistically-representative sample of all NSAs with a confidence level of 95 percent and a confidence interval of 7 percent would require a sample size of 164. Given that each NSA file often contains dozens of documents, such a large sample was not feasible.

⁶⁴ In some instances, this was because the package level data related to a more recent NSA from the customer, rather than the FY 2016 NSA included in the OIG sample.

■ [REDACTED]

- **A third of the 21 contracts are no longer in effect.** Of the 21 contracts examined, eight are no longer active. Four of those are template Priority Mail contracts that were allowed to expire without being renewed. The other four are custom contracts that were eventually [REDACTED]

A Closer Look at a few Specific NSAs

Using available data on each customer’s pre-NSA shipments, the OIG more closely examined cases where customers shipped primarily through the Postal Service before receiving an NSA. We aimed to better understand how the NSA impacted USPS’ business with these individual customers. Of the [REDACTED] NSAs for which there was robust data about the customers’ pre-NSA shipments, [REDACTED] were with customers that had previously sent a majority of their packages through the Postal Service.⁶⁷ The OIG examined [REDACTED] of those customers to feature in more depth, with each telling a different, illustrative story.⁶⁸ [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

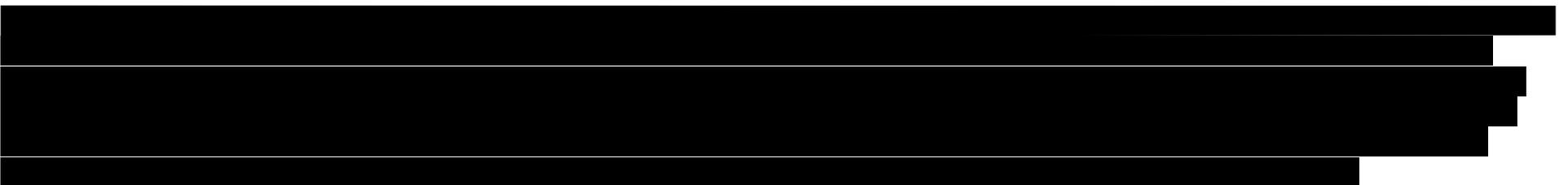
[REDACTED]

[REDACTED]

⁶⁵ Some contracts included multiple product agreements. In the discount analysis, each product agreement was counted separately.

[REDACTED]

Figure 7: The Financial Impact of Customer One's NSA



[REDACTED]

[REDACTED]

The Tension Between Meeting Customer Needs and Protecting the Bottom Line

At a high level, the Sales and Finance departments have different roles. Sales is primarily responsible for growing the business by winning new customers and expanding USPS' relationship with existing customers. It does this by understanding customer needs and meeting them. Finance's traditional role, on the other hand, is to protect the bottom line. It can do this by closely managing revenue and expenses and ensuring only appropriate discounts are approved. This natural tension is common in the private sector and is consistent with organizational best practices.

When the research for this project began, [REDACTED]

[REDACTED] The OIG sees this as a positive development that helps remedy some of the concerns the OIG noted during its research on this project. However, it remains to be seen how this will operate in practice. There is a need to remain vigilant and continue to review the new processes as appropriate.

Recommendations

To address these issues, the OIG recommends:

Recommendation #1

[REDACTED]

Recommendation #2

[REDACTED]

Conclusion

NSAs are an important tool that the Postal Service uses to win and retain customers in the extremely competitive package delivery market. As a whole, NSAs are solidly profitable and have helped grow volume, [REDACTED]

[REDACTED]

[REDACTED] the OIG recommends some additional changes that would help improve the effectiveness of the NSA program.

Management's Comments

Management agreed with the OIG's recommendations and also expressed a few areas of concern regarding the OIG's report.

Regarding Recommendation 1, [REDACTED]

[REDACTED]

Regarding Recommendation 2, [REDACTED]

[REDACTED]

See [Appendix B](#) for management's comments in their entirety.

Evaluation of Management's Comments

The OIG considers management's comments responsive and planned corrective actions should satisfy the intent of the recommendations.

All recommendations require OIG concurrence before closure. Consequently, the OIG requests written confirmation when corrective actions are completed. Recommendations 1 and 2 should not be closed in the Postal Service's follow-up tracking system until the OIG provides written confirmation that the recommendation can be closed.

Appendices

Click on the appendix title below to navigate to the section content.

Appendix A: NSA Financials Over Time	20
Appendix B: Management's Comments.....	24

Appendix A: NSA Financials Over Time

Below is a table showing the number of active NSA product agreements by product and year.

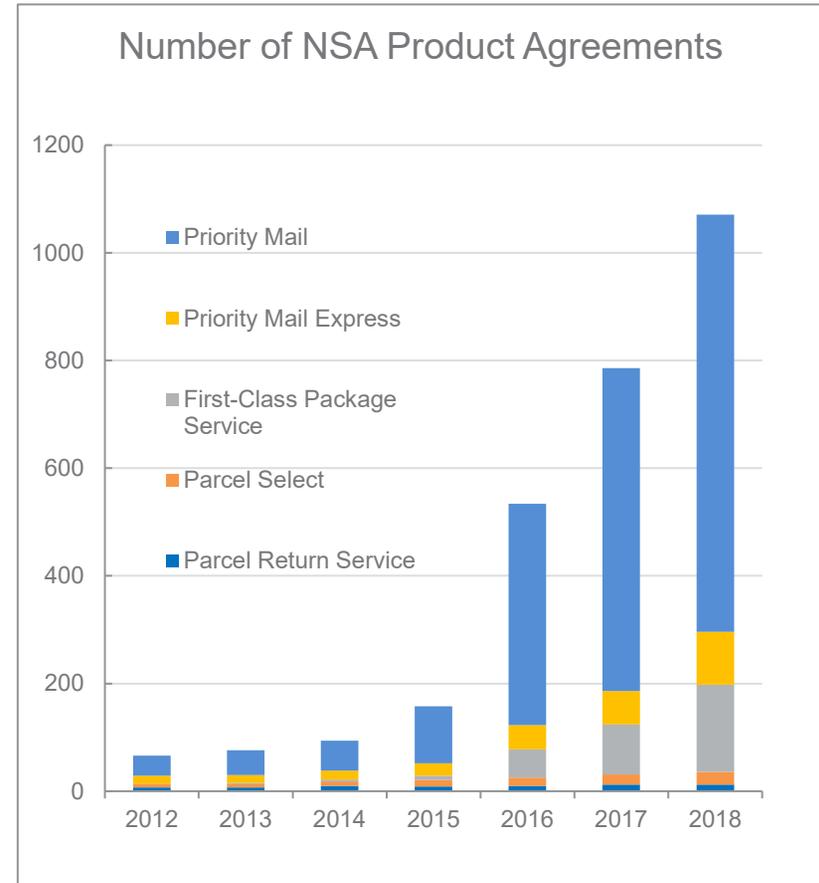
Table 2: Number of Active NSA Product Agreements

Product	2012	2013	2014	2015	2016	2017	2018
Priority Mail	37	46	56	106	411	600	775
Priority Mail Express	15	15	16	23	45	62	98
First-Class Package Service	0	2	4	8	53	93	162
Parcel Select	7	6	8	12	15	19	24
Parcel Return Service	7	7	10	9	10	12	12
Total	66	76	94	158	534	786	1,071

*Note: Some NSA contracts include agreements for multiple products. Those are counted as separate agreements in this analysis. For Parcel Select and Parcel Return Service, contracts that include separate types of drop ship locations are also counted as separate agreements.

Below is a graphic derived from the data in Table 2.

Figure 8: Number of Active NSA Product Agreements



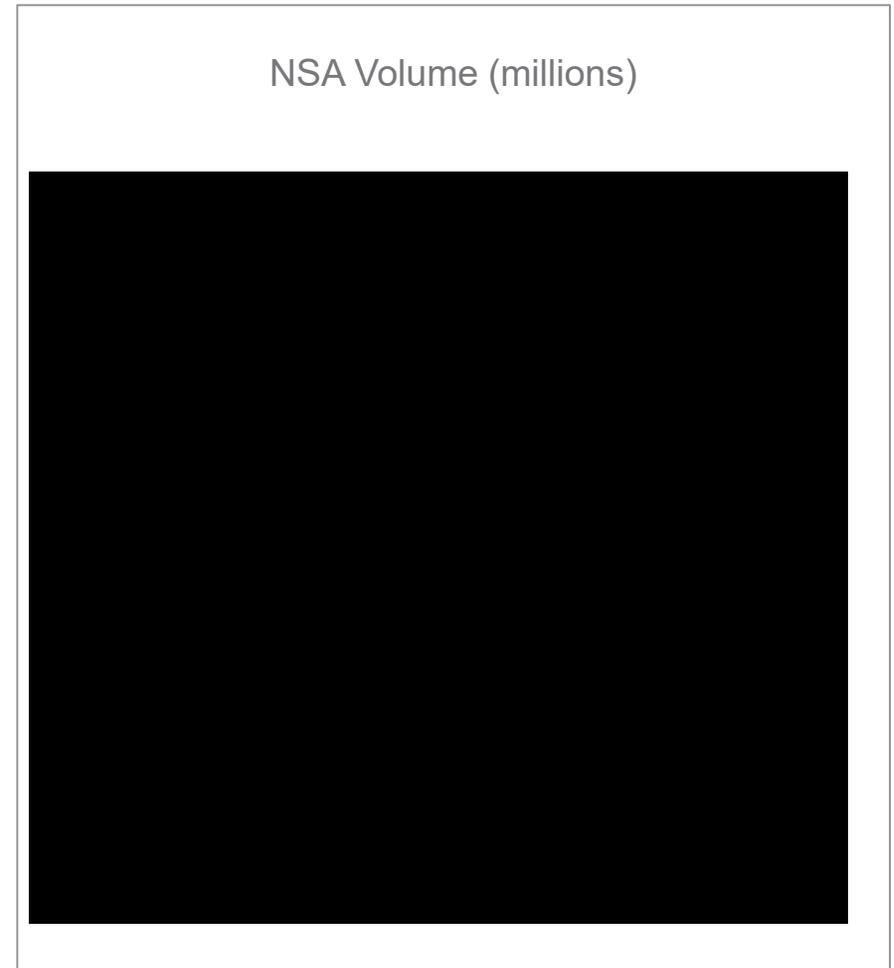
Below is a table showing the number of packages shipped through NSAs, by product and year.

Table 3: NSA Volume (millions)

Product	2012	2013	2014	2015	2016	2017	2018
Priority Mail	■	■	■	■	■	■	■
Priority Mail Express	■	■	■	■	■	■	■
First-Class Package Service	■	■	■	■	■	■	■
Parcel Select	■	■	■	■	■	■	■
Parcel Return Service	■	■	■	■	■	■	■
Total	■	■	■	■	■	■	■

Below is a graphic derived from the data in Table 3.

Figure 9: NSA Volume



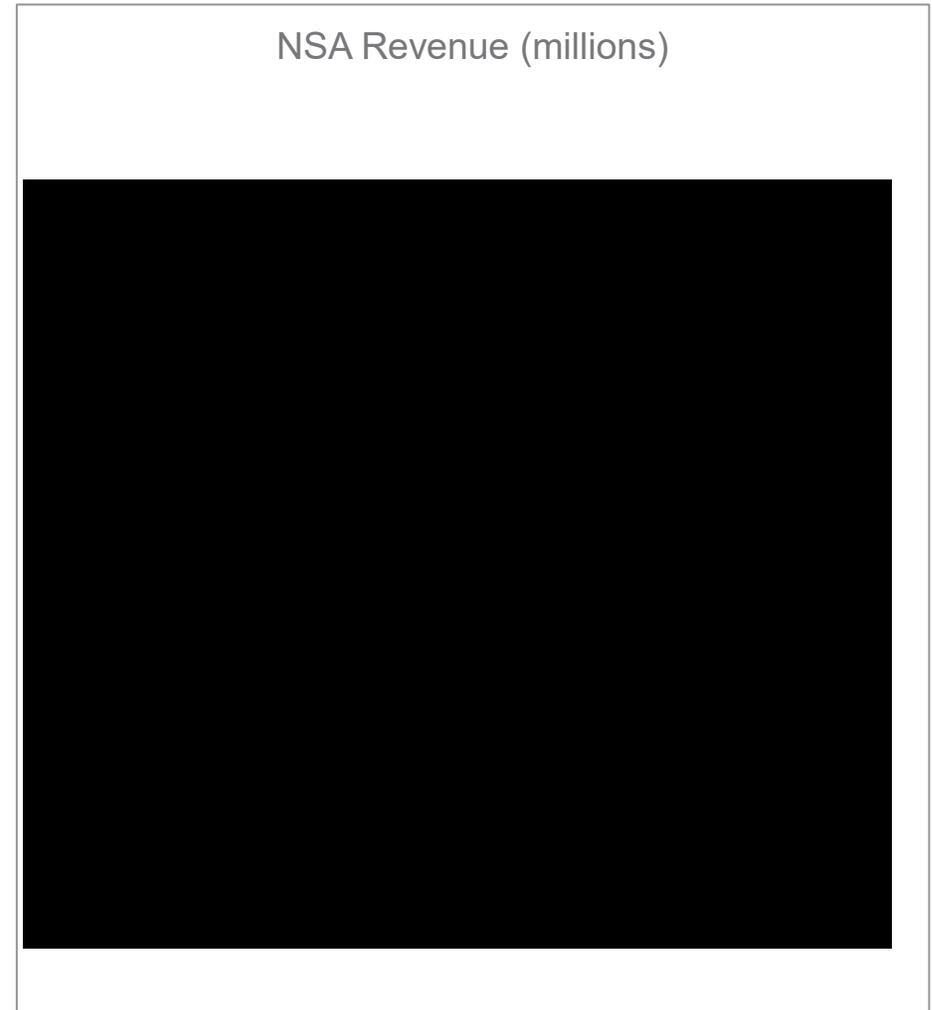
Below is a table showing NSA revenue, by product and year.

Table 4: NSA Revenue (millions)

Product	2012	2013	2014	2015	2016	2017	2018
Priority Mail	█	█	█	█	█	█	█
Priority Mail Express	█	█	█	█	█	█	█
First-Class Package Service	█	█	█	█	█	█	█
Parcel Select	█	█	█	█	█	█	█
Parcel Return Service	█	█	█	█	█	█	█
Total	█	█	█	█	█	█	█

Below is a graphic derived from the data in Table 4.

Figure 10: NSA Revenue



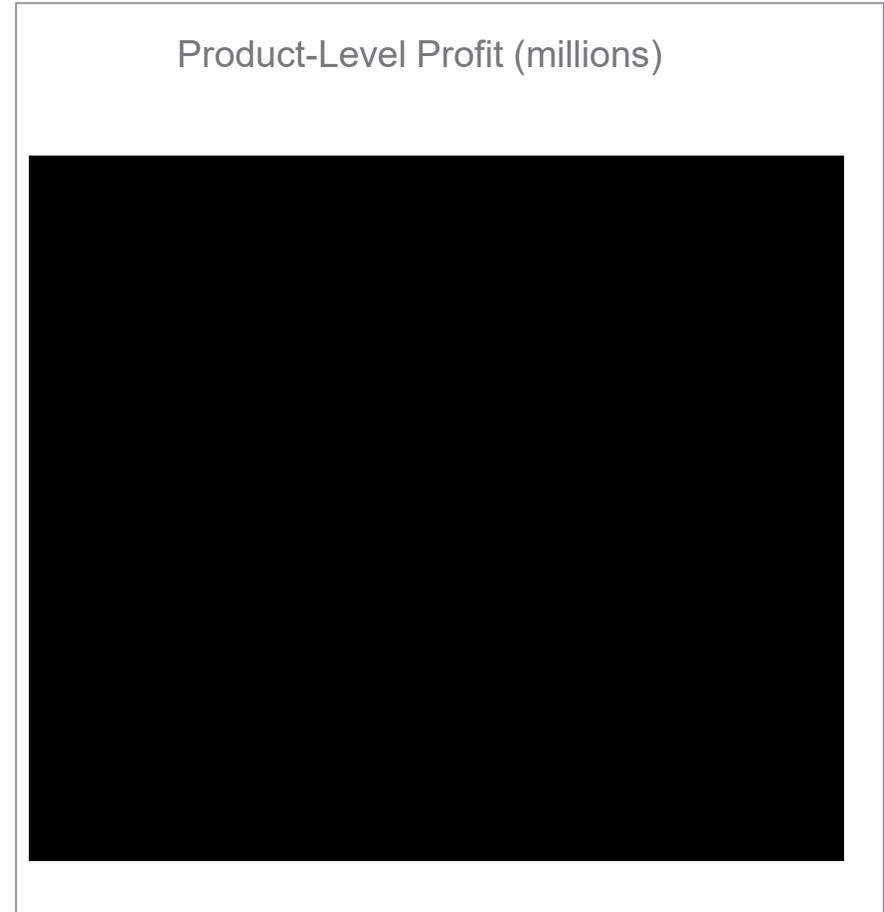
Below is a table showing NSA product-level profits, by product and year. This is calculated as the difference between revenue and attributable costs. It is officially known as “contribution” in postal parlance.

Table 5: NSA Product-Level Profits (millions)

Product	2012	2013	2014	2015	2016	2017	2018
Priority Mail	█	█	█	█	█	█	█
Priority Mail Express	█	█	█	█	█	█	█
First-Class Package Service	█	█	█	█	█	█	█
Parcel Select	█	█	█	█	█	█	█
Parcel Return Service	█	█	█	█	█	█	█
Total	█	█	█	█	█	█	█

Below is a graphic derived from the data in Table 5.

Figure 11: NSA Product-Level Profits (millions)



Appendix B: Management's Comments

SHARON OWENS
A/VICE PRESIDENT, SALES



March 14, 2019

AMANDA MARTINEZ
MANAGER, RARC CENTRAL
RISK ANALYSIS RESEARCH CENTER

SUBJECT: Final Review Draft – Assessing the Effectiveness of Domestic Competitive Negotiated Service Agreements (Project Number 2018RARC010)

We agree with the Office of Inspector General's (OIG) conclusion that negotiated service agreements (NSAs) are an important tool that allows the Postal Service to better meet the needs of customers within the highly competitive marketplace for the delivery of packages. We also recognize the need to continually examine our processes to ensure that each NSA is appropriate in the changing marketplace. These issues have been discussed extensively with the Governors since they took office.

As noted within the white paper, we have enhanced our existing processes over the past few months [REDACTED] or with customers that we would otherwise be unable to win at published rates or with standard offerings. The OIG recognizes that these process enhancements should address certain concerns it has previously raised. As the OIG also states, there is a need to remain vigilant and continue to review the new processes as appropriate. Management is committed to doing so and the processes recently implemented have [REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

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Finally, as a matter of clarification, while the OIG is correct that the “regulatory bar for Competitive NSAs is relatively low” when compared to Market-Dominant NSAs, that does not suggest any deficiency with the current regulatory environment. Congress in the Postal Accountability and Enhancement Act (PAEA) sought to ensure that the Postal Service had the tools to compete effectively within the marketplace, subject to rules Congress imposed to ensure fair competition. An enhanced ability to enter into contracts with customers, which is a common pricing approach used by carriers in the package marketplace, was one critical tool that Congress gave the Postal Service in the PAEA. At the same time, the limitations imposed on the Competitive NSAs ensures that NSAs cover their costs (and enable competitive products collectively to make an appropriate contribution to institutional costs). This limitation on individual contracts does not apply to our competitors, and our competitors are also not subject to a requirement to file contracts with a regulator. Thus, the regulatory rules are not “low” when one considers the Postal Service’s position relative to competitors. In addition, the fact that the Commission has consistently approved our NSA filings is simply a testament to the processes that we have established to ensure that NSAs meet regulatory requirements before being filed with the Commission. Management’s responses to the recommendations are listed below:

OIG Recommendation #1

[REDACTED]

Management Response:

[REDACTED] the Postal Service does agree [REDACTED]
[REDACTED]

Responsible Official: Vice President, Finance & Planning

Target Implementation Date: June 2019

OIG Recommendation #2

[REDACTED]

Management response:

The Postal Service agrees with recommendation #2. [REDACTED]
[REDACTED]

- 3 -

Responsible Official: Vice President, Pricing & Costing

Target Implementation Date: September 2019



Sharon Owens

cc: Ms. Krage Strako
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Mr. Grossmann
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We conducted work for this white paper in accordance with the Council of the Inspectors General on Integrity and Efficiency's Quality Standards for Inspection and Evaluation (January 2012).