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United States General Accounting Office

GAO

Report to the Chairman, Committee on Armed Services, House of Representatives

March 1988

HOUSEHOLD GOODS

Implications of Increasing Moving Companies' Liability for DOD Shipments

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GAO

United States
General Accounting Office
Washington, D.C. 20548

National Security and
International Affairs Division

B-229396

March 24, 1988

The Honorable Les Aspin
Chairman, Committee on Armed Services
House of Representatives

Dear Mr. Chairman:

The Department of Defense (DOD) shares liability with carriers for loss and damage to household goods shipments of military service members. In late 1986, DOD, through the Military Traffic Management Command (MTMC), proposed changes that would increase carrier liability for domestic household goods shipments. These changes also established a rate, in addition to transportation charges, to compensate household goods carriers for their increased liability. On December 15, 1986, you asked us to review MTMC's proposed changes and to determine a rate that is fair and adequate. MTMC implemented the proposed changes on April 1, 1987, for intrastate shipments, and on May 1, 1987, for interstate shipments.

We could not determine a fair and adequate level of compensation for the increased carrier liability for two reasons. First, it is too early to determine the impact of increased liability on carrier performance. Carrier performance affects the number and amount of claims submitted by military service members for lost and damaged household goods. In 1981 the Air Force conducted a test—Project REVAL—that was designed to determine the effect of increased liability on claims, but we found that the accuracy of REVAL test results was questionable. Without such carrier performance information, the potential effect on carrier revenues or government costs cannot be determined. This information is necessary for determining a fair and adequate compensation level.

Second, determining a fair and adequate compensation level for the increased carrier liability requires a policy judgment about the appropriate performance level to be expected from carriers. Because carrier performance levels vary widely, a single rate may not be perceived as fair and adequate by all carriers. For example, a rate that adequately covers the claims liability costs of a carrier that causes few claims would not be adequate to cover those of a poorly-performing carrier. Conversely, a rate that covers the claims liability costs of a poorly-performing carrier would result in overpayment to a better-performing carrier.

We found that MTMC's new rate will compensate only the better-performing carriers for increased liability costs if carriers perform as they did in fiscal year 1985, the most recent year for which adequate claims data was available at the time of our review. This rate should reduce government claims costs and should provide increased incentive for improved carrier performance.

If claims and carrier performance continue at the fiscal year 1985 levels, we estimate that approximately $3 million to $4 million in government costs will be transferred to the carriers under the increased liability program. This amount represents about 1 percent or less of total carrier revenues received for domestic DOD household goods shipments during fiscal year 1985.

We reviewed MTMC household goods claims data for 54 carriers that moved about 56 percent of DOD's domestic household goods shipments during fiscal year 1985. We found that under the new liability program, added revenues should be greater than increased liability costs for about 28 percent of the carriers examined (the better-performing carriers), even if carrier performance does not improve over the fiscal year 1985 levels. Carriers with liability costs greater than the added revenues could (1) improve performance so less damage and loss occur, (2) increase transportation rates, or (3) absorb the loss.

A primary objective of the increased liability program is to increase the incentive for carriers to reduce the level of loss and damage to household goods shipments. While currently it is not possible to determine a fair and adequate compensation rate, we support MTMC's policy of attempting to provide increased incentive for improved carrier performance. We therefore believe that the current rate of compensation under MTMC's increased liability program should remain unchanged until carrier performance data or additional cost information indicates that changes are needed.

We requested that DOD and seven carrier associations review and comment on a draft of this report. DOD generally agreed with the results of our review but argued that our findings about Project REVAL could not be generalized since we had reviewed the accuracy of this test for only one carrier. The carrier associations agreed with our findings regarding the imprecision of Project REVAL data. However, they (1) believe that currently available data are sufficient to determine the impact of increased liability on the number and amount of claims and (2) consider unacceptable the three alternatives we suggested on how carriers could handle the increased liability costs associated with the new program. Details on our findings, conclusions, and our evaluation of DOD and industry comments are included in appendix I. The full texts of DOD and carrier association comments are included as appendixes II, III, and IV.

In conducting this review, we interviewed officials and reviewed documents associated with programs for the movement of domestic household goods at DOD and the General Services Administration. We also interviewed and obtained documents from carrier association officials and representatives of selected carriers. Our carrier performance analyses used data provided by MTMC for fiscal year 1985. The data and records used to evaluate Project REVAL were provided by Interstate Van Lines, Inc., and by Headquarters, U.S. Air Force. We conducted our review from January to August 1987 in accordance with generally accepted government auditing standards.

We are sending copies of this report to the Chairman, Senate Committee on Armed Services; interested Members of the Congress who have requested copies; selected carrier associations; and the Secretaries of Defense, the Army, the Navy, and the Air Force.

Sincerely yours,

Mark E. Gebicke

Mark E. Gebicke
Associate Director

Contents

Abbreviations

AMC	American Movers Conference
DOD	Department of Defense
GAO	General Accounting Office
GSA	General Services Administration
HGCB	Household Goods Carriers' Bureau
MTMC	Military Traffic Management Command

Implications of Increasing Carrier Liability on DOD Shipments

Background

From 1967 to early 1987, carriers handling military household goods movements were liable for damage or loss at the rate of $0.60 per pound per article. For example, if a carrier lost or damaged a 70-pound television worth $400, it was liable for the depreciated value or for repairs—up to a maximum of $42 (70 pounds times $0.60).

Under the new system adopted in early 1987 by the Military Traffic Management Command (MTMC), the carrier is liable for the full depreciated value of damaged or lost articles up to a maximum amount (valuation) per shipment based on the shipment weight multiplied by $1.25 per pound. For example, if a shipment weighs 4,000 pounds, the carrier is liable for a maximum of $5,000 (4,000 pounds times $1.25). Thus, if only one item in this shipment is lost and its depreciated value is established at $5,000, the carrier is liable for this amount. In the case of the $400 television, the carrier would be liable for the full depreciated value ($400) or for the cost of repairs, whichever is less, and for all other lost or damaged items in the shipment until the total amount of loss and damage reached $5,000. Carrier liability under the new system generally is increased because it is no longer computed on a per-article basis.

Commercial tariffs currently include a separate charge (in addition to transportation charges) of $0.50 per $100 of shipment valuation, and in return, the carrier is liable for damages up to $1.25 times the shipment weight. However, the carrier industry has objected to moving Department of Defense (DOD) household goods at this rate primarily because military service member claims for lost or damaged household goods are settled by the military services. DOD then attempts recovery from the carrier up to the extent of the carrier's liability. In commercial practice, the carrier usually settles such claims. The carrier industry generally believes that military claims settlement is too generous and results in excessive claims payments. Excessive payments cause higher levels of recovery from carriers, which in turn result in increased carrier costs. At one time, DOD allowed carriers to settle claims directly with the service member. This practice was changed, according to DOD, because carrier resolution of claims was found to be unacceptable.

Because the military services wanted to retain claims settlement authority for DOD household goods shipments, MTMC established a separate charge for the additional carrier liability of $0.64 (instead of the commercial rate of $0.50) for every $100 of shipment valuation in addition to transportation charges, plus an additional 10 percent of any temporary storage charges. The American Movers Conference (AMC) and the Household Goods Carriers' Bureau (HGCB), on behalf of member carriers, believe that the separate charge should be $1.13 per $100 of valuation, plus 10 percent of any temporary storage charges.

Fair and Adequate Separate Charge Cannot Be Determined

We could not determine a fair and adequate separate charge to compensate carriers for their increased liability for two reasons. First, the impact of this increase on carrier performance, and consequently the number and amount of claims submitted by service members, are unknown. Without such information, it is impossible to determine the effect of increased liability on carrier revenues and government costs. In 1981 the Air Force conducted a test—Project REVAL—that provided this information, but we found the accuracy of this test to be questionable.

Second, because carrier performance levels vary widely, establishing a single separate charge that is fair and adequate for all carriers is difficult and requires policy judgments about the appropriate performance level to be expected from carriers.

Project Reval

Project REVAL compared costs and carrier performance on 40,567 shipments of Air Force household goods with a maximum carrier liability of $0.60 per pound per article with 12,252 similar shipments using the maximum carrier liability of $1.25 per pound times the shipment weight (purchased for a separate charge of $0.50 per $100 valuation). The results of the test showed that, with the increased carrier liability, the average amount of household goods damage claim paid by the Air Force was reduced by 34 percent from the amount paid for shipments with $0.60 per pound per article liability. The Air Force concluded that (1) the increased liability gave the carriers incentive to reduce shipment damage and (2) the combination of reduced average claim amounts and added liability compensation would have a favorable impact on carrier profitability.

Project REVAL results were a major factor in MTMC's decision to increase carrier liability. Other major factors included the high frequency and cost of damage and loss to military service members' household goods, the inadequacy of the former liability rate in covering a reasonable share of the liability for losses, the need to provide increased carrier incentive for reducing claims, and increases in government costs associated with military service members' household goods claims.

Accuracy of Project Reval Questionable

Officials of the AMC, other carrier associations, and most of the carriers we contacted stated that Project REVAL data were inaccurate and that therefore the Air Force's conclusions were erroneous. These officials stated that carrier costs during the REVAL test had exceeded the additional revenues generated by the separate charge and that little reduction in damage and losses had actually occurred.

We could not verify Project REVAL's data because the computer tapes containing the data had been destroyed. We did obtain Project REVAL data printouts, but we could not manually compare them with a sufficient number of carrier records to adequately test the accuracy of Project REVAL's data because of the time and resources such an analysis would require and because these records were not available from many carriers.

However, we did test the accuracy of Project REVAL's data at Interstate Van Lines, Inc., of Springfield, Virginia.[1] We found that the data for this carrier were seriously flawed. Project REVAL data recorded fewer than half the number of actual military service member claims and less than half of the amounts of DOD's payment of claims and subsequent recovery from the carriers. For example, our analysis of Project REVAL, Air Force, and Interstate documents and data showed that DOD had paid 76 military service member claims totaling $47,501, while Project REVAL only recorded 33 claims totaling $22,726. Also, our review of Air Force claims records and cancelled Interstate checks showed that DOD had recovered $23,486 from Interstate, rather than the $7,182 indicated by Project REVAL data. The number of Interstate's claims and their costs under the new rate were therefore much higher than Project REVAL indicated. Recurrence of such problems in the data on other carriers, as is claimed by the carrier industry, would clearly render Project REVAL results invalid.

We asked the Claims and Tort Litigation Staff of the Office of the Air Force Judge Advocate General to search their files to verify our findings. Air Force officials confirmed our findings and told us that Project REVAL's data on other carriers probably contained similar errors. One Air Force official told us that these errors had occurred primarily because claims data associated with Project REVAL shipments were sometimes not properly identified or included in the REVAL test data

[1] We tested Project REVAL's accuracy at Interstate Van Lines, Inc., a carrier that had disputed the Project REVAL figures, because Project REVAL shipment records were readily available from this carrier.

base by installation claims personnel. Since Interstate REVAL shipments were made between various Air Force installations and Air Force installations also used many other carriers for REVAL shipments, we believe that some claims data for the other carriers were probably not included in the REVAL test data base. We therefore believe that Project REVAL's accuracy is questionable.

Carrier Performance Differs

We evaluated MTMC's carrier performance data for 54 selected carriers that had moved about 56 percent of DOD's domestic household goods shipments during fiscal year 1985, the latest period for which sufficient data for analysis were available. We found that the average level of loss and damage to these shipments varied widely by carrier.

For example, the percentage of shipments incurring claims ranged from slightly over 1 percent for the best-performing carrier to about 25 percent for the worst, with the overall average slightly over 16 percent. The average claim paid by DOD to the military service member also varied widely by carrier, ranging from $297 for the best-performing carrier to $823 for the worst, with an overall average of $600.[2]

Such variations in carrier performance contributed to our difficulty in determining a separate charge that would be fair and adequate for all carriers. A high separate charge would result in windfall revenue increases for the better-performing carriers, while a low one would be inadequate to cover costs associated with increased liability for poorly-performing carriers.

Estimate of Impact on Government Costs

Although we could not determine a fair and adequate separate charge, we did estimate the impact the increased liability program will have on government costs. Our estimate uses MTMC's fiscal year 1985 claims data and assumes no reduction in the number or amount of claims. Details on our estimate are shown in table I.1.

[2]Claims data filed since the time of our analysis indicate that the average amount of claim for fiscal year 1985 may increase to about $629. However, some data from military services with historically lower than average claim amounts have not been filed.

Table I.1: Impact of the New Rate on Government Costs for DOD Domestic Household Goods Shipments

Dollars in millions

	Old rate	New rate
Claims paid by DOD	$21.8[a]	$21.8[b]
Less recovery from carriers	4.7[c]	17.0[d]
	17.2	4.8
Plus amount paid carriers for increased liability	0	9.4[e]
Total government cost	**$17.2**	**$14.2**

Note: Some totals do not correctly add due to rounding.

[a]Estimated DOD claims cost for fiscal year 1985 shipments was based on available Army and Air Force data projected to include the Navy and Marine Corps. Projections were based on a historical analysis of previous Navy and Marine Corps claims costs.

[b]We assumed that the amount and number of claims would remain unchanged from those under the old rate during fiscal year 1985.

[c]Estimated DOD recovery from carriers for fiscal year 1985 shipments was based on available Army and Air Force data projected to include the Navy and Marine Corps. Projections were based on a historical analysis of previous Navy and Marine Corps claims costs.

[d]Project REVAL indicated that under the increased liability concept, 78 percent of the total amount paid should be recoverable from carriers. We could not determine whether this portion of the REVAL data was accurate. The REVAL test did not identify and include all REVAL shipment claims data in the data base. However, the overall recoverable percentage for the claims included in the data base should not be significantly different from the percentage for those that were not included. Claims officials from all the military services confirmed a recovery rate range of from 74 to 80 percent of the amount asserted against carriers. Also, according to MTMC, claims data filed since the implementation of the increased liability program indicated an overall recovery rate of 78 percent as of February 1988.

[e]Based on MTMC's separate charge of $0.64 per $100 valuation.

Fiscal year 1985 claims data filed since our analysis indicate that government claims costs may decline to about a million more than our estimate of $3 million. This decrease in government costs means that carrier costs would increase, and consequently their revenues would decline by a similar amount. However, this amount is less than one percent of the $450 million in total revenues, including transportation charges, received by the carriers in fiscal year 1985 for domestic DOD household goods shipments. Carriers whose liabilities exceed the revenues provided by the $0.64 rate would have several options: to (1) improve performance so less damage and loss occur, (2) increase transportation rates, or (3) absorb the loss.

The estimated potential impact of increased liability on government and carrier costs varies according to which assumptions are used. Using fiscal year 1985 carrier performance data, the current rate of compensation of $0.64, and the most unfavorable conditions to the carrier industry (no improvement in performance and a DOD recovery rate from carriers of 95 percent), 9 of the 54 carriers we reviewed (about 17 percent) would have liability revenues greater than additional liability costs. If carrier performance does not improve and the DOD recovery rate from carriers remains at 78 percent (as shown by REVAL and confirmed by military claims officials), 15 of the 54 carriers (about 28 percent) would have liability revenues in excess of liability costs. Using these assumptions (no performance improvement and 78 percent recoverable) and the $1.13 compensatory rate proposed by the carriers, our analyses showed that 46 of the 54 carriers would have liability revenues in excess of liability costs and that 5 of these would have liability revenues at least 100 percent greater than liability costs.

We believe that carrier compensation for increased liability should be based on the performance levels demonstrated by the better-performing carriers. The $0.64 rate therefore appears to be a reasonable base rate and should remain unchanged until carrier performance data or other information indicates that changes are needed.

Agency and Industry Comments and Our Evaluation

We asked DOD and seven carrier associations to review and comment on a draft of this report. Carrier association comments were consolidated and submitted by AMC. We received supplemental comments from HGCB. Complete DOD and industry comments are included as appendixes II, III, and IV.

DOD Comments

DOD generally agreed with our findings but stated that several areas of the report needed clarification. DOD stated that, although Project REVAL data for Interstate Van Lines contained errors, data on this carrier did not represent a statistically valid sample and the magnitude of the problem at Interstate was not necessarily the same for all carriers.

We agree that data for Interstate Van Lines, Inc., do not represent a statistically valid sample of Project REVAL. Our report acknowledges that we could not test Project REVAL's data adequately because its computer tapes had been destroyed. Although our evaluation of Project REVAL's data extraction techniques and our interviews with Air Force officials indicated that data on other carriers participating in Project REVAL had probably been omitted, we did not confirm that such omissions had actually occurred, nor did we measure the impact of such omissions on the data from any other carrier. We believe that the information we obtained from Air Force officials, coupled with the REVAL errors at

Interstate, supports a conclusion that the accuracy of Project REVAL's results is questionable.

DOD also suggested that we clarify the report (1) by indicating that the claims data we used represent only domestic shipments and (2) by noting that DOD did, at one time, allow carriers to settle claims directly with service members. These changes were incorporated.

AMC Comments

AMC stated that Project REVAL was the major factor in MTMC's decision to increase carrier liability. It noted the defects in Project REVAL identified in our report and said that it was a mistake to base conclusions and projections and to justify expansion of the carrier liability provisions in DOD's domestic rate solicitation on Project REVAL data. AMC believed that we should have concluded that justification for increasing carrier liability was based on faulty Project REVAL data and that any projections of claims costs and carrier revenue recoveries might not be factual and would likely be misleading.

MTMC's decision to expand carrier liability was not due solely to Project REVAL's results. We modified our report to show the other factors influencing MTMC's decision. Furthermore, MTMC's justification for increasing carrier liability is really not an issue, since industry officials acknowledged that an increase in carrier liability was warranted.

With respect to Project REVAL, we believe that its defects were clearly identified in a draft of this report. We used selected Project REVAL data (a DOD claims recovery rate of 78 percent) to make certain projections. However, we found no indication that this particular piece of REVAL data was inaccurate, and the accuracy of the REVAL data we used was supported through other means. We modified table I.1 to explain our reasons for accepting this particular piece of REVAL data.

AMC stated that movers generally did not share our conclusion that the impact of increased liability on the number and amount of claims could not be predicted with currently available data. AMC believed that, using MTMC shipment and claims data for fiscal year 1985, we should have been able to determine the potential effect the increased carrier liability program would have on carrier revenue and government costs and that we should have included that effect in our report.

In our opinion, such a determination can be made only if assumptions are made regarding (1) carrier performance as it relates to the number and amount of claims that will occur and (2) the amount of such claims recoverable from carriers. It is unclear at this time what effect the increased liability program will have on these factors.

AMC agreed that establishing a single compensation rate that is fair to all carriers would be difficult. It believed, however, that we could determine a single rate, using fiscal year 1985 data, that would be fair to both the average- and the better-performing carriers. AMC determined that this rate should be $0.85 per $100 valuation.

This rate should compensate the average- and better-performing carriers for their increased liability costs only if the number and amount of claims against a carrier remained the same as the number and amount of claims in fiscal year 1985 and the recoverable rate remained at 78 percent. Furthermore, under the $0.85 proposal, the better-performing carriers would receive compensation in excess of full liability costs. The average-performing carriers would receive compensation for their liability costs, while compensation for only the poorly-performing carriers would be inadequate to cover increased liability costs. We believe that the rate should be set at a level that fully compensates only the better-performing carriers, thus providing greater incentive for performance improvement by both the average- and poorly-performing carriers.

Also, based on AMC data, it appears that government costs would remain approximately the same under the $0.85 proposal, thus providing little benefit to the government over the old liability rate ($0.60 per pound per article). MTMC believed that the level of government costs was unacceptably high under this formula because carriers had little incentive to reduce loss and damage to household goods shipments. From the overall fiscal viewpoint, government costs at the $0.85 rate would continue at an unacceptably high level.

One objective of the increased liability program is to increase the incentive for carriers to reduce the level of loss and damage to household goods. According to AMC, movers agreed that most carriers could make some improvement in performance. The wide variance in the frequency and average amount of claims among carriers further attests to the potential for reduction. Carrier frequency of claim rates ranged from 1 percent to about 25 percent of the total number of shipments, and the average claim among carriers varied from $297 to $823.

The current $0.64 rate will fully compensate only the better-performing carriers for increased liability costs if there is no improvement in carrier performance and the DOD recovery rate from carriers remains unchanged. This rate should reduce government claims costs and provide incentives for improved performance for carriers with both average and poor performance levels. These carriers could recover any increased liability costs by improving their performance or, if necessary, by increasing their transportation rates.

AMC stated that its proposed separate charge of $0.85 per $100 valuation would not make the carrier industry "whole," that is, would not fully compensate for the increase in liability. They noted that average claim payouts are increasing and that our calculations do not consider the increased carrier administrative, insurance, and capital costs they believe this program will cause. They also believe that the DOD recovery rate from carriers will increase to 95 percent.

We did not attempt to adjust our analysis to consider other carrier costs that may change as a result of increased liability (such as insurance premiums, administrative costs, and capital costs). Data currently available are insufficient to substantiate and measure these costs or to indicate the degree to which they might be affected by the increased liability program.

Carrier industry officials and some DOD officials told us they believed that the DOD recovery rate from carriers could be increased to as much as 95 percent under the increased liability program. DOD claims officials disagreed. They told us that the recoverable rate ranges from about 74 percent to 80 percent and that they do not expect this rate to increase. The increased liability program has not been in effect long enough to develop meaningful data on this issue.

AMC agreed that most carriers can make some improvement in performance but stated that Project REVAL's prediction of a 34-percent reduction in claims cost is misleading. We agree that the 34-percent reduction is questionable and that such a reduction did not occur in the case of Interstate Van Lines. All the numerical projections we used in this report were based on the conservative assumption that no improvement in carrier performance (no reduction in number and/or amount of claims) would occur.

AMC stated that if transportation rates were adjusted to cover claims costs, congressional oversight of these costs and determination of actual transportation costs would be difficult. Under the increased liability program, those carriers whose claims would not be fully covered by the compensatory payment could increase the transportation rate they charge the government. In these cases, the government might not be able to determine the portion of the transportation rate associated with the increased liability costs.

Claims costs should be adequately visible to the government through claims data collected by the military services. The government could readily determine claims costs related to the service member as well as total household goods transportation costs (claims costs plus transportation charges).

More importantly, carriers experiencing higher levels of loss and damage on DOD household goods shipments will have to improve their performance, absorb the loss, or cover their claims costs through higher transportation rates. Carriers with continued poor performance would probably be forced to increase their transportation rates, thus becoming less competitive in obtaining contracts for the movement of military service members' property. Carrier selection for DOD's business would then be more closely aligned with the quality and cost of the service rendered.

AMC stated that carriers would have difficulty adjusting transportation rates to cover claims liability costs in a timely fashion. Since carriers must file their transportation rates for the next period before claims data are available for the current period, some carriers would have cash flow problems. AMC added that carriers and agents that are totally dependent on military business would be particularly affected and would be forced to meet competitors' rates without knowing their true claims costs.

While we agree that carriers would initially have limited experience on which to base revisions to their transportation rates under the new liability rate, most carriers should be able to approximate their claims costs under the increased liability program. Further, DOD pays carrier transportation charges and compensation for increased carrier liability at the time of shipment delivery, but 6 months to 1 year or longer often passes between delivery and the time service members file claims and the military services begin recovery efforts. The carriers have use of these funds and can accumulate them during this period to cover any increased liability costs until the carriers' next opportunity to submit revised transportation rate bids, if such revisions are needed. The poorly-performing carriers are the most likely to have problems adjusting transportation rates, but they can avoid such problems by improving their performance.

HGCB Comments

HGCB stated that two of the conclusions in our report were contradictory: (1) the impact of increased liability on the number and amount of claims cannot be predicted and (2) approximately $3 million in costs that are now absorbed by the government will be transferred to the household goods carrier industry.

While these conclusions may appear on the surface to be contradictory, we do not believe that is the case. The impact of increased liability cannot be accurately predicted at this time because it is unclear how carrier performance will be affected by the change. In its comments on our report, AMC agreed that most carriers could make some improvement in performance; however, the extent of such improvement is uncertain.

The cost figure used in our report (approximately $3 million to $4 million) indicates the potential effect of the increased liability program using two primary assumptions: (1) carrier performance will not change from fiscal year 1985 levels and (2) the DOD recovery rate from carriers is 78 percent. These are but two of several assumptions that could affect the impact of increased liability.

Comments From the Department of Defense

ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D.C 20301-8000

PRODUCTION AND LOGISTICS

OCT 1 1987

(L/TP)

Mr. Henry Conner
Senior Associate Director
National Security and
International Affairs Division
US General Accounting Office
Washington, DC 20548

Dear Mr. Conner:

This is the Department of Defense (DoD) response to the General Accounting Office (GAO) Draft Report entitled HOUSEHOLD GOODS: Carrier Liability on DoD Shipments Increased, dated August 18, 1987 (GAO code 393226/OSD Case 7385).

See pp. 2, 11.

While the DoD is in general agreement with the report findings, there are several areas needing clarification. These areas are addressed in the detailed DoD comments on the draft report findings, which are provided in the enclosure.

Sincerely,

Robert B. Costello

Enclosure

GAO DRAFT REPORT - DATED AUGUST 18, 1987
(GAO CODE 393226) OSD CASE 7385
"HOUSEHOLD GOODS: CARRIER LIABILITY ON DOD SHIPMENTS INCREASED"

DEPARTMENT OF DEFENSE COMMENTS

* * * * *

FINDINGS

FINDING A: Carriers Liability. The GAO reported that, since 1967, carriers handling military household goods movements have been liable for damage or loss at the rate of $.60 per pound, per article. The GAO explained that, if a carrier lost or damaged a 60 pound television worth $400, it was liable for the depreciated value for repairs up to a maximum of $36 (60 pounds x $.60 per pound). The GAO found that under the new system adopted by the Military Traffic Management Command (MTMC), the carrier is liable for the full depreciated value of damaged or lost articles, up to a maximum amount per shipment, based on the shipment weight multiplied by $1.25 per pound. (If a shipment weighed 4,000 pounds, the carrier is liable for a maximum cumulative valuation of $5,000.) The GAO concluded that, generally, carrier liability under the new system is increased because it is no longer computed on a per article basis. The GAO reported that commercial tariffs currently provide for a charge of $.50 per $100 valuation, in addition to freight charges. The GAO reported, however, that the carrier industry has objected to moving DoD household goods at this rate because Service member claims for lost or damaged household goods are settled by the Services, and (according to the moving industry) the Military Service claims settlement is too liberal and results in excessive claims payments. The GAO observed that, since the Military Service wanted to retain claims settlement for DoD household goods shipments, the MTMC, established a compensatory rate for the additional carrier liability of $.64 for every $100 of shipment valuation, in addition to freight charges, plus 10 percent of any temporary storage charges. The GAO reported, however, that the American Movers Conference and the Household Goods Carriers Bureau contend that the compensatory rate should be $1.13 per $100 valuation, plus 10 percent of any temporary storage charges. (pp. 2-3/GAO Draft Report)

DoD Response: Concur.

FINDING B: Fair and Adequate Compensatory Rate Cannot Be Determined. The GAO reported that it could not determine a fair and adequate level of compensation for several reasons. The GAO explained, as follows:

See pp. 8, 9, and 11.

- first, the impact of the increased liability on the number and amount of claims cannot be predicted and without this information, it is impossible to accurately determine the potential effect on carrier revenue or Government costs; and

- because of the differing levels of carrier performance, it would be difficult to establish a single rate that is perceived as fair and adequate for all carriers.

The GAO concluded that, if the new MTMC program does not result in a reduction in the number and amount of Service member claims and carriers perform as they did in FY 1985, approximately $3 million in costs that are now absorbed by the Government will be transferred to the household goods carriers. The GAO further observed the carrier options for handling this transfer of liability are: (1) improving performance so less damage and loss occurs; (2) obtaining more compensation through higher freight rates; or (3) absorbing the loss. (pp. 1-3/GAO Draft Report)

DoD Response: Partially concur. The GAO subsequently observes that the accuracy of the project REVAL test is questionable. The DoD disagrees with this finding to the extent it was based on information obtained in a review of Interstate Van Lines records. While some errors in test data were identified at Interstate, one carrier's experience alone should not be a sufficient basis to refute the accuracy of project REVAL. Further, the results are not based on a statistically valid sample and should not be used as a basis for general conclusions applicable to all carriers. (Also, see DoD Response to Finding D.)

FINDING C: Project REVAL: The GAO found that, in 1981, the Air Force conducted Project REVAL, a test to determine the impact of the increased valuation on the number and amount of claims. The GAO reported that project REVAL compared costs and carrier performance on 40,567 shipments of Air Force household goods at $.60 per pound per article maximum carrier liability with 12,252 similar shipments using the maximum carrier liability of $1.25 per pound times the weight of the shipment, with a compensatory rate of $.50 per $100 valuation. According to the GAO, the results showed that, with the increased carrier liability, the average amount of household goods damage claim paid was reduced by 34 percent from that occurring for shipments with the $.60 per pound per article liability. The GAO reported that the test concluded:

- the increased liability gave the carriers incentive to reduce shipment damage; and

- the combination of reduced average claim amounts and added liability compensation would actually have a favorable impact on carrier profitability.

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The GAO concluded that Project REVAL was a major factor in the MTMC decision to increase carrier liability. (pp. 4-5/GAO Draft Report)

DoD Response: Concur.

FINDING D: Questionable REVAL Test Accuracy. The GAO reported that the American Movers Conference and other carriers it contacted asserted that Project REVAL data was inaccurate and, therefore, its conclusions were erroneous. The GAO reported that it could not verify project REVAL data because the computer tapes containing the data had been destroyed. The GAO did obtain Project REVAL data printouts, but found that manual comparison with carrier records at enough carriers to test REVAL data accuracy was impractical because of the time and resources it would require and the availability of records at the carriers. However, the GAO found that, for the Interstate Van Lines of Springfield, VA., the REVAL test data (for Interstate) was seriously flawed. The GAO observed that REVAL identified Service member claims, DoD payment of claims, and subsequent DoD recovery from the carrier in less than half of the Interstate cases where they occurred. As an example, the GAO noted that Air Force and Interstate documents and data show that DoD actually paid 76 Service member claims totaling $47,501, compared to the 33 claims totaling $22,726 indicated by REVAL. The GAO reported that Air Force officials from the Claims and Tort Litigation Staff, Office of the Air Force Judge Advocate General, confirmed the GAO findings and indicated that similar REVAL test data errors probably occurred for other carriers as well, because claims associated with REVAL shipments were sometimes not identified and included in the test data base. (pp. 4-5/GAO Draft Report)

See pp 8, 9, and 11.

DoD Response: Partially concur. The GAO concludes that REVAL data is seriously flawed for one carrier (Interstate Van Lines). This finding should be clarified so as not to infer Air Force officials confirmed that the magnitude of the problem found at Interstate was necessarily the same for all carriers. It is asserted that, inasmuch as Interstate is only one carrier out of a universe of hundreds, such a small sample does not support such an inference.

FINDING E: Differences In Carrier Performance. The GAO evaluated MTMC carrier performance data for 54 selected carriers responsible for moving about 56 percent of DoD shipments during FY 1985. The GAO found that the average level of loss and damage to household goods shipments varied widely by carrier. For example, the GAO noted that the percentage of shipments incurring claims ranged from slightly over 1 percent for the best performing carrier to over 24 percent for the worst, with the overall average slightly over 16 percent. In addition, the GAO observed that the average claim paid by the DoD to the

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Service member also varied widely by carrier, ranging from $297 for the best performing carrier to $823 for the worst, with an overall average of $600. The GAO concluded such variations in carrier performance contributed to the difficulty in determining a compensatory rate that would be fair and adequate for all carriers--i.e., a high rate would result in windfall profits for the better performers, while a low one would be inadequate to cover costs for poorly performing carriers. (pp. 5-6/GAO Draft Report)

DoD Response: Concur.

FINDING F: Estimate Of The Impact On Government Costs. Although it could not determine a fair and adequate compensatory rate, the GAO did estimate the impact the new MTMC program will have on Government costs, using MTMC FY 1985 claims data, as follows:

	Old Rate *	New Rate *
	(millions of dollars)**	
Claims paid by DoD	$ 21.8	$ 21.8
Less: recovery from carriers	4.7	17.0
	$ 17.2	$ 4.8
Plus: amount paid carriers for increased liability	0	9.4
Total DoD claims cost	$ 17.2	$ 14.2

* (Footnotes as shown in the report were omitted.)
** (Some totals do not add due to rounding.)

The GAO projected that, for a program with overall annual costs of about $450 million in FY 1985, Government claims costs would have declined by $3 million, meaning that carrier revenues would have declined by a similar amount. The GAO concluded that carriers, whose liabilities exceed the compensatory payment provided by the $.64 rate, would have the options of (1) improving performance so less damage and loss occurs, (2) obtaining more compensation through higher freight rates, or (3) absorbing the loss. (pp. 6-7/GAO Draft Report)

See p. 12.

DoD Response: Concur. It should be clarified, however, that the claims data used herein represents only domestic shipments.

FINDING G: Procedural Comparisons Between Military And Civilian Shipments. In comparing Military and civilian shipment procedures, the GAO found that the primary difference between the DoD and the GSA is the manner in which the claims are settled. The GAO observed that the DoD settles damage and/or loss claims with the Service member first, and then attempts recovery from the carrier, while GSA requires civilian employees to attempt settlement with the carrier first. The GAO also found that the degree of Government assistance provided to civilian employees in resolving claims against a carrier depends upon the method of shipment used and the policy of the Government agency involved. In addition, the GAO found that a civilian employee can file a claim against the Federal Government in the event that carrier compensation for damages is unsatisfactory. (p. 8/GAO Draft Report)

See pp. 6, 12.

DoD Response: Concur. It should also be explained, however, that the DoD, at one time, did allow carriers to settle claims directly with Service members but, because this process was unacceptable, it was changed to the current procedure.

Comments From the American Movers Conference

AMC

October 7, 1987

Dear Mr. Connor:

Attached is a coordinated industry response to your Draft Report entitled Household Goods: Carriers' Liability on DOD Shipments Increased (Code 393226). The Household Goods Carriers' Bureau will be submitting additional comments as a supplement in the next few days.

Yours truly,

Nathan R. Berkley
Director of Government
Traffic

NRB:mkb

Attachment

American Movers Conference · 2200 Mill Road · Alexandria, VA 22314 · (703) 838-1930 · *Affiliated with American Trucking Associations*

CHARLES C. IRIONS
Major General USAF (Ret.)
President

October 5, 1987

Mr. Henry W. Connor
Senior Associate Director
U.S. General Accounting Office
Washington, DC 20548

Dear Mr. Connor:

We thank you for the opportunity to provide comments on the draft report entitled Household Goods: Carrier Liability on DOD Shipments Increased (Code 393226).

See p. 12.

The moving industry agrees with GAO that Project REVAL was the major factor in MTMC's decision to increase the carrier's liability from $.60 per pound per article to the full depreciated value of damaged or lost articles up to a maximum amount per shipment based on the shipment weight multiplied by $1.25 per pound. However, to base conclusions, projections and/or to justify expansion of the carrier liability provisions in the DOD domestic rate solicitation upon Project REVAL data is a mistake!

As far back as 1983, the American Movers Conference, other carrier associations, and many carriers stated in writing to MTMC that the Project REVAL data was inaccurate and therefore, its conclusions were erroneous. This position is now supported by the GAO statement that, "We found the accuracy of this test to be questionable..." (page 3, Draft Report, Household Goods: Carrier Liability on DOD Shipments Increased, code 393226). The GAO verification of the Project REVAL data for Interstate Van Lines wherein GAO found that REVAL test data for this carrier was seriously flawed further supports the industry contention that REVAL data was erroneous. (page 4, Draft Report, Household Goods: Carrier Liability on DOD Shipments Increased, Code 393226). Additionally, Air Force officials confirmed GAO's findings concerning Interstate Van Lines and stated, "...that similar REVAL test data errors probably occurred for other carriers." (page 5, Household Goods: Carrier Liability on DOD Shipments Increased, Code 393226). Therefore, we believe the GAO

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should clearly indicate by a statement in the final report that the justification for transferring and expanding of the carrier liability provisions in the DOD Rate Solicitation was based upon faulty REVAL data and any projections of claims costs, carrier revenue recovery estimates using REVAL data may not be factual and are likely to be misleading.

See p. 12

Generally, movers do not share the GAO conclusion that the impact of the increased liability on the number and amount of claims cannot be predicted. Without using the flawed REVAL data, GAO could use the MTMC fiscal year 1985 historical shipment and military claims payout data to project the number and average claim amount under the increased carrier liability program. Carriers have little doubt that the military claim services will attempt to recover the entire claim payout which averaged in FY 1985 over $609 through direct demands on carriers or by set-off procedures. Therefore, using the MTMC historical FY 1985 shipment and claims data, the GAO should be able to determine the potential effect the increased carrier liability program will have on carrier revenue and government costs and put it in their final report.

See p. 12.

We would agree the establishment of a single rate for the valuation charge that is perceived as fair and adequate for all carriers would be difficult. However, we do believe that the GAO could determine a single rate for the valuation charge using MTMC historical claim frequency and payout experience that would be a fair and adequate rate for the "average" or better performing carriers. The "average" or better performing carriers being those carriers who had an average claim payout in FY 1985 of $609 or lower. The GAO selected 54 carriers from the FY 1985 MTMC historical data and concluded that the average claim frequency is 16.01 percent or one claim in every 6.25 shipments. Recognizing that carriers provide different levels of performance, carriers with the better performance records should receive proper compensation for their good services. Improved service is the military's stated overall objective for increasing carrier liability. Therefore, the GAO should recommend a single valuation charge that provides fair and adequate compensation for the "average" or better performing carriers.

See pp. 12, 13.

To arrive at a fair and adequate shipment valuation charge, the table below shows the comparison of shipments, claims and costs per claim for FY 1978 through FY 1985. The average cost per claim increased from $460 in 1978 to $609 in FY 1985, for a total increase of 32.2. percent. The CPI for all items during the same period increased 63.2 percent. Thus, claim costs lagged well behind inflation. The $609

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average cost in 1985 really equals $474 in 1978 dollars, verifying a decline in claims severity. ($460 to $373).

COMPARISON OF SHIPMENTS, CLAIMS & COST PER CLAIM

Fiscal Year	Total No. of Shipments	Total No. of Claims	Claims Frequency %	Average Cost Per Claim	% Increase Over Prior Year
1978	N/A	28,528	N/A	$460	---
1979	N/A	35,068	N/A	497	8.0
1980	N/A	34,110	N/A	520	4.6
1981	N/A	40,013	N/A	522	0.4
1982	202,544	41,319	20.4	525	0.6
1983	217,498	36,321	16.7	550	4.8
1984	209,000	36,403	17.4	591	7.5
1985	225,694	35,893	15.7	609	3.0
1986	231,000	Data Still Incomplete			

N/A - Not Available
Source: DOD reports and GAO estimate for FY 1986

See p. 14.

It is necessary to identify what proportion of the $609 average military claim payment to service members will be recovered from the carriers. GAO's draft report indicates that 22% is non-recoverable. Certain Air Force personnel have indicated to GAO that only 5% of a given claim will be non-recoverable from the moving industry. The moving industry believes that the Air Force reference to a 5% non-recoverable amount identifies the intent of the military. Nevertheless, for this response only and as a starting point, movers will accept the GAO's estimated 22% to show that a fair and adequate valuation charge can be arrived at for the "average" or better performing carriers. As times goes on, actual claim recovery figures will become available and should be used annually to adjust the valuation charge.

To start the program, the amount to be paid to the "average" or better performing carriers for increased valuation would be $.85 per $100 valuation computed as follows:

1.	Total Number of claims	35,893
2.	Basis for valuation $609 less 22% or $609 x 78%	$475
3.	Total claims dollars to be covered (Line 1 x Line 2)	$17,049,175
4.	Less: Portion applicable to 60 cents per pound liability - provided free by carriers	$4,650,367
5.	Less: portion to be paid to carriers as SIT valuation	$782,758
6.	Net to be recovered by valuation charge (Line 3 - Lines 4 & 5)	$11,616,050
7.	Total weight FY 85 shipments	1,088,158,592 lbs.
8.	Valuation @ $1.25 per pound (Line 7 x $1.25 divided by 100)	$13,601,982
9.	Charge per $100 of valuation (Line 6 divided by Line 8)	$.85

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See p. 13.

The actual cost to the government for providing a shipment valuation to the carrier of $.85 per $100 valuation is slightly less than DOD's current claim payout. Still though, this $.85 per $100 valuation will in large measure compensate the "average" or better performing carriers at the minimum level.

NET COST TO GOVERNMENT

		Under 60 cents Per Pound Liability	Under $1.25 Valuation @$.85 per $100 Valuation
1.	Total no. of claims (per GAO)	35,893	35,893
2.	Average claim paid to service Member (per GAO)	$609	$609
3.	Total Claims Cost (Line 1 x Line 2)	$21,858,837	$21,858,837
4.	Recovery from Carrier		
	@ $.60 per lb. (per GAO)	($4,650,367)	xxx
	@ 78% recovery from carriers	xxx	($17,049,893)
5.	SIT valuation payment to carriers		$782,758
6.	Valuation payment to carriers @ $.85 per $100 valuation		$11,561,685
7.	Net cost to government	$17,208,470 (sum of lines 3-4)	$17,153,887 (sum of lines 3 + 5 + 6 - 4)

To whatever extent that recovery from the carriers exceeds 78%, the costs to the government will decline. In fact, for each percentage point of recovery above 78%, the government will reduce its costs by $218,588.

See p. 14.

It is important to stress that the $.85 per $100 valuation charge will not make the "carrier industry whole" vis-a-vis the increase in liability--consider the following:

(a) The latest available MTMC 1985 average claim payout continues to be updated and each new update results in a higher average claim payout. The most recent average is $628. The $.85 charge is based on $609 developed by GAO.

See p. 14.

(b) The claim dollar recovery ratio according to GAO is 22%, whereas the Air Force believes it will be closer to 5%. The moving industry agrees with the Air Force; and, as a result, the valuation revenue will fall short of the claims dollars paid out.

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(c) The valuation charge ($.85) reflects claim dollar payouts only--the valuation charge does not include carriers' increased administrative costs, increased cost of capital, and increased insurance costs associated with the transfer of risk from the government to industry ($.60 per lb. per article vs. $1.25 x weight of shipment).

See p. 14.

The GAO draft report using the selected 54 carriers does not provide any evidence substantiating a "windfall" profit for the better performing carriers should they receive $.85 per $100 valuation. No evidence is provided that GAO considered and included in their explanation of carrier performance differences all the cost items for doing business; such as cost of borrowing money, increase in staff and overhead to handle $1.25 claims and the increased cost of insurance. The cost of insurance alone for movers since 1984 has risen 134 percent, based upon an HHGCB verified statement submitted to the Interstate Commerce Commission as part of a rate filing procedure. It appears GAO has used in their estimate of impact on government costs, the faulty REVAL data on a claim revenue in/revenue out basis to arrive at a conclusion that there is only a $3 million revenue shortfall for the carrier industry using $.64 per $100 valuation.

See p. 14.

To say carriers can handle this transfer of claims costs in several ways ignores day-to-day business practices. First, movers agree that most carriers can make some improvement in performance but to believe that a 34 percent reduction in claims cost based upon the faulty REVAL report is misleading. The GAO-verified Interstate Van Lines data supports the position that 34 percent REVAL projected improvement is unrealistic.

See p. 14.

Next, carriers do not purposely lose or damage personal property shipments. In theory and over a period of time, fusing of claim costs into the transportation rates will be necessary for the inept carriers who do not improve their service and have claims costs higher than the "average" carriers. Additionally, hiding claim costs in the transportation rate would be misleading. Congressional oversight of claim costs would be nearly impossible, and actual transportation costs will be difficult to determine both for the carrier and the government.

See pp. 14, 15.

Additionally, even in today's highly competitive military marketplace, carriers have not been able to accurately include the claim costs in their transportation rates. The reason being is that after five months into the $1.25 program, some carriers have received only one or two subrogation claims and others have received a limited number

See p. 15.

See p. 15.

of claims in relation to the number of shipments transported. Service members traditionally are slow in filing their claims. Yet, the rate filing procedures required a carrier to file rates on September 1, 1987 with little or no claim experience. This places the carriers in a precarious position because some carriers and agents are dependent upon the military business for their existence and cash flow. They must be competitive for every cycle or their cash flow will stop. Therefore, they have met their competition's rate not knowing their true claims costs.

Finally, carriers/agents cannot absorb the loss and damage claims and continue to survive. In this situation, the carrier is a stand-in for the insurance company and if the "premium" does not cover losses, the mover will not be around in the future to provide shipment services.

Additional comments on the Draft Report are at Enclosure 1.

We thank you for the opportunity to provide comments on the draft GAO Report.

Yours truly,

Charles C. Irions
American Movers Conference

Joseph M. Harrison
Household Goods Carriers' Bureau

Calvin W. Stein
Household Goods Forwarders Association of America

Edward Bocko
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Enclosure

Comments on the GAO Draft Report Household Goods Carrier Liability on DOD shipments Increased (393226)

GAO - Background

Since the military services wanted to retain claims settlement for DOD household goods shipments, MTMC established a compensatory rate for the additional carrier liability of $.64 for every $100 of shipment valuation in addition to freight charges, plus an additional 10 percent of any temporary storage charges. The American Movers Conference and the Household Goods Carriers Bureau, on behalf of member carriers, contend that the compensatory rate should be $1.13 per $100 valuation, plus 10 percent of any temporary storage charges.

American Movers Conference Comments

See pp. 13, 14, 11.

The use of word "compensatory" in the underlined phrase has not been proven correct by either MTMC or the GAO. The moving industry has never been provided with any data on how MTMC arrived at the $.64 and has stated repeatedly that the $.64 was not sufficient compensation if the DOD continues to settle claims. The moving industry believes a figures of at least $1.13 is the minimum necessary for the "average" or better performing carrier to begin to cover most of their claims costs caused by the increased risk.

The offers of $1.13, $1.04 and now $.85 per $100 valuation will not compensate all carriers for all their risks. However, the industry made these series of offers in an attempt to point out the need for additional revenue. Each lowering of the valuation charge increased the shortfall of revenue to more carriers.

GAO - Project REVAL

Project Reval compared costs and carrier performance on 40,567 shipments of Air Force household goods at $.60 per pound per article maximum carrier liability with 12,252 similar shipments using the maximum carrier liability of $1.25 per pound per shipment with a compensatory rate of $.50 per $100 valuation. The results of the test showed that with the increased carrier liability, the average amount of household goods damage claim paid was reduced by 34 percent from that occurring for shipments with $.60 per pound per article liability. The test Concluded that (1) the increased liability gave the carriers incentive to reduce shipment damage, and (2) the combination of reduced average claim amounts and added liability compensation would actually have a favorable impact on carrier profitability. Project REVAL was a major factor in MTMC's decision to increase carrier liability.

See pp. 13, 14, 11.

The American Movers Conference Comments

The underlined phrase is misleading. In 1966, when the rate of $.50 per $100 valuation was established for commercial shipments, it may have been compensatory for the moving industry. The two primary reasons the moving industry has "lived" with the $.50 valuation charge is that first, on commercial shipments, the carrier settles the claims, not the owner or shipper as the DOD does at three times the claims settlement for commercial shipments at the same valuation ($609 vs. $225). Secondly, the moving industry "sells up" the valuation on commercial shipments to an average of $2.74 per $100 valuation. This generates a revenue pool from which claims are paid. The $.64 the DOD offers does not generate sufficient revenue to pay claims and therefore the $.64 is not compensatory.

Comments From the Household Goods Carriers' Bureau

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JOSEPH M. HARRISON
President

October 6, 1987

Mr. Henry W. Connor
Senior Associate Director
U.S. GENERAL ACCOUNTING OFFICE
Washington, DC 20540

Dear Mr. Connor:

On behalf of the 1700 members of the Household Goods Carriers' Bureau, we thank you for the opportunity to provide comment relative to GAO's draft report entitled, *Household Goods: Carrier Liability On DOD Shipments Increased.*

The Bureau has examined the referenced draft report carefully and, as a result, provided its initial response to the American Movers Conference as part of a joint submission of the moving industry's position regarding the GAO draft report. However, this letter will serve to provide supplementary comments to those submitted by the American Movers Conference on behalf of the industry.

The GAO draft report contains three conclusions which serve as the basis for the entire report. These are:

1. "First, the impact of the increased liability on the number and amount of claims cannot be predicted."
2. "Because of the differing levels of carrier performance, it would be difficult to establish a single rate that is perceived as fair and adequate for all carriers."
3. "...Approximately $3 million dollars in costs that are now absorbed by the government will be transferred to the household goods carrier industry."

See p. 16.

It is apparent to the Bureau that the draft report contains a contradiction in two of the three conclusions. That is, if conclusion 1 is accurate, then conclusion 3 cannot be accurate. Conversely, if conclusion 3 is correct, conclusion 1 must be inaccurate. It is the Bureau's position that conclusion 1 is inaccurate in that the dollar impact of increased liability can be reasonably predicted, and that conclusion 3 significantly understates the increased costs to be absorbed by the moving industry as a result of the transfer of risks associated with the increased liability at issue.

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Impact Of Increased Liability

There are three elements which affect increased liability exposure, namely:

1. Frequency of claims.
2. Severity of damage.
3. That portion of the amount of claims paid by the government to the service member that will be transferred (passed through) to movers.

Although precise forecasting of the economic consequences of the increase in liability is difficult, historical operating practices can serve as a reasonable basis for predicting the impact of increased liability on the carrier industry. It is reasonable to assume that each DOD approved carrier is a prudent businessman and follows prudent business practices. These carriers exercise the same degree of care in handling shipments released at 60¢ per pound, as they would in handling shipments released at the $1.25 level. Minimizing shipment damage enhances a carrier's reputation, reduces claims payouts, and contributes to a successful bottomline.

Because of the foregoing, there will be no significant change in claims frequency or claims severity as a result of the increase in liability. Therefore, use of available FY 85 shipment data does provide a reasonable estimate of the impact of the increased liability. However, it is important that the FY 85 data file containing the shipment data reflect complete and accurate information.

GAO's use of FY 85 data was based on the following data elements:

1.	Shipments	226,149
2.	Weight	1,074,591,224 lbs.
3.	Claims	25,100
4.	Total Claims Paid	$15,279,577
5.	Average Claim Paid	$609

See p. 10.

Source data used by GAO was comprised of computer printouts obtained from MTMC, which did not include Navy and Marine Corps claims data. To account for these missing Navy and Marine Corps claims, GAO used a factor of 1.43. The 1.43 factor was derived from historical MTMC records which were based on the ratio of Navy and Marine Corps claims to Army/Air Force claims. In other words, the assumption was that Army/Air Force claims equalled 70% of total claims, and factoring the 70% by 1.43 equalled 100% (25,100 claims x 1.43 = 35,893 total claims).

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GAO also factored the $15,279,577 of claims cost by the same 1.43 to determine its total claims cost of $21,849,795. At this point the 1.43 factor assumes that Navy/Marine Corps claims dollars and number of claims accounted for 30% of the total. However, the Bureau's analysis of recent MTMC claims data indicates that claims dollars for the Navy and Marine Corps in FY 85 will be significantly greater than estimated by GAO. Over the past year there have been a number of computer-generated analyses of claims costs for FY 85 made available by MTMC. Table 1 below contains summary results of these reports by date of availability.

Table 1

MTMC Summary Results Of FY 85 Claims Costs

Line No.	Description (a)	No. Of Claims (b)	Claims Amount Paid By Government (c)	Average Cost Per Claim (d)
1	Processed 8-13-86	20,873	$12,064,179	$578
2	Processed 1-22-87	24,817	14,742,586	594
3	GAO Data	25,100	15,279,577	609
	<u>MTMC commenced adding Navy/Marine Corps Claims in March, 1987</u>			
4	Processed 8-19-87	29,474	18,518,261	628
	<u>Difference between GAO Report and 8-19-87 Report</u>			
5	Line 4 less line 3	4,374	3,238,684	$740

The claims information added to the database between the date the GAO draft report was completed and the August 19, 1987, MTMC report are derived from either of two sources:

1. <u>Late filed Army/Air Force Claims</u> - To the extent this is fact, the 35,893 claims number and $21.8 million claims cost becomes understated, since the 25,100 Army/Air Force claims would be understated (25,100 x 1.43 = 35,893).

2. <u>Navy/Marine Corps Claims</u> - To the extent this is fact, the average cost of these claims is significantly higher ($609 vs. $740). This implies that factoring the claims dollars by 1.43 produces a significant understatement.

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GAO's analysis of FY 85 shipments and claims data included a detailed review of the specific activities of 54 carriers that accounted for 56% of the 226,149 shipments utilized by GAO. For these carriers, GAO developed a claims frequency of 16.01%, or one claim for every 6.24 shipments serviced. The Bureau's analysis of 10 major carriers (nine of whom are included in GAO's group of 54), developed a claims frequency of 17.54%, or one claim for every 5.7 shipments serviced.

An analysis of 54 carriers should produce more reliable results than that of 10 carriers; however, once again the 1.43 factor was used to factor the Army/Air Force claims to account for missing Navy and Marine Corps claims. The 10 study carrier analysis performed by the Bureau accounted for all shipments and all claims.

There appears to be no evidence to suggest that the 1.43 factor used by GAO is valid for FY 85 claims. In fact, Table 1 clearly indicates that use of the 1.43 factor may have understated the results, both as to number of claims and claims dollars.

There appears to be an additional problem associated with an accurate count of FY 85 total shipments. Table 2 below compares the various total shipment counts listed in several different reports released by MTMC.

Table 2

FY 85 Total Shipments And Weight

Line No.	Description (a)	Total Shipments (b)	Total Weight (lbs.) (c)
1	Report Processed 8-13-86	223,316	1,062,366,364
2	Report Processed 1-22-87	228,694	1,088,158,592
3	GAO Data	226,149	1,074,591,224

GAO has predicated its results on 226,149 shipments, whereas the Traffic Management Progress Report circulated by MTMC for FY 85 shows nearly 229,000 shipments. It appears that the January, 1987, report provides the correct count of Code 1 and 2 shipments.

When the Bureau developed its claims count of 40,122, we inputed the claims frequency of the 10 study carriers (1 in 5.7) to the 228,694 shipments. Assuming the 54 carrier analysis by GAO and the concomitant claims frequency (16.01%) is valid, the claims figure would be 36,614 (228,694 x 16.01%), not 35,893 as shown in the draft report.

If the revised claims count is used together with the latest average claims cost of $628, the total claims cost equals $23.0 million, rather than $21.8 million as computed by GAO. Instead of the $3.0 million shortfall calculated by GAO, the shortfall becomes 3.8 million.

See pp. 10, 14, 16.

The point of demonstrating the potential flaws in the GAO calculations is to confirm that the actual shortfall of carrier revenues associated with the increased liability is in fact somewhere between $3.0 million (based on 78% recovery from the carriers by the government) and $6.7 million (based on 95% recovery from the carriers by the government). This range assumes the 35,893 claims averaging $609 is valid.

A Fair And Adequate Rate Level

The moving industry has never requested a rate level that would cover all the costs for all carriers. Every analysis of required valuation revenue was based on average costs of claims. The Bureau's initial revenue determination was based on an average claims payout of $578, then based on $594 (later available statistics from MTMC). Obviously, use of averages never fully compensate those carriers that are above the average.

See p. 11.

GAO demonstrates a concern with "windfall profits" resulting from establishing a valuation level based on the average claim cost. The term "windfall profits" usually connotes "excessive and unusual profits". Of the 54 carriers reviewed by GAO, only 16 showed an excess of valuation revenue over claims costs. Three of these carriers, which happen to be the best performing carriers, were intrastate carriers. Part of their positive performance can be attributed to the short-haul intrastate nature of their market. Of these 16 carriers, the largest negative shortfall equalled $49,095. If the 85¢ valuation rate[1] were paid to this carrier, its negative shortfall would increase to $94,127. Based on gross revenues paid to this carrier of $7,096,445, its so-called "windfall profits" would equal 1.3%. Even using industry's latest offer of 85¢, 20 of the 54 carriers would continue to show a revenue shortfall.

It is important to stress that movers causing fewer claims would not reap "windfall profits"; instead, they would be appropriately rewarded for their favorable performance by being able to recoup some of the up-front money they invest in loss prevention programs, claims adjusting expenses, and safety efforts. "High performing carriers" do not accumulate excellent claims records without incurring major, ongoing expenses.

Superior performers should be rewarded for their investment in the commitment to quality, while marginal performers have a significant, immediate financial incentive to improve the quality of their service.

See p. 14.

In summary, it is difficult, if not impossible, to reap "windfall profits" until you have accounted for all the costs of performing the service, plus a reasonable profit margin. The computation made by GAO only accounted for an estimate of the claims dollars. The computation did not account for the costs of processing claims, training, or any other loss prevention programs.

1 See 85¢ valuation rate offer detailed by industry in AMC's letter dated October 5, 1987.

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Conclusion

See p. 2.

A reasonable and fair valuation charge can be developed from readily available claim and shipment data. Depending upon which "set of data" is utilized, a valuation charge can be developed to recoup revenues ranging from 3.0 to 3.8 million dollars (using the GAO method) or 6.7 million dollars (using industry's method).

See pp. 13, 14.

Although a revenue shortfall still exists, industry is willing to adopt 85¢ per $100 valuation, which essentially equates to GAO's revenue shortfall determination.

It has been demonstrated that adoption of the 85¢ valuation will not result in "windfall profits" to the carrier industry.

It has been previously demonstrated that the competitive rate solicitation program of MTMC rewards tonnage to carriers with the lowest competitive rate; therefore, a carrier who determines a need for more compensation through increasing his rate offer to recoup the increased liability is foreclosed from doing so as a result of the fact that his competition offers a lower rate. It does carriers little good to incorporate liability costs through higher rates, if no business is tendered.

The only viable alternative offered to carriers by GAO is to simply "absorb the loss". Since carriers will be absorbing the increased cost of capital, increased administrative costs, and increased insurance costs associated with this significant risk transfer, it is patently unfair to preclude industry from assessing a reasonable valuation charge (85¢ per $100).

Thank you for allowing the Bureau the opportunity to comment.

Very truly yours,

HOUSEHOLD GOODS CARRIERS' BUREAU

Joseph M. Harrison
President

JMH:mp

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