

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION

Before Commissioners:

Ruth Y. Goldway, Chairman;
Tony L. Hammond, Vice Chairman;
Mark Acton;
Dan G. Blair; and
Nanci E. Langley

Rate Adjustment Due to Extraordinary
or Exceptional Circumstances

Docket No. R2010-4

ORDER DENYING REQUEST FOR EXIGENT RATE ADJUSTMENTS



Washington, DC 20268-0001

September 30, 2010

TABLE OF CONTENTS

Page

I.	EXECUTIVE SUMMARY	1
II.	ROLE OF EXIGENT RATE CASES IN THE MODERN SYSTEM FOR RATE REGULATION	5
A.	Primary Purposes and Development of the Postal Accountability and Enhancement Act	6
B.	Improved Rate Adjustment Process Established By the PAEA	7
1.	The PAEA Established a New Paradigm	10
2.	Exigent Rate Provision—An Exception to the Price Cap	13
C.	Legislative Development of 39 U.S.C. § 3622(d)(1)(E).....	14
1.	House Legislation	16
2.	Senate Legislation	19
3.	The PAEA	20
4.	General Trends	20
D.	Interpretation of the Exigent Rate Provision	24
1.	Interpretation of Statutory Language.....	24
2.	Application of Standards to the Exigent Rate Provision	26
III.	PROCEDURAL HISTORY	28
IV.	COMMISSION ANALYSIS	38
A.	An “Extraordinary or Exceptional Circumstance” Exists.....	38
1.	Position of the Opponents of an Exigent Rate Increase	38
2.	Position of the Proponents of an Exigent Rate Increase.....	42
3.	Other Positions on the “Extraordinary or Exceptional Circumstances” Standard.....	47

4.	The Recession and Its Impact on the Postal Service Constitute an Extraordinary or Exceptional Circumstance	49
B.	Requested Increases Are Not “Due To” the Extraordinary or Exceptional Circumstance	53
1.	Extraordinary or Exceptional Circumstances By Themselves Do Not Authorize Rate Increases Above the Price Cap.....	53
2.	The Postal Service Fails to Demonstrate that the Proposed Rate Increase is Designed to Address the Effects of the Claimed Exceptional Circumstance	58
C.	The Liquidity Problem Stems Principally From an Overly Optimistic RHBFF Prefunding Schedule.....	68
1.	Retained Earnings Would Be Sufficient to Avoid Liquidity Problems But for Prefunding Requirement	70
2.	Even if the Extraordinary or Exceptional Circumstance Had Not Occurred, the Postal Service Would Still Face a Cash Flow Problem.....	78
D.	The Price Cap is Incenting Cost Reductions and Improved Efficiency	80
V.	ORDERING PARAGRAPH.....	87

Concurring Opinion of Commissioner Blair

Concurring Opinion of Commissioner Langley

Appendix A—Comments and Reply Comments

Appendix B—The Postal Service’s Pricing and Classification Proposal and Intervenors Comments

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

Before Commissioners:

Ruth Y. Goldway, Chairman;
Tony L. Hammond, Vice Chairman;
Mark Acton;
Dan G. Blair; and
Nanci E. Langley

Rate Adjustment Due to Extraordinary
or Exceptional Circumstances

Docket No. R2010-4

ORDER DENYING REQUEST FOR EXIGENT RATE ADJUSTMENTS

(Issued September 30, 2010)

I. EXECUTIVE SUMMARY

In December 2006, bipartisan legislation reformed the process for changing postal rates. The centerpiece of this reform is a price cap limiting increases to the rate of inflation which ensures rate stability and predictability for the nation's mail users, and provides incentives for the Postal Service to reduce costs and operate efficiently.

There is an exception to the price cap known as the "exigent rate" provision. In July 2010, the Postal Service filed the first-ever exigent rate request.

The Postal Service asks the Commission to find that it needs to raise rates above the price caps for all its market dominant products, including First-Class, Periodicals, and Standard (advertising) Mail. It seeks to raise prices by an average of 5.6 percent on January 2, 2011.

A wide variety of participants have submitted extensive legal arguments that assist the Commission to properly interpret the exigent rate provision in this case of first impression. The Commission has thoroughly reviewed the goals of postal reform legislation, and the role that the exigent rate authority plays in the new system of rate regulation.

The Commission has unanimously decided it must deny the Postal Service's Request for rate increases in excess of the price cap.

The Commission concludes that to be valid, an exigent rate adjustment must be shown to be:

- Due to either extraordinary or exceptional circumstances;
- Reasonable, equitable, and necessary under best practices of honest, efficient, and economical management; and
- Necessary to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

The Postal Service asks the Commission to find that volume declines resulting from the recent recession are an extraordinary or exceptional circumstance. It characterizes both the recession, and its recession-related volume declines, as far more extreme than any experienced since the Great Depression. The Postal Service's Chief Financial Officer further supports its Request, stating that it is facing a cash flow crisis, and that without some assistance it will be unable to make Congressionally-required payments in September/October 2011.

A number of mail users oppose this request. They contest whether the Postal Service adequately supports its contentions (1) that an extraordinary or exceptional circumstance occurred; (2) that the Postal Service needs increased rates as a result of this exigent circumstance; and (3) that the proposed rates are a reasonable and equitable way to generate any necessary funds.

A majority of the Commission finds that the recent recession, and the decline in mail volume experienced during the recession, do qualify as an extraordinary or exceptional circumstance. However, the Commission finds that the requested exigent rate adjustments are not designed to respond to the recent recession, or its impact on mail volume. Rather, they represent an attempt to address long-term structural problems not caused by the recent recession.

The plain language of the law, and a review of the legislative history of the law, both clearly indicate that the price cap can only be breached in certain, limited situations. Each and all of the three tests set out above must be met. The “due to” requirement in the law prevents a bona fide extraordinary or exceptional circumstance from being misused as a general revenue enhancement mechanism that circumvents the price cap.

The Commission’s decision is supported by analyses showing that the impending cash flow crisis identified by the Postal Service is not a result of the recession. To the contrary, this cash flow crisis would have occurred whether or not the recession took place, and it is the result of other unrelated structural problems. The Commission’s analysis shows that the proposed exigent rate adjustments will neither solve, nor even serve to delay that crisis.

The decision also includes an analysis of the impact of the current retiree health benefits payments schedule on the Postal Service’s retained earnings and its liquidity. This analysis shows that the Postal Service has been unable to meet the statutory payment schedule with funds from operations, and has instead used up all of its retained earnings and drawn down from its \$15 billion borrowing authority. Whether the requested rate increases are approved or not, the Postal Service will be unable to meet this annual obligation either in 2011 or in succeeding years.

The Commission also reviews Postal Service efforts to cut costs in response to the recent recession. Here there is a far more positive finding. The Postal Service achieved more than \$6 billion in cost reductions in 2009. While volume declines outpaced cost reductions during the actual recession, Postal Service cost containment programs appear to be continuing to adjust for the new volume levels. Moreover, workhours have declined faster than volumes in 2010.

The Commission concludes that the law limits exigent rate increases to amounts shown to be needed due to specific exigent circumstances. It finds that in this instance, the Postal Service fails to quantify the impact of the recession on postal finances, address how the requested rate increases relate to the recession's impact on postal volumes, or identify how the requested rates resolve the crisis at hand.

The Commission concludes that the requested increases are not justified as lawful exigent rate adjustments.

II. ROLE OF EXIGENT RATE CASES IN THE MODERN SYSTEM FOR RATE REGULATION

On July 6, 2010, the Postal Service filed an exigent rate request, pursuant to 39 U.S.C. § 3622(d)(1)(E) and 39 CFR § 3010.60 *et seq.*, seeking to increase rates for market dominant products, on average, by 5.6 percent.¹ The Postal Service cites volume declines stemming from the recent recession as “extraordinary or exceptional circumstances’ that trigger” its proposed increase. *Id.* at 6; *see also* Postal Service Reply Comments at 11-18.

The Postal Service’s Request presents novel issues. The Commission’s responsibility is to determine whether the Postal Service’s Request satisfies the requirements of the exigency provision, section 3622(d)(1)(E). To make that determination the Commission must first determine the meaning of section 3622(d)(1)(E), which reads as follows:

[N]otwithstanding any limitation set under subparagraphs (A) and (C), and provided there is not sufficient unused rate authority under paragraph (2)(C), establish procedures whereby rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances, provided that the Commission determines, after notice and opportunity for a public hearing and comment, and within 90 days after any request by the Postal Service, that such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States[.]

39 U.S.C. § 3622(d)(1)(E).

Numerous commenters oppose the Request arguing, *inter alia*, that the circumstances identified by the Postal Service are not extraordinary or exceptional, that the Postal Service fails to demonstrate that its proposed rate adjustment is related to

¹ Exigent Request of the United States Postal Service, July 6, 2010 (Request).

the claimed exigent circumstances, and that the proposed rate adjustment is neither necessary nor consistent with Congressional intent. A few commenters support the Postal Service's proposal.

This proceeding presents the first case in which the Postal Service has requested the Commission to determine that rate adjustments in excess of existing rate caps should be permitted. As required by section 3622(d)(1)(E), the Commission has conducted this proceeding on an expedited basis.

A. Primary Purposes and Development of the Postal Accountability and Enhancement Act

On December 20, 2006, Congress enacted the Postal Accountability and Enhancement Act,² the first major postal reform legislation since the Postal Reorganization Act.³ This bipartisan legislation incorporated five principles recommended by the Administration to guide Congress's effort to reform the Postal Service: implement best practices; enhance transparency; provide for greater operating flexibility; foster greater accountability; and ensure self-financing.⁴

The PAEA enacted several reforms to help the Postal Service meet the expected challenges from expanding forms of alternative communications in the new century. It provided new pricing flexibility to the Postal Service balanced by increased regulatory oversight to ensure transparency and accountability. The pricing flexibility for market dominant products was subject to an inflation-based price cap, while even fewer restrictions applied to competitive products. Additionally, the Postal Service was

² Pub. L. 109-435, 120 Stat. 3198 (2006) (PAEA).

³ Pub. L. 91-375, 84 Stat. 719 (1970) (PRA).

⁴ H.R. Rep. No. 109-66, pt. 1, at 43 (2005); see also Testimony of John W. Snow, Secretary of the Treasury, Joint Hearing of House Committee on Government Reform and Senate Committee on Government Affairs, March 23, 2004. The PAEA did not have any committee or conference reports. H.R. Rep. No. 109-66 is the committee report accompanying H.R. 22, a predecessor to the PAEA in the 109th Congress.

allowed to retain earnings to support future innovation and development. The monopoly over letter mail was clarified and retained in a slightly narrowed form.

B. Improved Rate Adjustment Process Established By the PAEA

The government of the United States has always provided postal services as an essential communications network to bind the nation together. Initially, postal services were provided by the Post Office Department, a part of the Presidential Cabinet. For most of its history, the Post Office Department operated at a loss, with Congress setting postage rates and the wages for postal workers. Constituencies could easily access lawmakers and argue against proposed increases.

In 1970, largely in response to wildcat strikes over low wages and escalating postal operating losses, Congress enacted the PRA, transforming the Post Office Department into the United States Postal Service, an independent establishment of the executive branch of the government. Congress determined that the Postal Service should be operated in a more business-like fashion and that postage rates should become sufficient to recover the costs of providing service. It established a system of before-the-fact review of proposed rates similar to those then applicable to many public utilities.

The new Postal Service established wage rates for its craft employees through collective bargaining and gradually eliminated the need for operating subsidies. Postal rates and fees were to be set to “provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs....” PRA § 2, former 39 U.S.C. § 3621. Appropriations were phased out over time, and “cost-of-service” rates soon allowed the Postal Service to break even.

The Commission was established to provide a forum for setting postal rates. All interested persons could participate in its on-the-record review of proposed rate

changes. The Postal Service Board of Governors proposed rate adjustments to the Commission whenever necessary on the basis of projected adjustments to historical costs. Mail users (both senders and recipients), competitors, suppliers, and an officer of the Commission appointed to represent the interests of the general public were assured the opportunity to discover relevant and material information from the Postal Service, and to present their views through testimony and briefs. Based on the evidentiary record, the Commission would then provide a recommended decision to the Governors, who could reject that recommendation only under limited circumstances.

This process allowed mailers and competitors to challenge whether the Postal Service was allocating costs fairly, whether statutory policies were adequately recognized, and whether proposed rates were efficient and properly reflected cost savings due to mailer worksharing. Over the years, the Commission reduced many proposed rates in response to such arguments. Moreover, appellate review was available to help ensure that rate decisions properly reflected the evidentiary record developed during Commission proceedings.

In 1976, Congress added a requirement that the Commission issue its decision in 10 months.⁵ Nonetheless, many viewed the ratemaking process as unnecessarily time consuming, expensive, and litigious. During Congressional hearings on postal reform held in 2004, both the Postal Service and mailers testified about their concerns with the then-current rate system.

For example, then-Chairman David Fineman of the Postal Service Board of Governors stated, “The current system is cumbersome and expensive, and it pits the entire postal community against one another in a litigious free-for-all.”⁶ NAA testified

⁵ Postal Reorganization Act Amendments of 1976 § 5(a), Pub. L. No. 94-421, 90 Stat. 1303 (1976) (codified in former 39 U.S.C. § 3624).

⁶ *The Postal Service in Crisis: A Joint Senate-House Hearing on Principles for Meaningful Reform Before the H. Comm. On Govt. Reform and the S. Comm. On the Judiciary*, 108th Cong. 54 (2004) (Joint Hearing) (statement of David Fineman, Chairman, Postal Service Board of Governors).

that the current ratemaking process was ineffective because it was “too lengthy, too litigious, and too expensive.”⁷ DMA agreed, testifying that the cost-of-service ratemaking process was “cumbersome and unbelievably costly.” S. Hrg. 108-508 at 55.

Congress also recognized the problems with cost-of-service ratemaking. During the 2004 hearings, Senator Susan Collins, one of the primary sponsors of postal reform in the Senate, stated:

The current rate-setting system can take 18 months. It costs millions of dollars and it has engendered widespread opposition. Almost no one is happy with the current system. Part of the recommendations by the [President’s Commission on the Postal Service was] to deal with the expense and length and the litigiousness of the current process....⁸

Similarly, during a 2005 hearing, Senator Joe Lieberman remarked that the current system prevented the Postal Service from competing effectively: “The Postal Service is unable to challenge this formidable competition [from electronic communications] effectively partly because it operates under a cumbersome system that prevents quick rate adjustment to meet the changing needs of customers and the changing strategies of competitors.” S. Hrg. 109-198 at 5.

Another major concern with cost-of-service ratemaking was the lack of incentive for the Postal Service to operate efficiently or control costs. In the 2005 Committee Report accompanying H.R. 22, a forerunner to the PAEA, the House noted that “[t]he current rate-setting process provides little or no incentive for the Postal Service to control its costs because all costs are ultimately passed through to the consumer regardless of how efficiently or inefficiently the Postal Service operates.” H.R. Rep. No. 109-66, at 48. Mailers expressed the same concerns during the 2004 hearings. For

⁷ *Postal Reform: Sustaining the Nine Million Jobs in the \$900 Billion Mailing Industry Before the S. Comm. on Govt. Affairs*, 108th Cong. 53, 57 (S. Hrg. 108-508).

⁸ *Postal Reform: The Chairmen’s Perspectives on Governance and Rate-Setting Before the S. Comm. on Govt. Affairs*, 108th Cong. 11 (S. Hrg. 108-527).

example, Ann Moore, CEO of Time, Inc., testified that “[t]oday’s rate system fails to provide the Postal Service with strong incentives to hold down costs, too.” S. Hrg. 108-508 at 4.⁹

1. The PAEA Established a New Paradigm

Responding to the concerns about cost-of-service ratemaking, the PAEA completely revamped the system for setting rates. It implemented a new, modern system for regulating rates and classes for market dominant products. See 39 U.S.C. § 3622(a). The PAEA required the new system to incorporate a price cap on rates for each market dominant class of mail. The price cap limited the percentage change in rates to the “change in the Consumer Price Index for All Urban Consumers (CPI-U) unadjusted for seasonal variation over the most recent available 12-month period....” *Id.* § 3622(d)(1)(A).

The evolution of the PAEA demonstrates increasing Congressional support for the price cap model. Earlier postal reform bills contained a provision enabling the Commission to design a system for regulating rates using either price caps or cost-of-service regulations, or both, as the Commission considered appropriate.¹⁰ The PAEA removed any reference to cost-of-service regulation, establishing the price cap as the only regulatory model to be used under the new rate system.

⁹ See also The Postal Reform Act of 1997: Hearing on H.R. 22 Before the H. Subcomm. on the Postal Service, 105th Cong. 33 (1997) (H. Hrg. 105-40) (statement of John Kwoka, Economics Professor, George Washington University) (“Cost-based regulation, however, was and is subject to serious and well-known limitations.... [T]he company has no real incentive to conserve on costs. To the contrary, the incentives it faces encourage excess costs which can simply be passed on in the form of higher price.”)

¹⁰ See proposed sections 39 U.S.C. § 3622(d) in H.R. 22, § 201, 109th Cong. (2005); H.R. 4341, § 201, 108th Cong. (2004); S. 1285, § 201, 108th Cong. (2003); H.R. 4970, § 201, 107th Cong. (2002).

The postal community broadly supported replacing cost-of-service ratemaking with a price cap model.¹¹ The price cap model simplifies the rate-setting process and provides greater accountability for the Postal Service. Most importantly, the price cap model was intended to promote predictability and stability in setting rates. The Committee Report to S. 2468 described the need for predictability and stability and the price cap's ability to meet that need.

In hearings, witnesses from the mailing industry cited the need for predictable and stable rates. Predictability and stability, the Committee learned, allows mailers to better plan their mailing and could allow them to increase the amount of business they do with the Postal Service. Of primary importance, then, is the establishment of a regulatory system that will provide for limits on the percentage changes in Postal Service rates. This system—frequently referred to as a rate or price cap—shall be designed to limit annual rate changes based on the level of inflation.

S. Rep. No. 108-318, at 10.

A price cap also provided the Postal Service with the proper incentives to control costs. The economic theory is that price cap regulation “severs the link between the rate the firm can charge and its costs.” H.R. Hrg. 105-40 at 57 (testimony of Kenneth Rose, Senior Economist, National Regulatory Research Institute). A regulated entity can only charge prices up to the cap, and if it can reduce its costs, it can retain part or all of the resulting profit. *Id.*

This economic theory is reflected in the major goals of the PAEA. Its objective “is to position the Postal Service to operate in a more business-like manner.” H.R. Rep. No. 109-66, at 43; S. Rep. No. 108-318, at 10. To achieve this goal, the new system for regulating rates was designed to permit the Postal Service to respond to market

¹¹ See Joint Hearing at 54 (statement of David Fineman, Chairman, Postal Service Board of Governors) (“[To replace the current system], we would support a system including a well-constructed price cap model that properly addresses the Postal Service’s economic situation.”); see *also* S. Hrg. 108-508 at 4 (testimony of Ann Moore, CEO, Time Warner) (“[I]t is also crucial to establish a rational rate cap system be put in place by Congress.”).

conditions and provide clear incentives for postal management and the Postal Service as an institution. H.R. Rep. No. 109-66, at 43. By no longer operating under a break-even mandate, the Postal Service could maximize gains and minimize costs, generating earnings that could be retained and/or distributed as incentives to management and employees. *Id.* It could not recover losses by increasing rates beyond the price cap without regulatory approval. *Id.* at 44.

Witnesses at postal reform hearings agreed that a price cap would provide the Postal Service with greater incentives to control costs and operate efficiently. Timothy Bitsberger, Assistant Secretary of the Treasury for Financial Markets, supported a hard rate cap, in part, “to give the Postal Service stronger incentives to control its costs by discouraging it from simply passing costs on to ratepayers through a cost-based regulatory structure....” S. Hrg. 109-198 at 34-35. Similarly, George Omas, then-Chairman of the Commission, testified that a price cap would achieve a “major goal of Postal reform...to provide...meaningful incentives that will encourage the Postal Service to be more economical and more efficient.” S. Hrg. 108-527 at 13.

The changes effected by the price cap model benefitted ratepayers and other mail users. However, the Postal Service also gained significant advantages in the form of pricing and management flexibility. Senator Tom Carper, one of the primary sponsors of the PAEA in the Senate, stated that the PAEA “give[s] Postal management the tools and the flexibility needed to run the Postal Service more like a business at a time when there is fierce competition from...electronic “communication....” S. Hrg. 109-198 at 9. The PAEA grants the Postal Service broad latitude to alter rates as long as no market dominant class of mail’s rates increased above CPI. Rate cases became shorter and less formal.

This broad flexibility underscores the importance of the price cap as a protection mechanism for ratepayers. Though they would have far less input in the rate-setting process, ratepayers would be protected by predictable and stable rates. In addition to

granting the Postal Service rate flexibility, the PAEA strengthens the complaint process and provides for after-the-fact compliance reviews. The price cap, however, stands as the single most important safeguard for mailers. Rates may not exceed the price cap except under very limited circumstances.

2. Exigent Rate Provision—An Exception to the Price Cap

While emphasizing the central role of the price cap, Congress also recognized that the Postal Service might need to pierce the cap in an emergency situation. To that end, the PAEA contains an exigency, or safety valve, rate provision.¹² However, all parties, including the Postal Service, acknowledged that proposed rate increases could only exceed the price cap under very limited circumstances.

Assistant Secretary Bitsberger emphasized the importance of adopting a fixed or firm price cap to the Administration. Responding to follow-up questions from a 2005 Senate hearing, he specifically rejected the idea of revisiting the cap from time to time. S. Hrg. 109-198 at 111. He argued that doing so would undermine confidence that rate increases will be reasonable and predictable, which was essential for ratepayers if they were to continue to use the mail and increase their volumes. *Id.* He contended that “a periodic review of the CPI cap...[will not provide] the Postal Service with the appropriate incentives to reduce its costs and improve its productivity and efficiency. The Postal Service will come to believe that the CPI cap is not binding, but is instead negotiable.” *Id.*

¹² “Exigency” is a term that was first introduced in the 104th Congress. Although the term “exigent” does not appear in current law, it was frequently used in discussions to describe the safety valve or escape mechanism for increasing rates above the price cap. See, e.g., Executive Office of the President, Office of Management and Budget, *Statement of Administration Policy: H.R. 22 – Postal Accountability and Enhancement Act*, July 26, 2005; S. Hrg. 109-198 at 10, 22 (testimony of Timothy Bitsberger, Assistant Secretary of the Treasury for Financial Markets, U.S. Department of the Treasury); *id.* at 61 (testimony of John Potter, Postmaster General, United States Postal Service).

The Postal Service also acknowledged the importance of a firm price cap, specifically in the context of exigent rate cases. In his statement at a 2004 Joint Hearing before Congress, Postmaster General John Potter stated:

[A]n imperfectly crafted price cap...could require the Postal Service to file an exigent rate case as the rule rather than the exception. If that were to occur, it would defeat the purpose of a price cap and, in raising rates beyond those defined by the cap, contribute to even greater volume decline, leading to a vicious spiral of destructive rate increases.

Joint Hearing 108-171 at 74.

The sections that follow review the legislative developments that led to enactment of the exigent rate provision and apply the actual language of that provision to evaluate the Postal Service's Request.

C. Legislative Development of 39 U.S.C. § 3622(d)(1)(E)

Postal reform legislation has an extensive 11-year legislative history that informs the Commission's interpretation of 39 U.S.C. § 3622(d)(1)(E). The legislative history began during the 104th Congress and ended with the enactment of the PAEA at the end of the 109th Congress. The House introduced postal reform bills during the 104th, 105th, 106th, and 107th Congresses.¹³ During the 108th and 109th Congresses, both the House and Senate introduced postal reform bills.¹⁴

Congress enacted the PAEA during the 109th Congress. The PAEA combined H.R. 22 and S. 662, two bipartisan postal reform bills proposed during the 109th Congress. Both bills were sponsored by the chairpersons and ranking minority members of the committees of jurisdiction. On January 4, 2005, Representative John

¹³ H.R. 3717, 104th Cong. (1996); H.R. 22, 105th Cong. (1997); H.R. 22, 106th Cong. (1999); and H.R. 4970, 107th Cong. (2002).

¹⁴ H.R. 4341, 108th Cong. (2004); H.R. 22, 109th Cong. (2005); H.R. 6407, 109th Cong. (2006); S. 1285, 108th Cong. (2003); S. 2468, 108th Cong. (2004); and S. 662, 109th Cong. (2005).

McHugh introduced H.R. 22, which was referred to the House Committee on Government Reform. H.R. Rep. 109-66, at 75. H.R. 22 was marked up, approved, referred to the House Committee on the Judiciary, and placed on Union Calendar No. 55. The House subsequently passed H.R. 22 on July 26, 2005 and placed it on the Senate legislative calendar.

In the Senate, Senator Susan Collins introduced S. 662 on March 17, 2005, which was referred to the Committee on Homeland Security and Governmental Affairs. *Id.* After amendment, the Senate adopted S. 662 as a substitute amendment to H.R. 22 and passed it on February 9, 2006. *Id.*

No conference was ever held to resolve the differences between H.R. 22 and S. 662. Instead, key members of Congress and the Administration informally worked out a compromise version.¹⁵ They agreed to a final compromise during a lame duck session held during December 2006. That compromise was introduced as a new bill, H.R. 6407, in the House, which passed the bill without amendment on December 8, 2006. 152 Cong. Rec. H9182. On the following day, the Senate also approved H.R. 6407 without amendment. *Id.* at S11822. President Bush signed the bill into law as the PAEA on December 20, 2006.¹⁶

Each postal reform bill included provisions designed to improve the procedures and standards for establishing postal rates and fees.¹⁷ Except for S. 1285, each bill

¹⁵ See 152 Cong. Rec. H9179 (statement of Rep. Tom Davis) (“This bill is the product of months of negotiations between the House and the Senate and the administration.”); *id.* (statement of Rep. Danny Davis) (“This bill is a prime example of bipartisan negotiation and collaboration.”); NPMHU Comments at 4-7.

¹⁶ See George W. Bush, *Statement on Signing the Postal Accountability and Enhancement Act*, Dec. 20, 2006.

¹⁷ See H.R. 3717, section 1001(a); H.R. 22 (1997), section 1001; H.R. 22 (1999), section 201; H.R. 4970, section 201; S. 1285, section 201; S. 2468, section 201; H.R. 4341, section 201; S. 662, section 201; H.R. 22, section 201 (2005); H.R. 6407, section 201.

adopted a price cap model by setting annual limitations on rate increases.¹⁸ Each bill also contained an exigent rate provision enabling rate increases to exceed the price cap under certain circumstances.¹⁹ The exigent rate provisions in these prior bills evolved into the language appearing in the PAEA and codified at 39 U.S.C. § 3622(d)(1)(E).

1. House Legislation

The first postal reform bill originated in the House in 1996. During the 104th and 105th Congresses, two substantially similar bills were introduced that contained price caps and the exact same exigent rate provision. The Postal Service could only ask the Commission to exceed the price cap²⁰ “[u]pon a majority vote of the [Governors] then holding office....”²¹ The Board also had the power to determine whether exigent circumstances were present. It was required to certify in writing that “the Postal Service faces severe financial exigencies” and “the change is warranted to restore the Postal Service to fiscal soundness.” H.R. 3717 and H.R. 22, *supra* note 22.

The exigent rate provision also required the Commission to issue a decision on the Postal Service’s Request. *Id.* However, unlike current law, the Commission did not have to evaluate certain factors when making its determination. In particular, the Commission did not have to consider whether the adjustments were “reasonable and equitable and necessary....” See 39 U.S.C. § 3622(d)(1)(E).

¹⁸ The price cap limited rate increases to the change in the CPI-U, Gross Domestic Product Chain-Type Index, or similar measurement. S. 1285 did not set a specific annual limitation on rates. However, S. 1285 stated that the system for regulating rates “may include...price caps, revenue targets, or other form of incentive regulation....” Section 201, proposed section 3622(d).

¹⁹ S. 1285 contained a clause similar to the exigent rate provision, enabling “rates [to] be increased on an expedited basis” in certain situations. *Id.* 201, proposed section 3622(e)(2).

²⁰ During the 104th, 105th, and 106th Congresses, the price cap was calculated using both a financial index and an “adjustment factor,” a percentage determined by Commission proceedings. H.R. 3717, § 1001, proposed section 3723; H.R. 22 (1997), § 1001, proposed section 3723; H.R. 22 (1999), § 201, proposed section 3733.

²¹ H.R. 3717, § 1001, proposed section 3723(f); H.R. 22 (1997), § 1001, proposed section 3723(f).

H.R. 22, introduced during the 106th Congress, revised the exigent rate provision proposed in the 104th and 105th Congresses. Again, the Postal Service could only ask the Commission to exceed the price cap “upon a majority vote of the members of the Board of [Governors]...” H.R. 22 (1999), § 201, proposed section 3733(f)(1). However, unlike prior bills, H.R. 22 granted the Commission the authority to determine whether exigent circumstances existed. The price cap could be pierced “only upon a written determination by the Commission that the change requested is justified...” *Id.* proposed section 3733(f)(2). The change had to be justified “because of any new and significant statutorily-imposed funding obligations not fully funded through appropriations” or “because postal revenues...would otherwise be insufficient to enable the Postal Service, under best practices of honest, efficient, and economical management” to continue providing quality postal services. *Id.*, proposed section 3733(c)(2)(B)(i). This bill first introduced the “best practices of” language that appeared in later postal reform bills and the PAEA.

During the 106th Congress, the focus of the exigent rate provision shifted from protecting the fiscal soundness of the Postal Service to protecting the quality of postal services provided. During the 104th and 105th Congresses, the exigent rate provisions ensured that the proposed adjustment was “warranted to restore the Postal Service to fiscal soundness.” In contrast, during the 106th Congress, the focus shifted to whether postal revenues were sufficient to enable the Postal Service to continue providing quality postal services.

If postal revenues were insufficient, the Commission was also required to “take into account costs anticipated by the Postal Service for the period of time involved, such as wages, benefits, and transportation costs...” *Id.*, proposed section 3733(c)(B)(ii). H.R. 22 (1999) was the first bill requiring the Commission to evaluate certain factors when determining whether to permit an increase exceeding the price cap.

During the 107th Congress, proposed H.R. 4970 had an exigent rate provision that was mostly incorporated into the PAEA. Rate increases could not exceed the price cap unless the Commission “determined that such increase is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” H.R. 4970, section 201, proposed section 3622.

H.R. 4970 retained the “best practices of” language added in H.R. 22 (1999). Otherwise, the exigent rate provision in H.R. 4970 differs significantly from those proposed in prior Congresses. H.R. 4970 dropped the exigency, the pressing or urgent situation triggering the need to exceed the price cap. Unlike prior House bills, exigent circumstances did not have to occur before rate increases could exceed the price cap. Instead, the bill focused solely on requirements relating to the Commission’s determination. (The PAEA, however, ultimately incorporated the exigency into current law by adapting language proposed in Senate bills.)

H.R. 4970 also removed all references to the Postal Service Board of Governors. It no longer required the Postal Service to obtain a majority vote of the Board before filing an exigent rate request.

Identical exigent rate provisions appeared in H.R. 4341, introduced during the 108th Congress, and H.R. 22, introduced during the 109th Congress.²² The latter half of these provisions appears verbatim in the PAEA, except that the PAEA replaces “increase” with “adjustment.” H.R. 6407, § 201, proposed section 3622(d)(1)(E).

²² H.R. 4341, § 201, proposed section 3622(e); H.R. 22 (2005), § 201, proposed section 3622(e).

2. Senate Legislation

The Senate first proposed postal reform legislation in 2003.

During the 108th Congress, the Senate introduced S. 1285 and S. 2468, two bills with different exigent rate provisions. S. 1285 required the Commission to “establish procedures whereby rates may be increased on an expedited basis when an unexpected decline in revenue or increase in costs threatens the ability of the Postal Service to maintain service at the standards established by the...Commission.” Section 201, proposed section 3622(e)(2). S. 2468 modified the provision in S. 1285 by requiring the Commission to “establish procedures whereby rates may be adjusted on an expedited basis due to unexpected and extraordinary circumstances.” Section 201, proposed section 3622(d)(4).

The Senate pursued a different approach than the House. Unlike the House bills, the Senate bills focused exclusively on a requirement for a pressing or urgent situation triggering the need to exceed the price cap.

S. 2468 removed the provision in S. 1285 requiring that exigent circumstances “[threaten] the ability of the Postal Service to maintain service....” However, it added a “due to” clause to the exigency provision, establishing and requiring the link between exigent circumstances and the need for the adjustment by requiring that the adjustment be “due to” exigent circumstances. In other words, extraordinary or exceptional circumstances alone would not meet the exigency requirement. S. 2468, as current law, required a causal connection between the exigent circumstances and the adjustment.

During the 109th Congress, the Senate proposed S. 662, which adopted the same exigent rate provision as S. 2468. This provision was largely incorporated into the PAEA with the test “unexpected and extraordinary” eased to “either extraordinary or exceptional.” H.R. 6407, § 201, proposed section 3622(d)(1)(E).

3. The PAEA

The exigent rate provision in the PAEA, codified in 39 U.S.C. § 3622(d)(1)(E), combines the two requirements set forth by the House and Senate during the 109th Congress. The first half of section 3622(d)(1)(E) contains an exigency standard as provided in the Senate bill, mandating that the proposed rate adjustments be “due to either extraordinary or exceptional circumstances.”

If that requirement is met, the Commission must then evaluate factors taken from the House bill to determine whether to permit the adjustment. These factors are listed in the second half of section 3622(d)(1)(E) and require the Commission to determine “that such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management” to maintain and continue providing quality postal services.

4. General Trends

Section 3622(d)(1)(E) is unique to the PAEA. None of its predecessors in prior Congresses had the exact same language. The Congressional intent behind section 3622(d)(1)(E) is not explained by committee or conference reports, as none were issued for the enacted bill. However, the evolution of the language from prior bills demonstrates certain trends that illustrate its meaning.

In general, the exigent rate provisions evolved from a less restrictive to a more stringent standard. As the language changed from one Congress to the next, requirements relating to both exigency and the Commission’s determination became more strict and difficult to meet. These changes culminated in the PAEA. As a whole, the exigent rate provision in the PAEA is more restrictive than any provision in any previous bill because it combines independent requirements proposed separately by the House and Senate.

Exigency. The exigency—the pressing or urgent situation triggering the need to pierce the price cap—became much more restrictive in later postal reform bills compared to earlier ones. In earlier bills, the exigency was met by financial circumstances threatening the fiscal soundness of the Postal Service. These circumstances could include insufficient postal revenues, new and significant statutorily imposed funding obligations, or unexpected declines in revenue or increases in costs.

Exigent rate provisions proposed in later bills established a higher bar. The focus shifted from situations affecting only Postal Service finances to circumstances affecting both the Postal Service and the world at large. The new PAEA language requires the existence of circumstances that are “either extraordinary or exceptional.”

Also, the party determining the occurrence of exigent circumstances changed from the Postal Service to the Commission. Initially, the Board of Governors had the authority to determine whether “the Postal Service faces severe financial exigencies[.]” H.R. 3717, § 1001(a), proposed section 3723(f)(2)(A); H.R. 22 (1997), § 1001, proposed section 3723(f)(2)(A). However, during the 106th Congress, this authority transferred from the Board of Governors to the Commission, which became responsible for determining whether exigent circumstances were present. In H.R. 22 (1999), rate increases could pierce the price cap “only upon a written determination by the Commission that the change requested is justified....” This transfer of authority is reflected in subsequent legislation and the PAEA, all of which remove references to the Board of Governors.

Current law does not specifically state who determines whether circumstances are “either extraordinary or exceptional.” The Postal Service argues that the Board of Governors still has the authority to determine exigency, and some commenters have

raised this issue as well.²³ However, this position is inconsistent with both the plain meaning and legislative history of section 3622(d)(1)(E).

The legislative history reflects a trend of Congress moving this authority away from the Board of Governors and to the Commission. Both postal reform bills in the 104th and 105th Congress vested the Board with power and authority over exigent rate cases. The Board decided whether to file an exigent rate request and determined whether exigent circumstances were present.

During the 106th Congress, H.R. 22 scaled back this authority. Though the Board of Governors decided whether to file an exigent rate request, it no longer determined whether circumstances were exigent. Beginning with the 107th Congress, the exigent rate provisions removed all references to the Board and focused solely on the Commission. Because the Board of Governors is not mentioned in section 3622(d)(1)(E), it is unlikely that Congress still intended that the Board have final responsibility for determining whether circumstances are exigent.

Commission determination. Requirements surrounding the Commission's determination also evolved into a stricter standard in later Congresses by becoming less general and more specific. All exigent rate provisions, including the one in current law, require the Commission to issue a decision granting or denying the proposed adjustment. Initially, however, the Commission did not have to consider or evaluate certain factors when rendering its decision. See H.R. 3717 and H.R. 22 (1997). During the 106th Congress, the Commission was required to account for certain costs anticipated by the Postal Service, such as wages, benefits, and transportation costs. H.R. 22, § 201 (1999). Though it was specifically required to evaluate these factors, the

²³ See Response of the United States Postal Service to Motion of the Affordable Mail Alliance to Dismiss Request, August 2, 2010, at 10-11; Docket No. PI2010-3, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Topics for Discussion at June 16, 2010 Technical Conference, June 9, 2010, at 2-3.

Commission still had leeway to evaluate other elements when determining whether to grant or deny the proposed adjustment.

Beginning with the 107th Congress, the exigent rate provision framed the Commission's determination much more narrowly by requiring the Commission to determine whether the proposed adjustment was "reasonable and equitable and necessary, under best practices of honest, efficient, and economical management" to enable the Postal Service to continue providing quality services. H.R. 4970, § 201 (2002). This new standard, which the PAEA eventually incorporated, contains a conjunctive multi-part test requiring the Commission to evaluate whether proposed rate adjustments are "reasonable and equitable and necessary."

The legislative history does not provide a clear meaning of this new standard. In the Committee Report to H.R. 22 (2005), a bill containing identical language, the House stated that "[t]o ensure fairness, the new system provides that rates...should not increase faster than CPI, unless the Commission finds such increase 'reasonable and equitable and necessary' to maintain services and quality." H.R. 109-66, at 48. This report does not provide examples of what is considered to be "reasonable and equitable and necessary" or "best practices of honest, efficient, and economical management."²⁴

The PRA had a provision on postal rates and fees with the same "honest, efficient, and economical management" clause.²⁵ The PAEA adopted this clause, but added "best practices of" before it. Congress most likely added the "best practices of" with the intent to establish a stricter standard. Adding "best practices of" requires the

²⁴ The Congressional Budget Office, when providing the cost estimate for H.R. 22 (2005), characterized the bill as mandating rates to remain within the price cap "unless a larger increase would be necessary to ensure the viability of the Postal Service." H. Rep. 109-66, at 86.

²⁵ Under the PRA, postal rates and fees had to be "reasonable and equitable and sufficient to enable the Postal Service under honest, efficient, and economical management" to continue providing quality postal services. PRA § 2, former 39 U.S.C. § 3621.

Postal Service not only to manage well, but also to meet “a standard of excellence that consistently rivals the private sector in both productivity and quality of service.”²⁶

Within the context of the legislative history and the development of the statutory language, the Commission must implement 39 U.S.C. § 3622(d)(1)(E) consistent with its best understanding of the plain meaning of those terms.

D. Interpretation of the Exigent Rate Provision

1. Interpretation of Statutory Language

The application of section 3622(d)(1)(E) depends upon the interpretation given to a number of key terms, including the words “extraordinary” and “exceptional” in the phrase “extraordinary or exceptional circumstances,” as well as the words “reasonable,” “equitable,” and “necessary” in the requirement that the rate adjustments proposed by the Postal Service be “reasonable and equitable and necessary.” The meaning attributed to these words, their relationship in the particular context in which they and section 3622(d)(1)(E) appear, and other factors must be considered to ensure the proper interpretation of the applicable statutory standards. The Commission’s interpretation of section 3622(d)(1)(E) is subject to and guided by established judicial precedents.

The meaning of a statute must be determined by reference to the language of the statute itself. *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999). When, as in the present case, key terms that establish regulatory standards, such as “extraordinary”, “exceptional”, “reasonable”, “equitable”, or “necessary” are not defined in the statute, the Commission must look first to the ordinary or plain meaning of those

²⁶ See Report of the President’s Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, July 31, 2003, at xii.

terms. *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995) cited in *Mac's Shell Service, Inc. v. Shell Oil Products Co., LLC*, 130 S. Ct. 1251, 1257 (March 2, 2010).

After reviewing the ordinary or plain meaning of a relevant term, the Commission must look to the structure and purpose of the statute. Statutes must be interpreted as a coherent and symmetrical regulatory scheme and, if possible, all parts must be fitted into a harmonious whole. *Chemehuevi Tribe of Indians v. FPC*, 420 U.S. 395 (1975); and *Cody v. Cox*, 509 F.3d 606, 609 (D.C. Cir. 2007). The meaning of words should be determined by specific context in which they are used and within the broader context of the statute as a whole. *Russello v. United States*, 464 U.S. 16, 23 (1983); *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997); *Food and Drug Administration v. Brown & Williamson Tobacco Corporation*, 529 U.S. 120, 132-33 (2000). Each word must be presumed to have a purpose. *Russello, supra*; *Robinson, supra*; and *Brown & Williamson, supra*. See also *United States v. Menasche*, 348 U.S. 528, 538-39 (1955). Each word must, if possible, be given an operative effect. *Dole Food Co. v. Patrickson*, 538 U.S. 468, 477 (2003).

The next step in statutory interpretation often involves a review of potentially relevant legislative history. See *United States v. Braxton-Brown Smith*, 278 F.3d 1348, 1352 (D.C. Cir. 2002). Such a review can include an examination of committee reports, floor debates, congressional testimony, statements by the sponsors or opponents of bills or amendments, and other potential information with probative value.²⁷ The reliance upon legislative history has for years been the subject of extensive debate.²⁸ Nevertheless, even those who have been critical of the use of legislative history have,

²⁷ See *Bilski v. Kappos*, 130 S. Ct. 3218 (2010) (committee reports); *Corley v. United States*, 129 S. Ct. 1558 (2009) (sponsor's statements); *Scheidler v. National Organization for Women, Inc.*, 547 U.S. 9 (2006) (floor debates); *Hamdan v. Rumsfeld*, 548 U.S. 557 (2006) (Thomas, Scalia, and Alito dissenting) (citing *In re Yamashita*, 327 US 1 at 19, n.7 (1946)) (congressional testimony).

²⁸ Kenneth W. Starr, *Observations About the Use of Legislative History*, 1987 Duke L.J. 371 (1987); Abner J. Mikva, *Reply to Judge Starr's Observations*, 1987 Duke L.J. 380 (1987); Stephen Breyer, *On the Uses of Legislative History in Interpreting Statutes*, 65 S. Cal. L. Rev. 845 (1992); *Chisom v. Roemer*, 501 U.S. 380, 404 (1991) (Scalia, J., dissenting).

on occasion, acknowledged the need to examine legislative history to ensure a proper outcome in a particular case. *Green v. Bock Laundry Machine Co.*, 490 U.S. 504, 327 (1989) (Scalia, J., concurring).

2. Application of Standards to the Exigent Rate Provision

The exigency clause states:

[N]otwithstanding any limitation set under subparagraphs (A) and (C), and provided there is not sufficient unused rate authority under paragraph (2)(C), establish procedures whereby rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances, provided that the Commission determines, after notice and opportunity for a public hearing and comment, and within 90 days after any request by the Postal Service, that such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

39 U.S.C. § 3622(d)(1)(E).

This provision can be broken down into two distinguishable parts. It directs the Commission to establish a procedure under which the Postal Service may obtain authority to adjust rates over applicable price caps. The Commission established such a procedure. Order No. 43, issued October 29, 2007;²⁹ see 39 CFR § 3060 *et seq.*

The statute then specifies that such adjustments are allowed only if they are

- due to either extraordinary or exceptional circumstances;
- reasonable and equitable and necessary to enable the Postal Service under best practices of honest, efficient, and economical management;

²⁹ Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007 (Order No. 43).

- to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

The Postal Service contends that its Request meets these requisites. A number of commenters challenge whether the Request meets these requirements with most of their comments focusing on the first two. The Commission will evaluate these requirements in the order in which they appear in the statute, as set forth above, applying the statutory interpretation principles described in section II.D.1.

The key terms of section 3622(d)(1)(E) are not defined. Therefore, the “plain meaning” test is applicable. The Commission must also review the context of these clauses and their legislative development to ensure that their plain meaning does not misapprehend the will of Congress. The Commission concludes that the plain meaning of section 3622(d)(1)(E) is both clear, and an accurate reflection of Congressional intent. This plain meaning provides the basis for the Commission’s decision.

As explained in chapter IV, the Commission has determined that while the Postal Service Request does identify an extraordinary or exceptional circumstance, it fails to demonstrate that the specific rate adjustments it proposes are **due to** those circumstances. Therefore, the proposed rate adjustments are not authorized by the PAEA, and the Postal Service Request is denied. As a result, there is no need to review commenter’s arguments concerning whether the proposed rates are reasonable, equitable, and necessary; or whether they are required to maintain and continue service of the kind and quality needed by the United States.

III. PROCEDURAL HISTORY

As part of the comprehensive changes enacted by the Postal Accountability and Enhancement Act, Pub L. 109-435, 120 Stat. 3198 (2006) (PAEA), Congress has authorized the Postal Service to adjust rates on an expedited basis for market dominant products "due to either extraordinary or exceptional circumstances."³⁰

The Commission adopted rules that established procedures to permit review of exigent rate adjustments within a functional and flexible framework on an expedited basis. Order No. 43 at 65-73. The rules were designed to foster efficient preparation and filing of an exigent rate case and reflect the statutory requirement that determinations on proposed exigent rate adjustments be made within 90 days of the date of filing. The rules require the Postal Service to submit supplemental information to support its proposal for an exigent rate increase which demonstrates its request comports with the statutory requirements of 39 U.S.C. § 3622(d)(1)(E).

The Commission has attempted to apply its rules to maximize effective public participation consistent with providing the required expedition. On May 7, 2010, the Commission gave notice that a technical conference would be held on June 16, 2010 to discuss the procedures for handling the exigent rate case that the Postmaster General had previously suggested might be filed.³¹

³⁰ Rate adjustments for extraordinary or exceptional circumstances under 39 U.S.C. § 3622(d)(1)(E) are commonly referred to as "exigent" rate adjustments, although the term "exigent" does not appear in the statute. Recognizing that the legal standard for assessing section 3622(d)(1)(E) rate adjustments is the "extraordinary or exceptional circumstances" standard, the Commission shall for convenience refer to rate adjustments proposed under section 3622(d)(1)(E) as exigent rate adjustments and to cases containing such rate adjustments as exigent rate cases. *See also* Order No. 43 at 66; 39 CFR § 3010.60 *et seq.*

³¹ Docket No. PI2010-3, Notice and Order Providing for Technical Conference, May 7, 2010, at 1 (Order No. 456).

This conference gave interested persons the opportunity to discuss procedures for management of the anticipated exigent rate case and to propose ideas, suggestions, and solutions to facilitate meaningful review of the proposed filing. It also promoted discussion regarding the timeframe required to adequately address the complex issues likely to arise during consideration of an exigent rate proceeding. Participants in the June 16, 2010 conference discussed a broad spectrum of topics, including, for example, the desirability of technical conferences, the nature and extent of permissible discovery, the manner in which participants would be permitted to ask or respond to questions, and procedures for filing written comments.³²

On July 6, 2010, the Postal Service filed its Request pursuant to 39 U.S.C. § 3622(d)(1)(E) and 39 CFR § 3010.60 *et seq.* of the Commission's rules. The Request seeks "to increase rates for market dominant products in excess of the otherwise applicable limitations of 39 U.S.C. § 3622(b)(1)(A) and 39 C.F.R. § 3010.11." Request at 1. The proposed prices represent an average increase of approximately 5.6 percent and are to be implemented on January 2, 2011. *Id.*

On July 8, 2010, the Commission issued Order No. 485 to docket the Postal Service's exigent rate case filing and establish a procedural schedule for the proceeding. The schedule included three technical conferences that were held on July 19, July 23, and July 27, 2010. The topics for those conferences were volume and revenue forecasts; pricing, including workshare discounts; and flats cost containment strategy. Initial comments were to be submitted by August 17, 2010. Reply comments were due September 2, 2010. The order identified October 4, 2010 as the deadline for the Commission's decision.

On July 26, 2010, the Affordable Mail Alliance filed a motion to dismiss the Postal Service's request and to have the Commission make an initial determination as to whether the Postal Service met the statutory requirement of extraordinary or

³² See Docket No. PI2010-3, Tr. 1 *et seq.*

exceptional. The Public Representative filed a response in support of the motion. The Postal Service, NALC, NRLC, NPMU, SMC, and Valpak filed in opposition. On August 4, 2010, the Commission issued Order No. 507 taking the AMA motion under advisement, deferring a decision because of the need for further investigation of the factual assertions raised in the motion and responses.

Public hearings were held August 10–12, 2010, at which the Commission questioned the three Postal Service officials whose supporting statements accompanied the Request. The Commission also asked the Postal Service to provide a knowledgeable official to respond to questions about its flats cost containment strategy, and Frank Neri, Manager of Processing Operations in the Network Operations Group, appeared for that purpose. This process was enhanced by participants submitting potential lines of questions. Proposed questions were suggested by AMA, APWU, GCA, eBay, NAPUS, NPPC, TW and Valpak.

The Commission received 46 formal written comments and 21 formal reply comments. These submissions are identified in Appendix A. Comments addressed both the appropriate interpretation of applicable PAEA provisions and the specifics of the Postal Service rate proposals. Because this decision focuses on the prerequisites for granting an exigent rate increase, and finds that those prerequisites have not been met, participant concerns about proposed rate levels and rate designs have not been resolved. Appendix B identifies the principle issues raised to inform future rate adjustment proceedings.

This decision also makes it unnecessary to address the merits of the classification change requests incorporated in the Postal Service's proposal. Should the Postal Service wish to pursue one or more of these changes, it may refile them as separate proposals. In that circumstance, it may designate relevant testimony or supporting documents filed in this case as part of its supporting materials. In one instance, the Postal Service has already submitted a separate classification request,

Docket No. MC2010-36, that presumes a request made in this case will be approved.³³ If the Postal Service still wants to implement these changes, it also may supplement its Docket No. MC2010-36 request, and designate relevant materials for inclusion in that record.

Description of the Postal Service Request. In its Request, the Postal Service states that this is only one of several steps that it will take to improve its financial condition. Request at 2. It states further that without the authority to increase rates beyond current limitations, it would be confined to an overall rate increase of only 0.578 percent, an amount which it asserts would prevent it “from making discernible progress towards closing the multi-billion dollar shortfall between projected expenses and projected revenues for FY 2011....” *Id.* at 2-3. The Postal Service states that while the proposed increases will not eliminate the revenue shortfall, this is one of the few options that can reasonably be expected to have a short-term positive impact. *Id.* at 3.

In support of its filing, the Postal Service asserts that the circumstances it faces are “extraordinary or exceptional” and that the proposed rates are reasonable, equitable, and necessary. *Id.* at 4-8. The Postal Service goes on to describe the structure of its proposed rate adjustment stating that the concept it has followed involves the identification of available price caps by class, the presentation of an explanation of why the revenue generated from increases limited by price caps would be inadequate, and the presentation of an alternative proposed set of higher-percentage price increases. *Id.* at 9. The proposed increases are evaluated against factors set forth in the Commission’s rules. *Id.* at 10. According to the Postal Service, this Request could be viewed as an exercise in borrowing against future price caps and that if future circumstances permit, the Postal Service might be able to “pay back” some

³³ Docket No. MC2010-36, Request of the United States Postal Service to Transfer Commercial Standard Mail Parcels to the Competitive Product List, August 16, 2010.

or all of the exigent increase by basing future price increases on price caps calculated below levels that future CPI-U calculations might otherwise indicate. *Id.* at 10-11.

Using its proposed methodology, the Postal Service states that the percentage changes by class for its proposed exigent prices are as follows:

First-Class Mail	5.417 %
Standard Mail	5.616 %
Periodicals	8.035 %
Package Services	6.700 %
Special Services	5.225 %

Cumulatively, these percentage increases result in an overall percentage increase for market dominant products of approximately 5.6 percent. *Id.* at 15.

All of the proposed rates are set forth in Attachment A to the Request. The Postal Service also includes several proposed changes to the Mail Classification Schedule (MCS) in the Request. The Postal Service states that while it has attempted to minimize the scope of MCS changes, some beneficial programs requiring MCS changes are warranted. *Id.* at 19. The following changes are identified:

- In First-Class Mail, a Reply Rides Free Program is added for presorted letters;
- For First-Class Mail Parcels, a single-piece commercial price category is added;
- For First-Class Mail Single-Piece Parcels, a single price cell for 0 – 3 ounces is created;
- For First-Class Mail Commercial Single-Piece Parcels weighing less than 2 ounces, the non-machinable surcharge is eliminated;

- For Move Update, the tolerance level is reduced from 30 percent to 25 percent;
- In Standard Mail, a Saturation and High Density Incentive Program is added;
- The Standard Mail Not Flat-Machinable/Parcels product is renamed Standard Parcels and, as renamed, is divided into Marketing parcels and Fulfillment parcels. The Not Flat-Machinables price category is replaced by a Regular Marketing Parcels category;
- For Bound Printed Matter, half-pound rate cells are eliminated; and
- Standard Mail denominations for Stamped Envelopes are eliminated.

Supporting justification for the proposed exigent price increase is provided in the statement of the Postal Service's Chief Financial Officer, Joseph Corbett (Corbett Statement), and the statement of Stephen J. Masse, Vice President of Finance and Planning for the Postal Service (Masse Statement). They detail the Postal Service's past financial history and the current financial condition as of the end of FY 2009. Mr. Corbett also discusses how the requested exigent price increase is but one aspect of an overall plan by the Postal Service to return to financial stability and solvency. Mr. Masse provides volume, revenue, and cost projections for FY 2010 and FY 2011. Mr. Masse also presents *pro forma* financial data for FY 2010, FY 2011 before the price changes (Before Rates), and two versions of FY 2011 after the price changes (After Rates). One version is based on an implementation date of January 2, 2011, while the second version is based on an implementation of new prices on October 1, 2010. The second version is to provide information on the effect of the change in prices for a full year. Masse Statement at 8. Finally, the statement of James M. Kiefer (Kiefer Statement), a pricing economist for the Postal Service, presents the proposed rate increases and the justifications for the price changes.

Mr. Corbett states that numerous economic sources cite this most recent recession as being the worst economic downturn since the Great Depression of the 1930s. While there have been other recessions since postal reorganization, none has

had as severe an effect on unemployment, created as much turmoil in the financial markets, or generated as much uncertainty in the markets and in consumer confidence. Corbett Statement at 13-14. This recession also had a marked effect on postal volumes as, unlike previous recessions, the hardest hit sectors of the economy were some of the biggest customers of the Postal Service. The extreme tightening of the credit markets specifically affected First-Class Mail with fewer credit card and mortgage solicitations. Additionally, the migration of bill presentment and payments to electronic methods accelerated significantly. Finally, the advertising market saw one of the largest downturns in recent history as ad pages in periodicals declined dramatically and even caused many periodicals to cease publication. *Id.* at 14-15.

Mr. Corbett states that the Postal Service is now on the brink of financial insolvency. With the bulk of its costs fixed by laws and regulations, its operating flexibility is limited. Additionally, the Postal Service is bound by legal requirements to maintain service levels despite the reduction in demand for those services. *Id.* at 2. He notes that the business model which was based on increasing mail volumes generating sufficient revenue to cover the costs of providing service is no longer viable. The significant volume decreases since the end of FY 2007 have resulted in a severe decline in revenues, and despite aggressive cost reductions over the past years, the expanding delivery network and the imposition of significant new costs by the PAEA have led to a "...grave and unsustainable financial imbalance." *Id.* at 4. He attributes the severe financial situation to a lack of operating flexibility and three factors: the diversion of mail to electronic alternatives; the initial and subsequent effects of the economic recession; and the statutory obligation to pre-fund retiree health benefits at an accelerated pace. *Id.* at 5.

On March 2, 2010, the Postal Service unveiled a 10-year Action Plan that included seven major recommendations.³⁴

- Restructure retiree health benefit prefunding;
- Adjust delivery frequency from 6 to 5 days per week;
- Modernize retail access;
- Establish a more flexible workforce;
- Elevate the role of demand factors in pricing and implement a modest exigent price increase;
- Expand the scope of product and service offerings; and
- Streamline oversight and regulatory processes.

While most of these actions would require legislative action, the exigent price increase is identified as one able to provide a more immediate impact, and one that can be accomplished under current law. Mr. Corbett emphasizes that the exigent price increase is not intended to correct the financial difficulties of the Postal Service, but is just one part of the overall plan. *Id.* at 9-11. *See also* Tr. 1/36-38.

Mr. Masse discusses the Postal Service's recent financial history and current situation. From FY 2003 through FY 2006, the Postal Service reported positive net incomes resulting from healthy volume growth, cost reductions of \$1 billion per year, and reductions in total long-term debt. Also contributing significantly to the positive financial results was the enactment of Public Law 108-18, which significantly reduced the Postal Service's contributions to the Civil Service Retirement System (CSRS) in

³⁴ *Ensuring a Viable Postal Service for America, an Action Plan for the Future*, March 2, 2010, at 10-15 (Action Plan). A copy of the Action Plan is available on the Postal Service's website: http://www.usps.com/strategicplanning/_pdf/ActionPlanfortheFuture_March2010.pdf.

order to prevent a significant overfunding of the Postal Service obligations to the CSRS. The Postal Service was allowed to use the savings from the reduced CSRS payments to reduce debt and make capital investments until FY 2006, at which time the savings were to be held in escrow until Congress determined an appropriate use for the savings. Masse Statement at 3.

Volumes declined slightly in FY 2007, but by the middle of FY 2008, the volume losses began to grow significantly. Also during this time, the Postal Service began to make the first of ten scheduled payments into the newly established Retiree Health Benefits Fund (RHBF). These payments, ranging from \$5.4 to \$5.8 billion per year, were established with the enactment of the PAEA. The net losses for FY 2007 and FY 2008 were driven by these payments. Total losses for the 2 years were \$7.9 billion, while the total of the first two payments, plus the payment of the FY 2006 escrow, was \$14 billion, almost twice the net loss. *Id.* at 4.

By the beginning of FY 2009, the volume declines and subsequent revenue losses had accelerated significantly. Total volumes declined 12.7 percent over the year. The Postal Service accelerated its cost reductions, reducing costs by over \$6 billion. However, because of the high level of fixed costs within the nationwide delivery network, the Postal Service was unable to reduce costs commensurate with the declines in volumes. With the added burden of funding the RHBF by \$5.4 billion, the Postal Service was facing a significant liquidity problem. Congressional action to reduce the scheduled payment to the RHBF by \$4 billion averted a cash flow crisis in FY 2009, but did not solve the primary financial problem. *Id.* at 5-6.

FY 2011 is expected to show an increase in the net loss for the year, despite an expected increase in total volumes. The Postal Service projects continued losses in FY 2010 to FY 2011, and forecasts that it will exhaust its borrowing authority of \$15 billion and still fall \$4 billion short of its cash needs by the end of FY 2011. The exigent

price increase proposed by the Postal Service does not address FY 2010 financial conditions, and it will not solve the liquidity problems in FY 2011. *Id.* at 6-7.³⁵

The Postal Service projects that the rate and fee changes it proposes will produce FY 2011 revenues of \$69.8 billion with \$74.5 billion of expenses, resulting in a FY 2011 revenue deficiency of \$4.7 billion. Additionally, the Postal Service estimates that there will be a cash shortfall of \$2.1 billion in FY 2011, even if the higher rates are put in place on January 2, 2011. *Id.* at 11.

Included with the Request are Attachment A, which shows the requested rate schedules and changes to the MCS; Attachment B, which provides calculations underlying what the CPI-U cap would be if the Postal Service were to file a Type 1 rate adjustment; Attachment C, which is a list of supporting materials; and Attachment D, which is an application for non-public treatment of a non-public annex. It also includes nine public library references with five sets of worksheets for the five market dominant classes, a Product & Cost Distribution Model, A Cost Factor Development analysis, revenue and volume forecasts, and its “Flats Strategy”.

³⁵ See *also* Statement of Stephen J. Masse, Attachment 4.

IV. COMMISSION ANALYSIS

A. An “Extraordinary or Exceptional Circumstance” Exists

Section 3622(d)(1) of title 39 provides rate stability and predictability through a cap on annual rate increases for each market dominant mail class at the level of CPI-U. The cap is intended to serve as the primary mechanism for preventing the Postal Service from taking advantage of its monopoly position in markets that it dominates, as well as the primary source of discipline over the Postal Service’s costs. The price cap is the centerpiece of the modern system of ratemaking that the Commission has established under the PAEA.

Section 3622(d)(1)(E) provides a mechanism for freeing class rates from the cap under “either extraordinary or exceptional” circumstances. There is a sharp divide among the commenters over whether the most recent recession meets this threshold standard.

1. Position of the Opponents of an Exigent Rate Increase

Central role of the cap. The opponents of the Postal Service’s Request for an exigent rate increase take the position that the “extraordinary or exceptional circumstances” needed to trigger the exigency clause are in fact much narrower than its plain language would imply. They draw this inference from what they consider to be the indispensable role that the cap plays in incentive ratemaking. They infer a narrowed meaning of “extraordinary or exceptional” by adding requirements of unforeseeability and unavoidability. They also characterize the legislative history of section 3622(d)(1)(E) in a way that reinforces this inference. Thus narrowed, the opponents of an exigent rate increase argue, the “extraordinary or exceptional” standard excludes economic cycles and their impact on postal finances, including the recent recession.

One proponent of this view is the Affordable Mail Alliance (AMA), an association of more than 50 postal-related trade associations joined by several hundred individual newspapers, non-profit organizations, and other companies. AMA filed a motion to dismiss the Postal Service's Request on, among other things, the ground that the Postal Service had failed to make the threshold showing of extraordinary or exceptional circumstances necessary to adopt exigent rates.³⁶

In supporting its motion, AMA emphasizes that the PAEA replaced a cost-of-service system of regulating postal rates with an incentive system. *Id.* at 5, 11. It views the price cap on class rates as the centerpiece of the incentive system and considers it indispensable to its functioning. *Id.* at 5. It cautions that to free the Postal Service from the pressure of the price cap primarily because it is losing money would discredit the price cap's function as an incentive to control costs. *Id.* at 2, 5, 12. It argues that consistent pressure from the price cap is necessary to give the Postal Service an effective incentive to cut costs to keep pace with the long-term decline in demand for postal services that has been occurring over the last two decades. *Id.* at 1-5. It warns that if the Postal Service is allowed to breach the price cap under current circumstances, it will conclude that it is easier to use its monopoly power to pass costs along to the users of the mail and their customers than to do the hard work of trimming excess network infrastructure or insisting that its labor organizations agree to eliminate inflexible work rules, excess staff, wage premiums, and excessive fringe benefits that dwindling demand for postal services can no longer support. *Id.* at 4, 7-8, 38-39, 60, 71.

AMA contends that in drafting the PAEA, Congress was aware that some economic trends unfavorable to the Postal Service were already in place and that economic cycles would continue. *Id.* at 65. It maintains that Congress did not intend

³⁶ Motion of the Affordable Mail Alliance to Dismiss Request, July 26, 2010, (Motion to Dismiss). That motion was taken under advisement by the Commission (see Order No. 507 filed August 4, 2010) and is denied in this order.

economic cycles and unfavorable economic trends to be grounds for freeing the Postal Service from the pressure of the price cap. *Id.* It argues that Congress understood that allowing the price cap to be breached on such grounds might make escapes from the price cap routinely available to the Postal Service, which would “nullify the primary line of defense established by Congress to protect mailers and the American public....” *Id.* at 5, 12.

Senator Susan Collins provides support for AMA’s position.³⁷ She agrees with AMA that the price cap is indispensable to incentive regulation and that exceptions should be rare. She states that congressional intent behind the price cap is clear: “[T]he cap, in addition to creating stability and predictability, was set to induce the Postal Service to improve its business model and, ultimately, its effectiveness. [T]he exigent rate provision]...was intended to provide the Postal Service with an extremely limited safety valve.” *Id.* at 2.

Senator Collins also agrees with AMA that Congress was aware that incentive rate regulation would fail if exigent rate increases were not rare. As evidence of that awareness, the Senator cites the testimony of then–Postal Rate Commission Chairman George Omas during a postal ratemaking reform hearing: “A mechanism for regularly exceeding the rate levels around which postal management is expected to make its operational plans could completely undermine this central objective [of ratemaking reform].” *Id.* (Emphasis omitted.) Senator Collins concludes that Congress did not intend the exigent rate provision to be used under the current circumstances. *Id.* at 1.

Exigent circumstances must be unforeseeable and unavoidable. Both AMA and Senator Collins believe that the exigent rate provision requires circumstances to be both unforeseeable and unavoidable.

³⁷ Comments of Senator Susan Collins, Ranking Member of the Senate Committee on Homeland Security and Governmental Affairs, August 9, 2010 (Collins Letter).

AMA contends that “extraordinary or exceptional circumstances” imply unforeseeability.³⁸ It asserts that the principles underlying incentive ratemaking require unforeseeability “[t]o provide credible incentives for efficient operation..” Motion to Dismiss at 16, n.8. It argues that the Postal Service “may not be allowed to seek above-CPI increases to recover shortfalls that result from causes that [it] reasonably could have anticipated and mitigated.” *Id.*

The legislative history of the exigency clause narrows the meaning of “extraordinary or exceptional.” Opponents of the exigent rate increase contend that the legislative history of the exigency clause supports their narrow interpretation of the terms “extraordinary or exceptional circumstances.” H.R. 22 originated in the House of Representatives in the 109th Congress and was a precursor to the PAEA. Section 201 of H.R. 22, endorsed by the Postal Service, authorized the regulator to lift the price cap whenever it found that it was “reasonable and equitable and necessary” to maintain appropriate levels of service. Senator Collins asserts that Congress rejected this standard in favor of a more restrictive version which includes the current requirement in the PAEA that the price cap be breached only in extraordinary or exceptional circumstances. Collins Letter at 2.

Like Senator Collins, AMA notes that Congress rejected the more lenient exigent rate standard in H.R. 22 and extrapolates from that rejection that Congress intended to exclude economic cycles as exigent events. It believes that such an inference is supported by the fact that Congress rejected the more lenient standard even after Postmaster General Potter testified that a rigid price cap could be harmful to the Postal Service “given the volatility of today’s market place.”³⁹

³⁸ Motion to Dismiss at 14 (citing Docket No. RM2007-1, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007, at ¶ 2105 (Order No. 26)). In Order No. 26, the Commission initially limited exigent requests to unforeseeable emergencies. However, the Commission modified this conclusion in the order promulgating the final regulations. See Order No. 43, ¶ 2211.

³⁹ Motion to Dismiss at 15 citing Joint Hearing at 63.

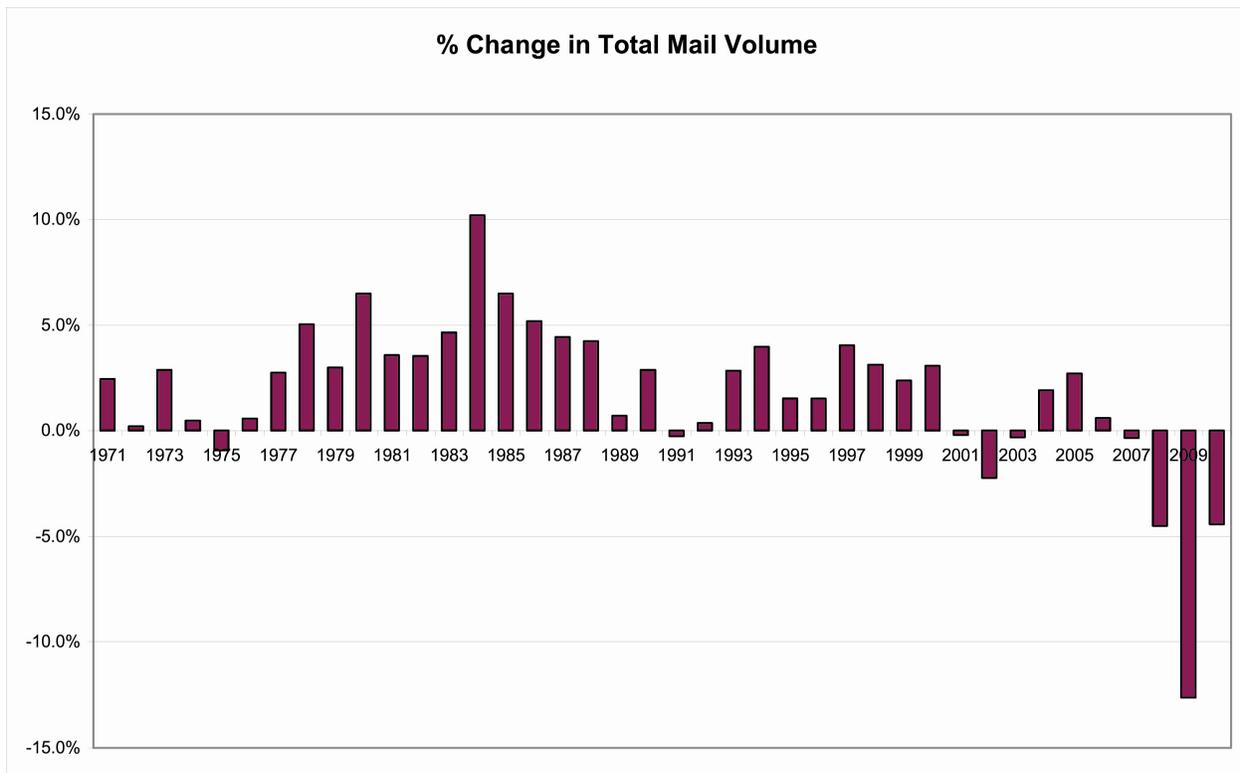
The opponents of an exigent rate increase argue that the effect of the recent recession on postal finances was neither unforeseeable nor unavoidable. AMA offers detailed allegations that the Postal Service has allowed long-term inefficiencies in network capacity, staff capacity, and wage premiums to persist. Motion to Dismiss at 17-27. It also offers statistics to support its view that the Postal Service did not cut costs in response to the recent recession as nimbly as its private competitors. *Id.* at 28-34.

2. Position of the Proponents of an Exigent Rate Increase

The Postal Service. The Postal Service supports its request for an exigent rate increase with a statement from Joseph Corbett, its Chief Financial Officer.

Mr. Corbett's Statement describes the multi-billion dollar losses in mail volume that the Postal Service has incurred since FY 2007. Corbett Statement at 3. He forecasts that, given the severely low cash and legal borrowing capacity carried into 2011, the Postal Service will be unable to pay all of its 2011 obligations. *Id.* at 8.

Mr. Corbett describes the recent economic recession as the most severe economic crisis since the Great Depression resulting in the "worst contraction in mail volume in modern American postal history...." *Id.* at 11. He supports this description with the following graph of postal volumes from 1971 to the present:



Mr. Corbett also compares the volume decline from the current recession with past recessions from the last 36 years. *Id.* at 12. He notes that the current volume decline is six- times greater than the next most serious decline, the volume decline which reflects the combined effects on volume of the 2001 recession, the 9/11 terrorist attack, and the anthrax attacks.

Mr. Corbett asserts that the recession underlying these volume declines was unforeseen by the most sophisticated of economic forecasters. He states that the recent recession and its impact on mail volume “clearly constitutes ‘extraordinary or exceptional circumstances’ as those terms are used in the statute.” *Id.* at 16.

In its response to the Motion to Dismiss,⁴⁰ the Postal Service challenges AMA's grounds for arguing that the phrase "extraordinary or exceptional circumstances" is narrower than the plain and ordinary meaning of these terms. The Postal Service cites judicial precedent holding that statutory construction should begin with the plain, ordinary meaning of the terms employed, and should remain there where the statute does not define those terms. *Id.* at 11.⁴¹ It turns to a standard dictionary to find the ordinary meaning of "extraordinary"—"beyond what is usual, ordinary, regular, or established," and the ordinary meaning of "exceptional"—"forming an exception or rare instance" and "unusual." *Id.* at 11-12. It asserts that the severe and sudden declines in volume caused by the recent recession demonstrated by Corbett clearly satisfies either term.

The Postal Service says that it is pointless for AMA to dwell on the fact that the diversion of mail volume to electronic alternatives is foreseeable since the Postal Service nowhere claims that such diversion satisfies the standard. *Id.* at 13. Similarly, it says that AMA gains nothing by arguing that it is foreseeable that recessions in general can occur since that does not mean that the effects of a particular recession (like a specific hurricane) that are abnormally abrupt and severe, are foreseeable. *Id.* at 14, 18.

The Postal Service contends that it is illogical to accept terrorist attacks as "extraordinary or exceptional circumstances," but not the current recession, given that the current recession had much greater volume and revenue impacts. *Id.* at 14. It emphasizes that a logical interpretation of the standard would not focus on the type of triggering event, but rather on the impact on postal revenues and costs. *Id.*

⁴⁰ See Response of the United States Postal Service to Motion of the Affordable Mail Alliance to Dismiss Request, August 2, 2010 (Postal Service Response to Motion) at 11-12 citing *Webster's Encyclopedic Unabridged Dictionary*, 674, 686 (1996).

⁴¹ The NPMHU agrees. See NPMHU Comments at 10.

The Postal Service notes that Congress deleted the requirement that the triggering circumstance be “unexpected” from a previous version of the exigency clause. It, thus, considered and rejected an unforeseeability requirement. It adds that even if unforeseeability were part of the exigency standard, it would be easily met by the recent recession. It was, it argues, the most sudden and severe economic crisis since the Great Depression, and was not predicted by the most sophisticated economic forecasting organizations. It notes that the loss of mail volumes that resulted was not foreseen by the mailing industry or by the Postal Service. *Id.* at 18-19.

The Postal Service challenges AMA’s assertion that allowing an exigent rate increase under current circumstances risks routine breaches of the price cap leading to the collapse of incentive ratemaking. *Id.* at 19. The Postal Service argues that the opposite is true: denying its Request would eliminate “the Postal Service’s ability to use the *only* safety valve incorporated into the PAEA’s price cap regime...[which] would preclude any exigent increase over the foreseeable time horizon....” *Id.* at 20-21. (Emphasis in original.)

Finally, the Postal Service asserts that AMA cannot legitimately use the post-enactment comments of Members of Congress to support its conclusion that the Postal Service’s exigent rate request does not meet the “extraordinary or exceptional circumstances” standard in the PAEA. The Postal Service cites judicial precedent holding that the post-enactment statements of Members of Congress may not be viewed as legislative history, and are “inherently entitled to little weight.” *Id.* at 14-15.

National Postal Mail Handlers Union. NPMHU argues that the financial crisis that the Postal Service faces as a result of the recent recession falls squarely within the requirements for justifying an exigent rate request. NPMHU Comments at 2. It provides a thorough examination of the legislative history to support its contentions and concludes that the statutory language and legislative history have been misunderstood. *Id.* at 3.

NPMHU describes the “extraordinary or exceptional circumstances” standard as a legislative compromise between a provision in a House bill (H.R. 22) that was less restrictive, and a provision in a Senate bill (S. 662) that was more restrictive than the current exigency clause. It argues that this compromise standard has been mischaracterized as the equivalent of the more restrictive Senate provision that Congress discarded. NPMHU notes that the House provision would have allowed an exigent rate increase if the Commission found it to be “reasonable and equitable and necessary” to support appropriate levels of service. *Id.* at 4. It notes that the corresponding Senate provision would have imposed a more restrictive standard by requiring exigent circumstances to be “*unexpected and extraordinary.*” *Id.* at 5. (Emphasis added.)

NPMHU observes that after considerable debate, compromise language (“extraordinary or exceptional circumstances”) was incorporated into the PAEA. *Id.* Like the Postal Service, NPMHU emphasizes that this language omits the requirement that an exigent circumstance be unforeseeable. *Id.* at 9. It argues that Congress flatly rejected an unforeseeability requirement by eliminating “unexpected” and substituting “exceptional”. *Id.* It contends that the revised language also lowered the restrictions on the exigency requirement by allowing either an extraordinary circumstance or an exceptional circumstance, standing alone, to provide an independent basis for adjusting rates above the price cap. *Id.* at 8.

NPMHU contends that the legislative history cited by the letter submitted by Senator Collins predates the legislative compromise, and sheds light primarily on the meaning of the discarded standard in the Senate bill. NPMHU argues that pre-compromise legislative history is most useful to indicate what the compromise standard does not contain. *Id.* at 12. Like the Postal Service, NPMHU addresses the issue of post-enactment statements regarding the meaning of the PAEA. It cites extensive judicial precedent explaining why post-enactment statements may not be treated as legislative history, and are entitled to little weight in interpreting a statute. *Id.* at 13.

After analyzing the plain language of the exigency clause together with its legally cognizable legislative history, NPMHU concludes that the “extraordinary or exceptional circumstance” standard allows exigent rate increases where the need is precipitated by an event that is *either* unusual in kind *or* degree, as long as the other requirements of the exigency clause are met. *Id.* at 11.

3. Other Positions on the “Extraordinary or Exceptional Circumstances” Standard.

GCA and the Public Representative take positions on the meaning of the exigency clause that fall somewhere between those of the proponents and the opponents of an exigent rate increase summarized above.

The Public Representative. The Public Representative observes that Congress has provided little guidance on the meaning of the phrase “due to extraordinary or exceptional circumstances.” After consulting numerous dictionaries, he notes that they often use the term “extraordinary” to define the term “exceptional” and vice versa. From this he concludes that Congress is unlikely to have attached a distinct meaning to the two terms. He concludes that the use of these terms carries no guidance on what type of event could trigger an exigent rate increase, but that whatever the type, it is clear that it should be atypical. Public Representative Comments at 14-15. He concludes that the unprecedented depth and severity of the recession and the resulting decline in mail volume and postal revenue far exceeds that which could be attributed to a normal business cycle or to the long-term electronic diversion of mail volume. He, therefore, concludes that current circumstances satisfy the “extraordinary or exceptional” standard of section 3622(d)(1). However, he argues, to meet the remaining requirements of this paragraph, the Postal Service must propose exigent rates that are designed to resolve the specific effects of this exigent circumstance. This, he argues, the Postal Service has failed to do. After examining the magnitude and the distribution of its proposed exigent rate increases, the Public Representative argues that those increases are

designed to address the Postal Service's long-term revenue needs rather than those specifically caused by the recent recession. *Id.* at 18-23.

Greeting Card Association. Like the Public Representative, GCA closely analyzes dictionary definitions of “extraordinary” and “exceptional” and concludes, unlike the Public Representative, that those definitions leave room to distinguish one from the other. See GCA Comments. It argues from the definitions that it cites that “extraordinary” suggests a reference to things that are unusual in kind, while “exceptional” suggests a reference to things that are unusual in magnitude. It contends that such a distinction has practical consequences. As examples, it offers terrorist events that can be *sui generis* in nature and compares them to events such as business recessions that are common, but may vary greatly in magnitude. *Id.* at 6.

Applying this distinction, GCA concludes that the recent recession on which the Postal Service's exigent rate request is predicated would not qualify as “extraordinary” since recessions are historically relatively common. But, because the recent recession was far worse than the average recession, GCA argues, it clearly qualifies as “exceptional”. See GCA Detailed Analysis at 6. It contends that to deny that a recession of such unusual severity is “exceptional” would set a bad precedent because it would foreclose virtually any use of the exigent rate provision. On the other hand, GCA argues, allowing exigent rates to recover the full impact of the recent recession would set an equally bad precedent, because it would encourage the Postal Service to invoke the exigent rate mechanism to recover revenue losses which would have been incurred if the event were of normal severity. GCA Comments at 6.

Accordingly, GCA argues that where an event fits only under the “exception” prong of the exigent event standard, it should be decomposed into a portion that is normal, and the remainder that exceeds the norm for events of that type. GCA asserts that only that portion that exceeds the norm should qualify as an exigency. It argues that once the exigent loss is identified (in percentage terms), it can be used to prorate

the amount of revenue that the Postal Service estimates is needed to recover from the exigent event. The proration would separate the revenue need that is due to a like event of normal size (in this instance, a normal recession) and the remaining need, which is due to the exceptional portion of that event. *Id.* at 8-9. See also GCA Detailed Analysis at 5.

GCA proposes to define the severity of a recession in terms of the number of months that elapse between the recession's trough of economic activity and the preceding peak. GCA then addresses the issue of what historical period should be used to determine the magnitude of normal recession. It examines recessions occurring before World War II and after World War II and concludes that such recessions are different in kind.

GCA concludes that the permissible range for the exigent portion of the Postal Service's net revenue losses experienced during the recent recession is from 36 percent to 45 percent. The former estimate compares the recent recession to the average pre-World War II recession while the latter estimate compares the recent recession to the average post-World War II recession. This range, it argues, implies a permissible exigent rate increase of between 3.55 percent and 3.84 percent, depending on whether pre-World War II or post-World War II comparisons are used. GCA Comments at 10; GCA Detailed Analysis at 23-25.⁴²

4. The Recession and Its Impact on the Postal Service Constitute an Extraordinary or Exceptional Circumstance

The Commission agrees with AMA and Senator Collins that the role of the price cap is central to ratemaking, and the integrity of the price cap is indispensable if the

⁴² GCA cautions, however, that it would be unreasonable to allow the Postal Service, as a monopolist, to raise prices by these percentages under current economic conditions. Under current deflationary conditions, GCA asserts, mailers (because they are not monopolists) would not be able to pass postal rate increases on to their customers. GCA Comments at 9-10; GCA Detailed Analysis at 33-34.

incentive to reduce costs is to remain effective. Therefore, it would undermine the basic regulatory approach of the PAEA if the Postal Service could pierce the price cap routinely. However, the Commission disagrees that a finding of extraordinary or exceptional circumstances under the unique facts presented in this proceeding undermines the primacy of the price cap.

The statement of Joseph Corbett submitted on behalf of the Postal Service effectively demonstrates that the recent recession was unprecedented in the post-World War II era in terms of its suddenness and severity. He notes that previous recessions, although serious, were not as severe in terms of job losses, financial sector turmoil, and general uncertainty in the markets. Corbett Statement at 13-14. His data, for example, show that the decline in employment over the year 2008 to 2009 was approximately 74 percent greater than the next most severe recession. He notes that the recent recession was, first and foremost, an implosion of the financial system following the collapse of the housing bubble. The ensuing credit crisis was severe enough to threaten the continued existence of many of the nation's oldest and largest financial institutions—Bear Stearns, Lehman Brothers, AIG, Fannie Mae, and Freddie Mac, as well as industrial icons such as General Motors.

GCA's comments are helpful in explaining why the recent recession is unique in America's post-World War II experience. Not only was the recent recession unique in kind and severity in post-war America, its impact on the Postal Service was unique in kind and severity as well. The credit crisis disproportionately damaged the very economic sectors on which demand for postal services depends most—real estate, banking, mortgage lending, credit card lending, insurance, and advertising. Mr. Corbett argues that the Postal Service experienced a volume decline of over 20 percent during the last 3 years, a decline greater than the cumulative decline associated with all other recessions experienced in the last 35 years. Corbett Statement at 11-15. Given these facts, the Commission concludes that the recent recession and its impact on postal volumes is an "extraordinary or exceptional" circumstance.

The Commission finds GCA's analysis of the recent recession as only partly exigent to be a useful contribution to the record in several areas, particularly its discussion of the nature and causes of the recent recession on which the Postal Service predicates its Request. As a concept, the notion of decomposing an extraordinary or exceptional event into a normal portion and an exigent portion and using that analysis to estimate a range of acceptable exigent rate increases would appear to have merit. However, GCA's application of this conceptual approach demonstrates the difficulties inherent in quantifying the portion of a complex economic event that should be considered normal and any portion that should be considered abnormal.

Opponents of the Request emphasize that the diversion of mail volume to electronic alternatives is a long-term trend that does not qualify as an "extraordinary or exceptional circumstance." Both the Postal Service⁴³ and the Commission agree. Declines in volume that arise from the normal life cycle of a product, or set of products, would not come within the plain meaning of those terms.

As summarized earlier, the opponents of the Postal Service's exigent rate request argue that the "extraordinary or exceptional circumstances" requirement includes an implied requirement that the circumstance be unforeseeable and unavoidable and that the financial impact of the recent recession does not meet either of these requirements. The Postal Service contends that the foreseeability issue is moot with respect to its Request, since the severity of the recent recession clearly was not foreseeable. As evidence, Mr. Corbett notes that the Open Market Committee of the Federal Reserve Board failed to see the oncoming recession only a few months before it occurred. Corbett Statement at 15. The forecasts of Global Insight, the macroeconomic forecasting service most widely relied on by industry (including the Postal Service), also failed to forecast the recession, now recognized as beginning in

⁴³ See Postal Service Response to Motion to Dismiss at 13, n.2.

December 2007. It forecast in January 2008 that GDP would grow continuously throughout calendar years 2008 and 2009.⁴⁴ The Commission concurs that the issue is moot, as the severity of this circumstance was unforeseeable by any reasonable standard.

As noted, based on their reading of the statute and legislative history, some opponents of the Request contend that Congress meant to exclude certain types of events, such as economic cycles, from the meaning of “extraordinary or exceptional circumstances”. These contentions reduce to arguments that “[r]ecessions are a recurring fact of life,”⁴⁵ that one can not be substantially unlike another in the risks that they present to postal finances, and that Congress knew this in fashioning the exigent rate provision.

The facts summarized above are sufficient to dispose of this argument. There is nothing in the plain meaning of the terms “extraordinary or exceptional” that excludes a particular type of unusual circumstance. Nor does the PAEA’s legally cognizable legislative history suggest that Congress intended to do so. Opponents of the Request point out that some of the PAEA’s predecessor bills, which required “unexpected and extraordinary circumstances,” would have limited exigent circumstances to terrorist attacks, natural disasters, and other national emergencies. However, the PAEA eased this standard to “either extraordinary or exceptional,” thus expanding the types of events that may qualify as an exigent circumstance. Under the PAEA, a recession may qualify as “either extraordinary or exceptional.”

⁴⁴ See Global Insight website, <http://www.globalinsight.com>, U.S. Executive Summary, January 2008, Table 2. The Postal Service also notes that private industry could not forecast the impact of the recession on particular industries even after the recession had begun. As evidence, it describes a December 2008 forecast by one of the advertising industry’s most trusted forecasters that advertising expenditures for calendar year 2009 would decline by 3 percent. Instead, advertising expenditures declined over 15 percent for calendar year 2009, as did Standard Mail volumes. The forecast was made after the collapse of Lehman Brothers and AIG, yet it still was off by a factor of 5. See Postal Service Response to Motion to Dismiss at 18-19.

⁴⁵ See Motion to Dismiss at 66.

Moreover, as Corbett points out, the financial impact on the Postal Service of the September 11 terrorist attack, the anthrax incidents, and the 2001 recession, taken together, were substantially less than the financial impact of the recent recession. Corbett Statement at 12. It is not logical to infer that Congress sought to provide relief from the discipline of the price cap for types of unusual circumstances that can cause less damage to postal finances, but not for other types of unusual circumstances that can cause more.

In evaluating whether the “extraordinary or exceptional circumstance” requirement has been met, it is not the type of circumstance that is dispositive, but its departure from the commonplace—whether it rises to the level of “extraordinary or exceptional.” The purpose of the exigent rate provision is to compensate for the costs incurred “due to” an anomalous event. Accordingly, having established the recession as an extraordinary or exceptional circumstance, the next inquiry is whether the requested rate adjustment addresses the effects of the recession.

B. Requested Increases Are Not “Due To” the Extraordinary or Exceptional Circumstance

1. Extraordinary or Exceptional Circumstances By Themselves Do Not Authorize Rate Increases Above the Price Cap

A Commission determination that “extraordinary or exceptional circumstances” have occurred is not by itself sufficient to authorize the collection of rates in excess of otherwise applicable rate caps. Two additional requirements must be met. First, the proposed adjustment must be “due to” the extraordinary or exceptional circumstances. Second, “such adjustment” (*i.e.*, the adjustment due to extraordinary or exceptional circumstances) must meet a “reasonable and equitable and necessary” test.

The system for regulating rates and classes for market-dominant products shall—(E)...establish procedures whereby rates may be adjusted...*due to* either extraordinary or exceptional circumstances, provided that the Commission determines...that *such adjustment is reasonable and equitable and necessary* to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

39 U.S.C. § 3622(d)(1) and (d)(1)(E). (Emphasis added.)

Together, the three requirements (the existence of extraordinary or exceptional circumstances; the requirement that the adjustment be “due to” those circumstances; and the requirement that the adjustment be reasonable and equitable and necessary) create a narrow exception to the general statutory rule that rates for market dominant products are limited by CPI-U-based rate caps.

Having previously found that extraordinary or exceptional circumstances have occurred, the Commission turns next to the requirement that the requested rate adjustment be “due to” those extraordinary or exceptional circumstances. Once again, the starting point for the Commission’s analysis is the plain meaning of the expression “due to” that links the proposed adjustments to the specific extraordinary or exceptional circumstances identified. *Asgrow Seed, supra*.

According to Webster’s *Third New International Dictionary* (G. & C. Merriam Co. 1966) the expression “due to” means “because of.” *Roget’s 21st Century Thesaurus* (3rd ed. 2010) provides the following synonyms for the expression “due to”: “by reason of”; “by cause of”; “by virtue of”; and “as a result of.” Each meaning and synonym expresses a causal relationship and leads the Commission to conclude that the Postal Service’s proposed adjustment must be causally related to the alleged extraordinary or exceptional circumstance.

The statutory context or legislative history underlying section 3622(d)(1)(E) does not contradict the requirement of such a causal connection. *See Russello; Robinson;*

Brown & Williamson; and Braxton-Brown, supra. The exigent rate provision in S. 2468 had the same “due to” language, enabling rates to be adjusted “due to unexpected and extraordinary circumstances.” When discussing the exigent rate provision, the Committee Report to S. 2468 emphasized the need to address exigent circumstances “and their effect on the Postal Service and its financial requirements.” S. Rep. 108-318, at 11. In other words, exigent circumstances must have adversely affected the Postal Service, triggering the need for an adjustment. The legislative history thus supports interpreting “due to” in order to relate the effects of the exigent circumstances and the proposed rate adjustment.

If section 3622(d)(1)(E) did not include the phrase “due to”, extraordinary or exceptional circumstance could conceivably be used to justify any proposed adjustment without regard to whether or how the proposed adjustment would address the consequences of the specific circumstances that had triggered the adjustment request. For example, an adjustment based upon an anthrax attack would then be possible without any showing that increased revenues generated by the adjustment would be needed to address costs incurred because of the attack. In that case, revenues produced by an adjustment could be used for general corporate purposes unrelated to the attack.

Section 3622(d)(1)(E) does not, however, authorize such open-ended adjustments. On the contrary, section 3622(d)(1)(E) requires that “such adjustment” (*i.e.*, the adjustment “due to” the extraordinary or exceptional circumstances) be “reasonable and equitable and necessary.” This further requirement provides context for the statutory command that a proposed adjustment be “due to” an extraordinary or exceptional circumstance. *See Russello; Robinson; and Brown & Williamson, supra.* The imposition of the “reasonable and equitable and necessary” test also implicitly requires that the Postal Service demonstrate a causal relationship between the proposed adjustment and the extraordinary or exceptional circumstances relied upon. For an adjustment to be “due to” an extraordinary or exceptional circumstance, the

Postal Service must show that the adjustment is a “reasonable and equitable and necessary” way to respond to the circumstance.

Using the example set forth above, the additional requirement that the adjustment be “reasonable and equitable and necessary” means that the Postal Service is required to demonstrate that an adjustment “due to” an anthrax attack will address the consequences of the anthrax attack by targeting the additional revenues generated by the adjustment to purchase security equipment, to remediate environmental damage, or to fund other consequences rationally related to the attack.

As interpreted and applied in the foregoing manner, the “due to” requirement prevents a *bona fide* extraordinary or exceptional circumstance from being misused as a general revenue enhancement mechanism that circumvents the rate cap system enacted by the PAEA. Such a result would be inconsistent with the broader statutory context in which section 3622(d)(1)(E) appears and with the purposes for which the PAEA was enacted.

Section 3622(d)(1)(E) was designed as a narrow exception to the rate cap regime. Then-Postal Rate Commission Chairman George Omas testified that the exigent rate provision “represents an enormous exception to the general thrust of postal ratemaking reform....” S. Hrg. 108-527 at 52. The Administration supported a rate cap “with a strict exigency requirement....limiting the circumstances in which rate increases can exceed the CPI rate....” Statement of Administration Policy, *supra* note 12. Assistant Secretary Bitsberger concurred, supporting an exigent rate provision “which establishes a very high bar to increase rates above CPI.” S. Hrg. 109-198 at 10.

The “due to” requirement also protects the basic integrity of the rate cap system by preventing unnecessary rate increases that would exacerbate volume declines. Senator Joe Lieberman expressed this concern during a 2005 hearing when he stated that the Postal Service was “approaching what those in the postal community call the ‘economic death spiral,’ [of] falling mail volume and unreasonable financial obligations

forc[ing] postal rate increases that lead to further drops in volume." *Id.* at 5. Likewise, Postmaster General Potter warned that filing an exigent rate case as the rule rather than the exception would "defeat the purpose of a price cap and...contribute to even greater mail volume decline, leading to a vicious spiral of destructive rate increases." Joint Hearing 108-171 at 74. The "due to" requirement is an added protection mechanism, preventing these destructive rate increases and further volume declines.

The importance of protecting the basic integrity of the rate cap system is reflected in comments filed by opponents of the requested adjustments. In those comments, a number of mailers have identified hardships that they believe will flow from the proposed rate adjustments.⁴⁶ Among those predicted hardships are: a reduction in mailings; a reduction in the size and circulation of publications; employee salary freezes; employee salary and benefit reductions; employee terminations; employee furloughs; a delay in staff recalls; an increase in the speed and scope of internet diversions; reduced advertising; decreased purchases from suppliers; the termination of senior discount programs; and actual business closings.

These representations can not be casually discounted, particularly since the same "extraordinary or exceptional circumstances" that have affected the Postal Service have also affected the mailers opposed to the requested rate adjustments. At a minimum, these comments highlight the importance of preserving the protections built into the PAEA by the rate cap system.

⁴⁶ See, e.g., eBay Inc. Comments; NPPC Comments; ABA Comments; AMA Comments; NAEDA Comments; Publishers Clearing House Comments; QVC, Inc. Reply Comments.

2. The Postal Service Fails to Demonstrate that the Proposed Rate Increase is Designed to Address the Effects of the Claimed Exceptional Circumstance

The Postal Service cites the recession and volume declines as the basis for its proposed exigent rate request.⁴⁷ Its witnesses emphasize the “existing financial crisis” to support its filing. See Corbett Statement at 3. Mr. Masse expresses it directly: “But what I believe the real extraordinary event is, and I would ask you to keep that in mind going further, the extraordinary event is the insolvency in 13 months.” Tr. 2/206.

Undeniably the Postal Service has experienced a substantial volume decline, in part, because of the recent recession. Equally true, it faces a liquidity problem. However, in attempting to justify its proposed rate increases, the Postal Service conflates the two and, as a consequence, fails to demonstrate the nexus between the additional \$3 billion in annual revenues it seeks, and the exigent circumstances that purportedly give rise to the need for it. It has not shown how the proposed relief relates to the claimed exigency as required by the Commission’s rules. See 39 CFR § 3010.61(a)(3). Therefore, the Commission rejects the proposed increase.

The failure to isolate the effects of the claimed exigency. On March 2, 2010, the Postal Service unveiled a seven-point Action Plan designed to address a host of issues, but principally designed to enhance its finances in the long-term, *i.e.*, by 2020. While the 10-year plan is dependent on achieving a certain level of savings, virtually all of the changes identified require legislative action. These include, for example, restructuring retiree health benefits prepayments, reducing the number of delivery days, new pricing flexibility, and authority to introduce new products. The plan, however, also announces the Postal Service’s intent to “pursue a moderate exigent price increase effective in 2011.” Action Plan at 1; see *also id.* at 14.

⁴⁷ Request at 6; Corbett Statement at 11, 13; see *also* Postal Service Reply Comments at 11-18.

The Public Representative suggests a framework for determining whether the Postal Service has presented either extraordinary or exceptional circumstances that are adequate to justify its Request. Public Representative Comments at 8. The proposed framework includes identifying: (1) the extraordinary or exceptional circumstance and its effect on the Postal Service; (2) a recovery goal; (3) a plan to achieve the recovery goal; and (4) the cost of accomplishing that goal. *Id.* at 16-23. While the Public Representative concludes that the Postal Service has satisfied the first element of the framework, he cautions that, to satisfy section 3622(d)(1)(E), the Postal Service must show that the proposed rate adjustment “is somehow related to resolving the effects of the proffered exigent circumstance.” *Id.* at 18.

In discussing the remaining elements of the framework, the Public Representative makes it clear that he is not disputing either the effects of the recession, or the “serious cash flow problems the Postal Service faces.” *Id.* at 19. He concludes, however, that the Postal Service has conflated its liquidity crisis with the claimed exigency (the volume decline), fails to address the effects of the exigency, and never justifies rate increases in the amounts sought. He recommends that the Commission deny the Postal Service’s Request without prejudice. *Id.* at 11.

In response, the Postal Service argues that the Public Representative’s framework is not incorporated into the Commission’s rules and, therefore, may not be lawfully applied. Postal Service Reply Comments at 55. In addition, the Postal Service contends that the Public Representative’s framework is flawed, but that, in any event, it has demonstrated that its proposed rate increase “is ‘necessary to deal with a particular exigent circumstance.’” *Id.* at 55-56.

But, that is precisely what the Postal Service is doing here: it is directly responding to the financial crisis caused by the recent volume declines, which affected all classes of mail, throughout the nation.

Id.

The Postal Service is correct that the Commission's rules do not incorporate the Public Representative's framework. The rules, however, do require "[a] full discussion of the extraordinary or exceptional circumstance(s) giving rise to the request, and a complete explanation of how both the requested overall increase, and the specific rate increases requested, relate to those circumstances[.]" 39 CFR § 3010.61(a)(3). In response to this requirement, the Postal Service cites the statements of Joseph Corbett and Stephen J. Masse. A review of those statements, including their oral testimony, fails to reveal how either the rate increases in general, or the specific rate increases proposed, relate to the extraordinary or exceptional circumstances that purportedly give rise to them. Instead, the proposed rate increases are identified as part of a long-term plan designed to address, among other things, liquidity issues. Action Plan at 1 and 14.

The failure to relate the proposed rate relief to the identified exigent circumstance can not be ignored. As discussed above, for market dominant products, the PAEA supplanted cost-of-service ratemaking with a price cap tied to the rate of inflation. While section 3622(d)(1)(E) provides an exception to the price cap, it is to be narrowly construed. It is not intended as a surrogate for cost-of-service ratemaking to be invoked by the Postal Service simply by demonstrating a need for revenues detached from the circumstances giving rise to that need and from the specific increases requested. Instead, rates in excess of inflation may be authorized only upon a showing that the proposed rate adjustment is both due to the claimed extraordinary or exceptional circumstance, and a "reasonable and equitable and necessary" response to that circumstance. Stated otherwise, as provided by the Commission's rules, the relief requested must relate to the exigency claimed.

The Postal Service has demonstrated that it faces a liquidity problem. There are many reasons for this, the most frequently cited and easily identifiable being the overly optimistic prefunding requirement of retiree health benefits. While the recession and volume declines may contribute to the problem, it is incumbent on the Postal Service to demonstrate how the specific rate increases it proposes flow from the particular

circumstances that it cites as exceptional. This it failed to do. Instead, it appears that recession-driven volume losses serve simply as an expedient for piercing the price cap in order to realign rates more closely with the cost of service. Several considerations support this conclusion.

Nature of the Request. Mr. Corbett provides the financial context for the Postal Service's proposed exigent rate increase. He begins his testimony with the statement that the Postal Service is on "the brink of financial insolvency." Corbett Statement at 2. Among other things, he discusses: (a) the decline in mail volume, emphasizing the "unprecedented" 26 billion piece decline in FY 2009; (b) the Postal Service's current financial condition, noting its cumulative net losses of \$11.7 billion since passage of the PAEA; and (c) cash flows, indicating that the Postal Service has sufficient cash flows to meet its FY 2010 obligations for operations, but that there is some "limited uncertainty" whether these cash flows, coupled with borrowings of \$3 billion, will be sufficient to fund the September 2011 \$5.5 billion payment to the RHBF. *Id.* at 4, 5, 8. He concludes that "a liquidity problem is looming and must be addressed." *Id.*⁴⁸

To be sure, Mr. Corbett presents a stark picture. But the issue presented to the Commission by the Postal Service's filing is not the Postal Service's current financial condition, but whether under the PAEA the Postal Service has made the requisite showing that the relief it seeks is due to the exigency it claims.

The root cause of the Postal Service's "existing financial crisis" or, alternatively, its "liquidity problem" is clear from the theme that permeates Mr. Corbett's testimony. *Id.* at 3, 8. It is not the recession or "unprecedented" loss of volume, although those may be contributing factors; rather, it is because "[t]he bulk of [the Postal Service's] costs are fixed by laws, contract or regulations and its operating flexibility is severely

⁴⁸ Mr. Corbett also outlines the commendable job the Postal Service has done in reducing costs, particularly in FY 2009. *Id.* at 5-6.

limited.” *Id.* at 4.⁴⁹ Mr. Corbett attributes the Postal Service’s current financial condition to a lack of operating flexibility and three factors: diversion of mail to electronic alternatives, the effects of the recession, and the obligation to prefund retiree health benefits at an accelerated pace. *Id.* at 5.⁵⁰ “Without fundamental changes,” the Postal Service anticipates losses will continue unabated into the future. Corbett Statement at 5.

Against this backdrop, the proposed exigent rate increase is characterized as “part of a coordinated strategy,” as outlined in the Action Plan, “to resolve severe shortcomings in [the Postal Service’s] business model.” *Id.* at 4. Relative to the “pressing need,” the exigent increase is characterized as “modest.” *Id.*

Notwithstanding the pressing need, under the PAEA the exigent rate provision is a safety value, a narrow exception to inflation-based rates. It is not intended as a cost-of-service surrogate to address “fundamental” (*id.* at 5) underlying issues relating to the Postal Service’s business model or lack of operating flexibility. To be invoked, the rate adjustment must be due to extraordinary or exceptional circumstances. In this case, the circumstances cited by the Postal Service are a severe recession, and a large recession-related decline in volumes.

Several commenters note that the increase, whether or not approved, will not avert the Postal Service’s looming liquidity problem.⁵¹ Their views appear consistent with the Postal Service’s sentiment. Mr. Masse states, “The proposed increases will not be sufficient by themselves to avert the liquidity crisis at the end of FY 2011, nor will

⁴⁹ The phrase “operating flexibility is severely limited” refers to various statutory constraints involving restrictions on closing facilities, introducing new products, changing delivery frequency, and altering the RHBF prepayment schedule. *Id.* at 3.

⁵⁰ The Postal Service is not claiming that either the volume loss attributable to electronic diversion or any statutory provision, including its obligation to prefund the RHBF, qualifies as an extraordinary or exceptional circumstance. See Postal Service Reply Comments at 17 regarding electronic diversion.

⁵¹ See AMA Comments at 4-5; Public Representative Comments at 20; Masse Statement, Attachment 4.

they return the Postal Service to financial health.” Masse Statement at 13. Likewise, at the hearing, Mr. Corbett testified as follows:

Chairman Goldway: Without a rate increase in what month does the Postal Service expect to run out of cash?

The Witness: And that would be September 30, 2011.

Chairman Goldway: With a rate increase in what month does the Postal Service expect to reach its borrowing limit of \$15 billion?

The Witness: Most likely that date would still be September 30, 2011.

* * * * *

Chairman Goldway: With a rate increase in what month does the Postal Service expect to run out of cash?

The Witness: With a rate increase and no other changes, no other fundamental changes, we would run out of cash September 30, 2011.

Tr. 1/39-40.

Referencing Mr. Corbett’s testimony, AMA contends that the increase, even if granted, would not extend Postal Service operations by a single day. AMA Comments at 4. The Postal Service counters that AMA’s argument suggests that the exigent rate adjustment should have been even greater, concluding that “[s]ufficiently higher prices would clearly surmount AMA’s criticism that the proposed increases fail to ‘extend the Postal Service’s operations by a single day.’” Postal Service Reply Comments at 44. This argument, while addressed to AMA’s claim that the increase is not necessary, underscores how the “pressing need” for “fundamental changes” is the essence of the Postal Service’s Request.

The claimed exigency is not the cause of the Postal Service’s liquidity problem and, as a consequence, an even larger exigent increase, putatively designed to solve it, could never be justified. The Postal Service can not resolve severe shortcomings in its business model by resorting to the exigent rate provision. The Postal Service filed its

Request reluctantly (see Corbett Statement at 3) and it portrays the exigent rate provision as its only available option. Mr. Corbett puts it as follows: “Given the constraints under which the Postal Service must operate, an exigent rate filing is the one avenue [the Postal Service] can pursue under current law that stands the greatest chance of yielding sufficient revenues to help address the existing financial crisis.” *Id.*

Testimony by other Postal Service witnesses lends credence to the conclusion that its pricing is not designed to address the specific exigency, but rather, more globally, the Postal Service’s existing financial crisis. Mr. Masse, for example, discusses how prices were developed and does not disagree that the proposed rates may be characterized as what the market will bear. Tr. 2/209-10. Similarly, in response to questioning, Mr. Kiefer describes how price levels were determined based on management’s guidance that, generally, the increase should be in the range of 4 to 6 percent by class. Tr. 3/440-48.

The Request is simply not focused on the specific effects of the claimed exigency. Plainly, the Postal Service confronts a financial crisis, if not immediately, then in the not too distant future. However, the modern system of regulation adopted by the PAEA imposes a price cap on rates tied to inflation. It is designed to incent the Postal Service to reduce its costs and improve efficiency, while creating predictable and stable rates. The exigent rate provision does not provide an all purpose exception to the price cap. It may not be invoked simply by demonstrating a need for revenues, as was permissible under earlier iterations of the PAEA.⁵² Instead, an exigent rate adjustment must be due to, and commensurate with, some specific extraordinary or exceptional circumstance. In reviewing the record, including the testimony supporting the Request, the Commission finds that the Postal Service has not made that showing.

⁵² These iterations only required the Postal Service to demonstrate situations threatening its fiscal soundness, such as severe financial exigencies, statutorily-imposed funding obligations, insufficient postal revenues, or unexpected declines in revenue or increase in costs. See H.R. 3717, § 1001, 104th Cong. (1996); H.R. 22, § 1001, 105 Cong. (1997); H.R. 22, § 201, 106th Cong. (1999); S. 1285, § 201, 108th Cong. (2003).

The Action Plan represents the Postal Service's response to the current financial crisis, formulated "[t]o avoid potential insolvency." Action Plan at 1. In large part, the Action Plan seeks solutions for the very constraints cited by Mr. Corbett. The Request is peripheral to those objectives and, in the current environment, is perceived by the Postal Service as "the one avenue" available to generate revenues to ameliorate the effects of its current financial crisis.

The Postal Service's proposal harkens back to cost-of-service ratemaking—its impending liquidity crisis creates a need for revenues that can most easily be addressed by piercing the price cap. Mr. Corbett contends that the Postal Service is in the throes of the worst contraction in mail volume in modern American postal history caused, in large part by the worst economic crisis since the Great Depression." Corbett Statement at 11. There is no doubt that the Postal Service is attempting to address its current financial crisis. But its claim that its current financial crisis is caused by the recession and recent volume declines is never proven. The Postal Service neither attempts to isolate and explain how these circumstances caused its cash flow problem, nor show that its proposed rate adjustments are tailored to offset the specific effects of the claimed exigency.

The Commission is sympathetic to the Postal Service's current financial challenges and agrees that change is warranted regarding certain of the constraints cited by the Postal Service.⁵³ Those issues, however, must be decided in a different forum.

⁵³ See The Segal Company, Report to the Postal Regulatory Commission on: Civil Service Retirement System Cost and Benefit Allocation Principles, June 29, 2010, available at: http://www.prc.gov/Docs/68/68679/Report%20on%20CSRS%20Cost%20and%20Benefit%20Allocation%20Principles_1126.pdf; see also Postal Regulatory Commission Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management and U.S. Postal Service Office of Inspector General, July 30, 2009, available at: http://www.prc.gov/Docs/63/63987/Retiree%20Health%20Fund%20Study_109.pdf.

In section IV.C below, the Commission assesses the causes of the Postal Service's current financial crisis and concludes that (1) absent the RHBF prefunding obligation, the Postal Service would not have a liquidity problem, and (2) even if the claimed extraordinary or exceptional circumstances had not occurred, the Postal Service's forecasted cash flow problem would still exist.

Timing of the Request. As noted above, the Postal Service announced its intent to seek an exigent rate adjustment on March 2, 2010 when it revealed its long-term seven-point Action Plan designed to address fundamental issues affecting its finances. No actual request to adjust rates was filed at that time. The delay in pursuing its exigent rate relief raises additional questions about whether the Postal Service views its financial situation as an emergency.

The inclusion of the planned exigent price increase as an element of a long-term plan to enhance Postal Service finances belies the notion that there is, in fact, an exigency which requires exceptional rate relief.⁵⁴ The 4-month delay in filing a Request, and the deferral of the effective date of the proposed increase until January 2011, further suggest that the relief requested is not tied to the claimed exigent circumstances but to the broader, long-term liquidity issues.

Permanency of the increase. The Postal Service proposes to increase existing rates, on average, by 5.6 percent. The increase, if approved, would become permanent. Neither section 3622(d)(1)(E) nor the Commission's rules require that exigent rates be temporary. The Commission's rules do, however, require "[a]n explanation of when or under what circumstances, the Postal Service expects to be able to rescind the exigent increases in whole or in part[.] 39 CFR § 3010.61(a)(6). The Postal Service's response to this requirement is terse. Citing its "dire financial

⁵⁴ The Public Representative notes that by merging the exigent Request with its Action Plan the Postal Service, perhaps inadvertently, diminishes the significance of and separate basis for that Request. Public Representative Comments at 20, n.11.

situation,” the Postal Service does not anticipate rescission of the increase “anytime soon.” Corbett Statement at 19.

The Postal Service does suggest the possibility that the proposed increase could be viewed as being borrowed against future CPI-U price caps. Request at 11. This suggestion can not be read as a commitment. In any event, the suggestion is at odds with the working of the price cap. The exigent rate provision is an exception to the price cap, not an extension of it. Exigent requests are to be assessed on their own merits, not as an offset to future price increases.

It is no answer to cite the “dire financial situation” as support for an inability to rollback the increase. The focus instead has to be on the losses attributed to the exigency. The Postal Service made no attempt to identify and quantify that impact to determine the likelihood that the increase could be rescinded. Moreover, by incorporating its exigent rate Request into its 10-year Action Plan, the Postal Service gives the impression that the losses that implicitly inhibited its ability to right-size its operations to offset the sudden volume decline will continue indefinitely. To the contrary, there is every reason to expect that the Postal Service can, and will, right-size its operations in the reasonably near future. See Section IV. D.

An exigent circumstance is normally associated with a finite period and event. Even an abnormal recession does not continue indefinitely. By most economic measures, this one ended more than a year ago, in June 2009.⁵⁵ It may well be that if the “fundamental changes” discussed by Mr. Corbett are achieved or if interim Congressional relief is granted, the rate increase may no longer be needed in whole or in part. Given the primacy of the price cap and the narrow exception to it, exigent rate increases ordinarily should be relatively short-lived, *e.g.*, a surcharge designed to recover the costs associated with a specific event.

⁵⁵ See report by The Business Cycle Dating Committee of the National Bureau of Economic Research, September 20, 2010, available at <http://www.nber.org/cycles/sept2010.html>.

The Commission does not here suggest that such adjustments could never need to be permanent, but the case for a permanent \$3 billion a year revenue boost is not made by passing reference to “dire financial circumstances.” The overall impression is that the Postal Service filing is not driven by its claimed exigent event, but rather a desire to address its existing financial condition. As understandable as that goal is, it is not what is contemplated under section 3622(d)(1)(E).

C. The Liquidity Problem Stems Principally From an Overly Optimistic RHBF Prefunding Schedule

This proceeding is not the first time that the Commission has had occasion to consider the possibility of a liquidity crisis occurring in FY 2011. In its 2009 Annual Compliance Determination (2009 ACD), the Commission noted the Postal Service’s projection that such a crisis could occur by the beginning of FY 2011. *Id.* at 19. The Commission found that “[t]he reasons for the Postal Service’s liquidity problems are complex.”⁵⁶ *Id.* at 21. Since no ruling was required, the Commission did not make any formal findings regarding the causes of the projected crisis.

In this proceeding, the Postal Service has raised the issue of its “looming” liquidity problem. Corbett Statement at 8. Mr. Masse attributes the liquidity problem to the fact that the Postal Service “has been stretched to the limit mostly as a result of funding retiree health benefits.” Tr. 2/234.

In an effort to assess the primary cause of that problem, the Commission considers the Postal Service’s retained earnings and cash flows with and without the requirement to prefund RHBF payments for the period FY 2007 through FY 2011. That analysis demonstrates that the overly optimistic RHBF prefunding schedule is the principal cause of the Postal Service’s impending liquidity crisis. This analysis is not to

⁵⁶ The 2009 ACD was issued on March 29, 2010, approximately 4 weeks after the Postal Service had publicly announced its Action Plan.

suggest that the Commission advocates elimination of the prefunding requirement in its entirety. However, a schedule that funds this obligation in a more sound actuarial manner seems appropriate.

Postal Service liquidity is the combination of cash on hand and borrowing authority that it can use to finance its operations. The Postal Service borrowing authority is limited by law to a maximum of \$3 billion of new debt outstanding in any one year, and a cumulative total of \$15 billion. 39 U.S.C. § 2005(a). Typically, the Postal Service borrows funds using short-term credit lines throughout the year. When the Postal Service does not generate sufficient revenues to maintain a healthy cash balance, it can not pay off this short-term debt and must resort to long-term debt funding, thus increasing its overall debt load. Once it reaches its \$15 billion cumulative total, borrowing options are no longer available. As shown in Table 1, since passage of the PAEA, the Postal Service's total debt has grown substantially, a result that coincides with its RHBF prefunding obligation. In addition, the Postal Service anticipates borrowing an additional \$3 billion in FY 2010. Corbett Statement at 8; see *a/so* Table 4 below.

Table 1
End-of-Year Debt Balance
FY 2006 – FY 2010
(\$ in Billions)

	FY 2006	FY 2007	FY2008	FY 2009	FY 2010 (PROJECTED)
Debt Balance	2.1	4.2	7.2	10.2	13.2

1. Retained Earnings Would Be Sufficient to Avoid Liquidity Problems But for Prefunding Requirement

One objective of the PAEA was to ensure adequate revenues, including retained earnings, to allow the Postal Service to maintain financial stability. The final House Committee report on postal reform legislation described the important role of retained earnings in postal reform:

The objective of the [PAEA] is to position the Postal Service to operate in a more business-like manner. To achieve this goal, the [new] system [for regulating rates] must be responsive to market considerations and must provide clear incentives for postal management and the Postal Service as an institution. The Postal Service would no longer operate under a break-even mandate. By maximizing gains and minimizing costs, the Postal Service could generate earnings that would be retained, and which could be distributed as incentives to management as well as to employees through collective bargaining. In the same way, losses could not be recovered by increasing rates beyond the specific parameters without regulatory approval.

H.R. Rep. No. 109-66, at 43-44.

Retained earnings are accumulated earnings not distributed to shareholders. Businesses use retained earnings to maintain operations in slow business cycles or to grow the company in times of expansion. Because the Postal Service does not have shareholders, all accumulated net income would be retained earnings. Had the Postal

Service been able to accumulate retained earnings prior to the precipitous loss of volume in FY 2009, it would have been able to use these funds to meet its obligations related to operations. Consequently, it would not be facing a liquidity crisis. Prefunding its RHBF at the level required under the PAEA, however, precluded the Postal Service from accumulating retained earnings.

The PAEA also rescinded the escrow payment requirement and established a new schedule of payments to be made into the RHBF for FY 2007 through FY 2016.⁵⁷ Table 2 shows the payments required under the PAEA.

Table 2
PAEA Schedule of Payments into the
Retiree Health Benefits Fund

PAYMENT SCHEDULES (\$ BILLION)	
FY	PAEA
2007	5.4
2008	5.6
2009	5.4
2010	5.5
2011	5.5
2012	5.6
2013	5.6
2014	5.7
2015	5.7
2016	5.8

⁵⁷ Beginning in FY 2017, payments into the fund will reflect the present value of future retiree health benefits for current employees, the present value of future retiree health benefits for current annuitants, amortization of any unfunded liability or surplus, and interest earned on assets in the fund. Payments for health benefits for current annuitants will be deducted from the fund beginning in FY 2017.

The PAEA's 10-year prepayment schedule calls for the Postal Service to make, on average, an annual payment to the RHBF of nearly \$5.6 billion. These payments are in addition to payments made to fund retirement health benefits for its current annuitants. This schedule has transformed what would have been considerable operating profits into significant losses. Table 3 makes the point dramatically. It shows that without the prefunding schedule, the Postal Service's retained earnings at the end of FY 2009 would have been approximately \$6.9 billion, notwithstanding a loss of \$2.4 billion in FY 2009. Stated otherwise, the Postal Service would have had sufficient resources to weather the downturn in FY 2009 without any material adverse effect on its liquidity or any apparent need to adjust rates based on extraordinary or exceptional circumstances. Instead, under the current prepayment schedule, its retained earnings declined from positive \$3.2 billion to negative \$8.5 billion during that 3-year period.

Table 3
Statement of Changes in Net Capital (Deficiency)
(\$ in Millions)
With and Without Retiree Health Benefits Pre-Funding⁵⁸
Years ended September 30, 2007 through Estimated September 30, 2011

	(A)	(B)
	RETAINED EARNINGS (DEFICIT) w/o RHB ^{1/}	RETAINED EARNINGS (DEFICIT) w/RHB ^{2/}
Balance, September 30, 2006	3,242	3,242
Net Income (Loss) FY 2007	3,216	(5,142)
Balance, September 30, 2007	6,458	(1,900)
Net Income (Loss) FY 2008	2,794	(2,806)
Balance, September 30, 2008	9,252	(4,706)
Net Income (Loss) FY 2009	(2,394)	(3,794) ^{3/}
Balance, September 30, 2009	6,858	(8,500)
Est. Net Income (Loss) FY 2010	(940)	(6,440)
Balance, September 30, 2010	5,918	(14,940)
Est. Net Income (Loss) FY 2011	(1,499)	(6,999)
Est. Balance, September 30, 2011	4,419	(21,939)
<p>1 Source: USPS Form 10-K, FY 2009 at 52; Net Incomes (Losses) from PRC Library Reference 1, R2010-4; Cash Flows PRC Estimates R2010-4.XLS, tab <i>No RHB</i>.</p> <p>2 Source: USPS Form 10-K, FY 2009 at 52; Net Incomes (Losses) from PRC Library Reference 1, R2010-4, Cash Flows PRC Estimates R2010-4.XLS, tab USPS Forecast.</p> <p>3 Reflects \$4.0 billion Congressional deferral.</p>		

⁵⁸ For column (a) of Table 3, this analysis assumes that all other financial decisions remained the same.

Without the RHBF payments scheduled to be made in FY 2010 and FY 2011, the Postal Service's projected losses would be much lower, \$0.9 billion versus \$6.4 billion, and \$1.5 billion versus \$7.0 billion respectively. The Postal Service's projected retained earnings at the end of FY 2011 would be approximately \$4.4 billion, again, more than enough to weather any lingering effects of the recent recession.

The RHBF payments required under the current statute dramatically change the situation. Projected losses in FY 2010 and FY 2011 total \$13.4 billion, resulting in negative retained earnings of \$21.9 billion.

The difference between the two scenarios, retained earnings of \$4.4 billion versus a \$21.9 billion deficit, exceeds \$26 billion. This difference is attributable solely to the RHBF prepayment requirement. This comparison validates the contentions of several commenters—that the cause of the Postal Service's "financial crisis" or "liquidity problem" is the overly optimistic RHBF prepayment schedule. See, e.g., Valpak Comments at 5 and 7-8; Valpak Reply Comments at 5; SMC/Valassis Comments at 12-13; GCA Comments, at 7; Stamps.com Comments at 1-2.

In FY 2009, with the Postal Service facing a net loss of \$7.7 billion, concern over its potential insolvency and the effects of the prepayment schedule on Postal Service finances led Congress to defer \$4 billion of the scheduled \$5.4 billion RHBF payment. This deferral reduced the Postal Service's operating loss for FY 2009 to \$3.8 billion, while improving its end-of-year cash balance to \$4.1 billion.

The FY 2009 \$4 billion deferral of the RHBF payment allowed the Postal Service to meet its other immediate financial obligations, but it has not solved the Postal Service's liquidity problems. By the end of FY 2011, the Postal Service forecasts that it will have a negative \$4.4 billion cash balance and no available borrowing authority. As a consequence, the Postal Service expects that it will be unable to meet all of its obligations in FY 2012. As noted previously, it cites this liquidity problem as the reason for the exigent rate increase. See Tr. 1/52 (Corbett); Tr. 2/206 (Masse) ("[T]he

extraordinary event is the insolvency in 13 months.”). However, even if the rate increases requested by the Postal Service were to be approved, Congressional action will be necessary prior to the close of FY 2011. Furthermore, these problems will continue to arise as each annual RHBF payment becomes due.⁵⁹

Table 4, depicts the Postal Service’s cash flow from FY 2007 through FY 2011.⁶⁰ Net income (loss) is heavily impacted by the RHBF obligation of approximately \$5.5 billion each year. Cash flows from financing activities show the Postal Service using the maximum permissible borrowing to help finance operations. In FY 2011, it expects to have used its full \$15 billion authority, and to be unable to fund projected expenses, even if the requested exigent rate increases go into effect. The continuing RHBF obligations will cause new, annual liquidity crises each year through FY 2016.

⁵⁹ Valuations of retiree health benefit liabilities are based on assumptions about the discount rates for assets, health care cost inflation rates, number of employees, and demographics of the workforce. In the Postal Regulatory Commission’s Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management (OPM) and U.S. Postal Service Office of Inspector General (OIG), July 30, 2009, the Commission suggested an alternative calculation which produces a long-term liability that could result in lower fixed annual payments than the currently scheduled payments. The Commission’s recommended method included a graded trend rate reflecting current expectations of health care inflation while recognizing the issue of how much of the national GDP will be consumed by health care costs in the future, the assumption that the Postal Service’s workforce will be smaller in FY 2017, and a short-term rate of return on assets.

⁶⁰ The changes in cash flows as shown in Table 4 are summaries of the Statement of Cash Flows found in the USPS FY 2009 Form 10K for FY 2007 and FY 2008, and Attachment 4 to the Statement of Stephen J. Masse for the actual cash flows for FY 2009 and the estimated cash flows for FY 2010 and FY 2011. A detailed explanation of the derivation of the cash flows can be found in PRC Library Reference R2010-4/1. The line for the cash flows from financing activities has been detailed in order to show the extent of the Postal Service’s borrowing activities for those fiscal years.

Table 4
Postal Service Estimated Cash Flows FY 2007 – FY 2011
(\$ Millions)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011BR
Net Income/(Loss)	(5,142)	(2,806)	(7,794)	(6,440)	(6,999)
Less: RHB Relief			4,000		
Adj. Net Income/(Loss)	(5,142)	(2,806)	(3,794)	(6,440)	(6,999)
Non-Cash items and Other Cash Flows	2,539	2,367	5,367	2,183	1,146
Cash Flows from Investing Activities	500	(1,938)	(1,806)	(1,439)	(1,493)
Cash Flows from Financing Activities:					
Increase (decrease) in debt	2,100	3,000	3,000	3,000	1,800
Payments for Capital Leases	(19)	(29)	(46)	(47)	(49)
U.S. government appropriations - expensed	(76)	(61)	(64)	(63)	(63)
Net Cash (Used) provided by financing activities	2,005	2,910	2,890	2,890	1,688
Net Increase/(Decrease) in Cash	(98)	533	2,657	(2,806)	(5,658)
Cash Balance BOY	997	899	1,432	4,089	1,283
Cash Balance EOY	899	1,432	4,089	1,283	(4,375)
Debt Outstanding	4,200	7,200	10,200	13,200	15,000
Source: Attachment 4 of Statement of Stephen J. Masse, Revised, August 6, 2010					

Cash flows would have been adequate without the prefunding requirement. To assess the impact of the RHB payments on the Postal Service's cash flow, the Commission analyzed what the forecasted cash flows would be absent the prefunding requirement. The results, shown in Table 5, show estimated end-of-year cash balances high enough to obviate any need for increased borrowing. For purposes of this analysis, the Commission, therefore, assumes outstanding debt remains at the FY 2007 level of \$4.2 billion.

Table 5
Forecasted Postal Service Cash Flow Without RHBF Payments
(\$ in Millions)

	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011BR
Net Income/(Loss)	(5,142)	(2,806)	(7,794)	(6,440)	(6,999)
Less: Statutory RHBF Payments	8,358	5,600	5,400	5,500	5,500
Adj. Net Income/(Loss)	3,216	2,794	(2,394)	(940)	(1,499)
Non-Cash items and Other Cash Flows	2,539	2,367	5,367	2,183	1,146
Cash Flows from Investing Activities	(2,458)	(1,938)	(1,806)	(1,439)	(1,493)
Cash Flows from Financing Activities:					
Increase (decrease) in debt	2,100	0	0	0	0
Payments for Capital Leases	(19)	(29)	(46)	(47)	(49)
U.S. government appropriations - expensed	(76)	(61)	(64)	(63)	(63)
Net Cash (Used) provided by financing activities	2,005	(90)	(110)	(110)	(112)
Net Increase/(Decrease) in Cash	5,302	3,133	1,057	(306)	(1,958)
Cash Balance BOY	997	6,299	9,432	10,489	10,183
Cash Balance EOY	6,299	9,432	10,489	10,183	8,225
Debt Outstanding	4,200	4,200	4,200	4,200	4,200

Source: Cash flow activities from Statement of Stephen J. Masse, Attachment 4 Revised, August 4, 2010.

Without the RHBF payments, the Postal Service would not be facing a liquidity crisis. For each post-PAEA year, it would have maintained a healthy cash balance and had ample available borrowing authority. In FY 2009, for example, notwithstanding a \$2.4 billion loss, the Postal Service's end-of-year cash balance would have been almost \$10.5 billion. The Postal Service would maintain substantial end-of-year cash balances without any need to resort to borrowing, regardless of the volume loss due to the extraordinary or exceptional circumstance.⁶¹

⁶¹ It also would have sufficient resources to make some more realistic payments to offset its retiree health benefit obligation.

In short, regardless of the timeframe, without the overly optimistic prepayment requirement, the Postal Service would have had sufficient end-of-year cash reserves and had no reason to increase its debt. Instead, annually beginning in FY 2008, the Postal Service has been compelled to borrow the maximum annual amount, \$3 billion, to finance operations. It projects that it will exhaust its borrowing authority, \$15 billion, in FY 2011.

2. Even if the Extraordinary or Exceptional Circumstance Had Not Occurred, the Postal Service Would Still Face a Cash Flow Problem

Mr. Corbett suggests that losses incurred as a result of volume declines that occurred between FY 2006 and FY 2009 overwhelmed management's cost savings initiatives, thus implying that the volume losses caused the impending cash flow crisis. Corbett Statement at 16. His limited calculation is not persuasive.

Mr. Corbett estimates the Postal Service lost \$5 billion in contribution due to this volume decline. *Id.*, n.8.⁶² He develops this estimate of lost contribution by applying the FY 2009 average contribution per piece of 14.1 cents to the 35.6 billion pieces lost during that timeframe. This estimate likely overstates the contribution loss due to the extraordinary or exceptional circumstance for two reasons.

First, the estimate uses an average contribution per piece, a measure that would only be applicable if the volume loss were proportionate across classes. Accurately calculating the net impact of the recent recession on postal finances would require distinguishing between volume losses by major product, so that they can be weighted according to the different unit contribution that each product makes. This distinction should be made for each year analyzed. Table 6 illustrates the differences in unit contribution by product and year.

⁶² This appears to be the only Postal Service attempt to quantify the financial impact of the exigent circumstance.

Table 6
Unit Contribution
FY 2008 and FY 2009
(Cents)

	FY 2008	FY 2009
First-Class Single-Piece Letters and Cards	17.1	17.3
First-Class Presort Letters and Cards	22.0	22.4
Standard Regular Letters	9.0	8.1
Standard Flats	(2.2)	(7.9)
System-wide Average	14.4	14.1

Source: ACD FY 2008 and FY 2009.

The Postal Service states that the recent recession impacted Standard Mail substantially more than other classes. Postal Service Response to Motion to Dismiss at 18-19. A weighted estimate that accounts for the greater volume loss in a class with a substantially lower average contribution than the system-wide contribution would likely be lower than Mr. Corbett's estimate.

Second, and equally important, Mr. Corbett states that one-third of the volume decline during this period is related to electronic diversion while only two-thirds is related to the economic downturn. Tr. 1/24. That adjustment alone would reduce Mr. Corbett's 3-year impact estimate from \$5 billion to \$3.3 billion.

In addition, according to the National Bureau of Economics, the recession officially began in December 2007 which corresponds to the end of the first quarter of Postal Service FY 2008, and ended in June 2009, at the close of FY 2009 quarter 3. Inclusion of any volume loss prior to the beginning of the recession, or experienced after the close of the recession in an analysis of the impact of the extraordinary or exceptional circumstance would appear to be problematic. Subtracting pre- and post-recession volume declines will reduce the estimate still further.

The Postal Service projects a cash flow deficit of \$4.4 billion in FY 2011.⁶³ Even if the extraordinary and exceptional circumstance had not occurred, and the Postal Service had not suffered volume declines as a result of the recent recession, the Postal Service would still be facing liquidity problems.

D. The Price Cap is Incenting Cost Reductions and Improved Efficiency

The Postal Service has incurred substantial net operating losses since passage of the PAEA, which, as discussed above, are largely attributable to the overly ambitious RHBF payment schedule. The Postal Service, in defending management's response to the recent recession, makes a similar point.

[I]f it were not for the \$12.4 billion of [PAEA] Scheduled Payments to prefund retiree health benefits paid by the Postal Service since the enactment of the PAEA (an expense that any normal firm facing a financial crisis would forgo), the Postal Service's revenues would [have] exceeded its costs, despite the extreme volume losses.

Postal Service Response to Motion to Dismiss at 51; see *also id.* at 5.

Price cap rate regulation was expected to promote several goals, including, importantly, to incent the Postal Service to reduce costs and improve efficiency. Of late, in particular, it has done a commendable job. In FY 2009 alone, the Postal Service reduced costs by \$6 billion. *Id.* at 50.⁶⁴

Available data suggest that over time the Postal Service has reduced costs in response to volume declines as contemplated by the PAEA. Postal Service claims its cost cutting efforts are encumbered by various constraints and by the nature of its cost structure. The constraints identified by the Postal Service are not inconsequential. In

⁶³ In September 2009, Congress approved a \$4 billion deferral of RHBF payments. It could be argued that Congress has already addressed some or all of the need arising from the extraordinary and exceptional circumstance cited as the reason for the exigent increase.

⁶⁴ It has achieved other substantial savings as well. For example, it states that from FY 2007 through 2009 "the career workforce decreased by 114,000 full-time equivalents (FTEs), representing \$7.7 billion in annual savings going forward...." *Id.* at 5.

his testimony, Mr. Corbett attributes the Postal Service's critical fiscal condition largely to a lack of operating flexibility, including the RHBF payment schedule. Corbett Statement at 5. In responding to AMA's claims that management has been deficient, the Postal Service criticizes AMA for failing to take into account the legal context in which management operates. *Id.* at 27.⁶⁵ The legal context referenced by the Postal Service includes, *inter alia*, labor, network rationalization, and the cost of prefunding RHBF payments.

The issue before the Commission in this proceeding is whether the Postal Service exigent rate adjustment satisfies 39 U.S.C. § 3622(d)(1)(E). The Commission has concluded that the proposal does not satisfy that standard. Last year, Congress addressed the Postal Service's pressing financial condition. It determined that a deferral of \$4 billion of the scheduled RHBF payment was appropriate. In essence, the result represents an *ad hoc* modification of the payment schedule to a more manageable level. Going forward, it is likely that similar or lasting action will be needed if the Postal Service is to avert yearly liquidity problems.

In response to volume declines the Postal Service has successfully adjusted costs. With respect to Postal Service efforts to cut costs, data suggest that it is making strides over time to cope with volume declines consistent with how the PAEA was intended to function. Before turning to those data, a brief overview of Postal Service costs is in order.

The nature of the Postal Service's cost structure necessarily encumbers its efforts to reduce costs. Costs that are incurred by function, *e.g.*, mail processing and delivery, do not respond uniformly to changes in volume. Some, such as mail processing, are largely volume variable, fluctuating as volumes increase or decrease.

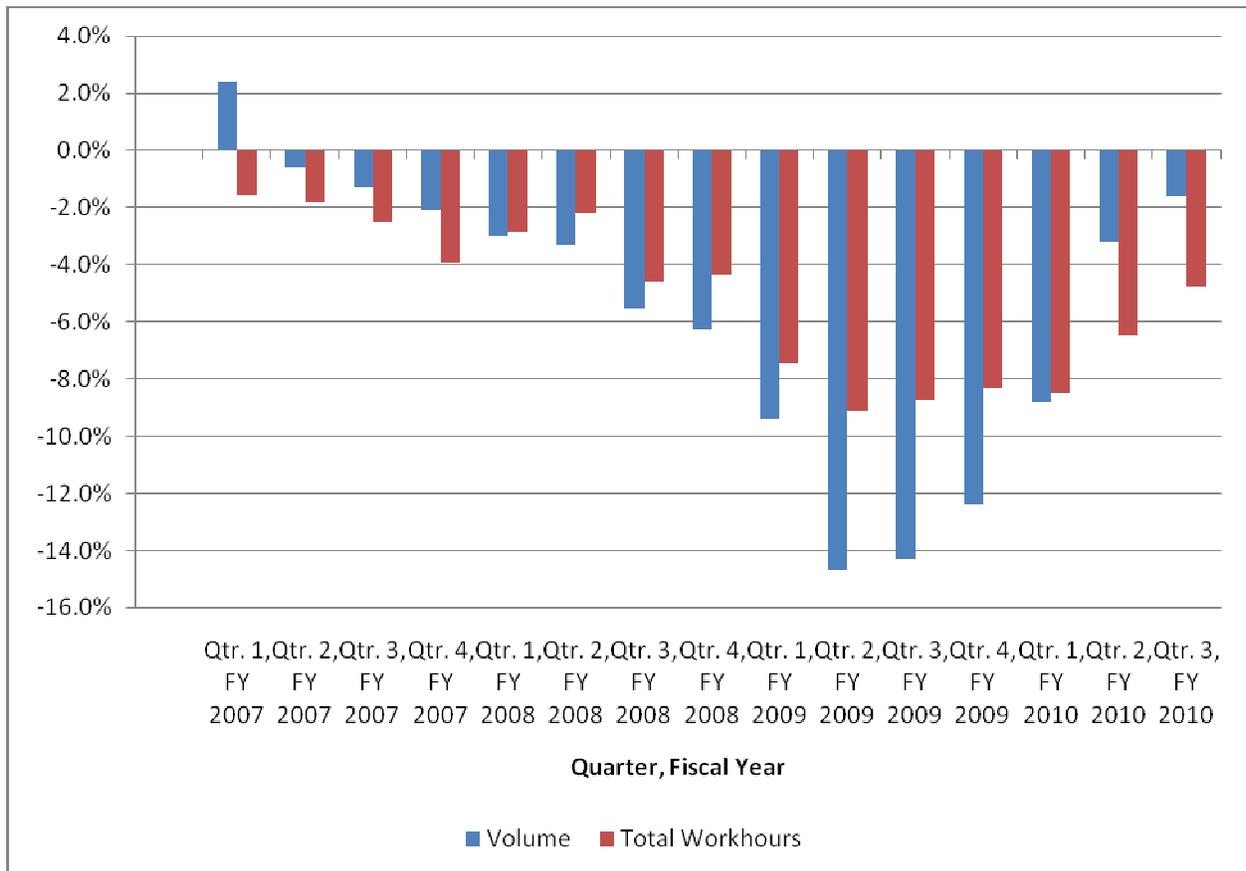
⁶⁵ In arguing that the proposed rate increase is not necessary, AMA asserts that the proposed increase could have been avoided through more efficient and economical management. Motion to Dismiss at 17-64. In particular, it points to the size and design of the mail processing network, the size of the Postal Service's workforce, and compensation rates. *Id.* at 21 *et seq.*

Others, such as delivery costs, are partially fixed and do not vary with volume changes. Dr. Kiefer confirms that as a consequence of the “sticky” nature of such costs, the Postal Service is unable to reduce costs immediately to reflect volume declines.⁶⁶ Over time, however, it has shown the ability to reduce costs in response to volume declines, providing an indication that the price cap is having the desired effect. Various cost data support this conclusion.

Figure 1 shows the change in volume and total workhours by quarter from FY 2007 through the third quarter of FY 2010. It shows that in FY 2007, the Postal Service succeeded in cutting workhours faster than volume declined. It was not able to match that success in FY 2008 and FY 2009. In FY 2010, however, the Postal Service has again succeeded in reducing workhours faster than volume has declined. This is a promising development, indicating that in response to volume declines, the Postal Service is moving to reorganize its workforce over time to better match its workload.

⁶⁶ At the July 27, 2010 technical conference, Dr. Kiefer commented on the “stickiness” of Postal Service costs: “The costs may have been a little bit sticky, or a little bit fixed, in response to volume changes, to the extent that they were sticky downward, they may also be a little sticky upward.”

Figure 1
Change in Volume and Workhours by Quarter
FY 2007 – Quarter 3, FY 2010



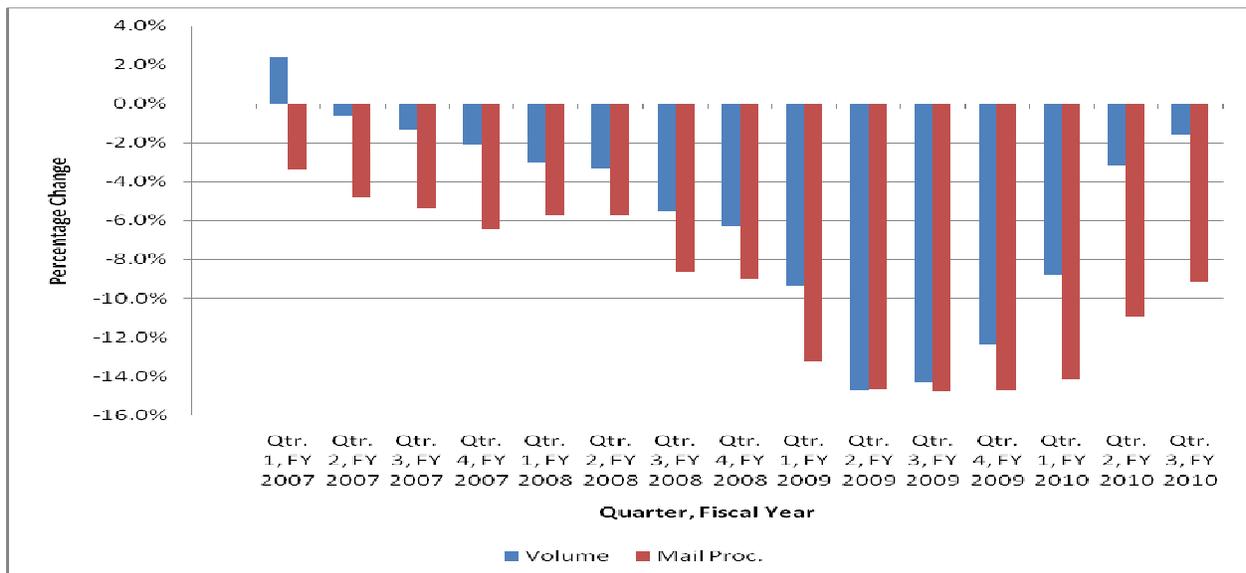
Source: USPS Form 10-K Quarterly Financial Statements
 Quarter 1, FY 2007 – Quarter 3, FY 2010

Additional data reinforce this point. Attachment A to the Postal Service’s Reply Brief presents workhour and volume changes for the period FY 2008 to FY 2010. That attachment shows that over the relevant period, volume declined by 20.2 percent. In response to that, the Postal Service was able to reduce mail processing and customer service workhours by 29.1 percent and 27.3 percent, respectively. Workhours associated with functions with higher fixed costs declined less, e.g., city delivery and

rural delivery workhours declined by 11.6 percent and 6.4 percent, respectively. Total workhours for the period declined 17.1 percent.

Figure 2 presents changes in volume and mail processing workhours by quarter from FY 2007 through the third quarter of FY 2010. Figure 2 shows that in every quarter but one, the Postal Service reduced mail processing workhours more rapidly than volume declined. The data indicate that the Postal Service is making strides to respond both immediately and in the longer term to volume changes affecting mail processing operations, thereby effectively reducing such costs.

Figure 2
Change in Volume and Mail Processing Workhours by Quarter
FY 2007 – Quarter 3, FY 2010



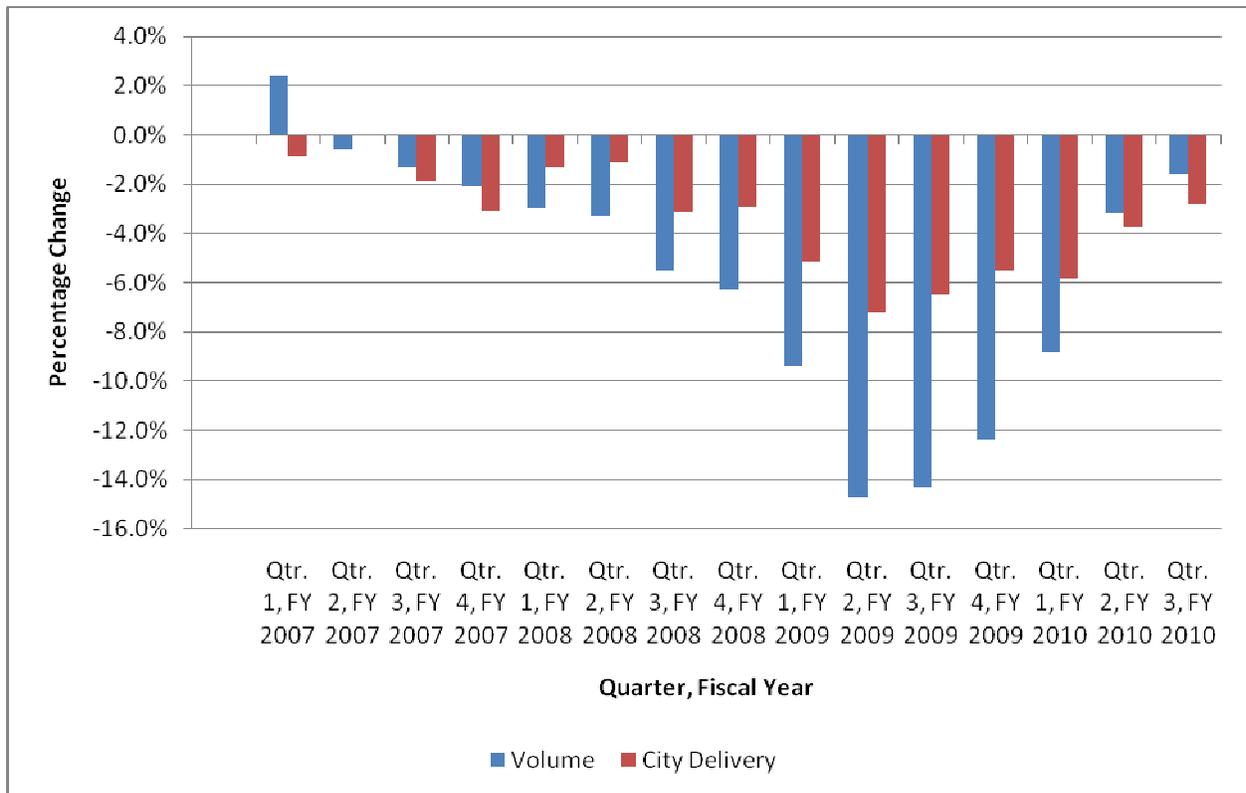
Source: USPS Form 10-K Quarterly Financial Statements
 Quarter 1, FY 2007 – Quarter 3, FY 2010

Delivery costs present more of a challenge. Costs associated with the time it takes carriers to walk or drive their route will not change noticeably if mail volumes

decline. As a consequence, the Postal Service is not able to reduce workhours as quickly in response to volume declines.

Figure 3 displays the change in volume and city delivery workhours by quarter from FY 2007 through the third quarter of FY 2010. The data show that for all quarters, from FY 2008 quarter 1 through FY 2010 quarter 1, volume declines outpaced reductions in workhours. That changed beginning in the second quarter of 2010. This development is a positive indication of the Postal Service’s ability to adjust over time in response to declines in volume and provides support for the conclusion that the price cap is having the desired effect.

Figure 3
Change in Volume and City Delivery Workhours by Quarter
FY 2007 – Quarter 3, FY 2010



Source: USPS Form 10-K Quarterly Financial Statements
 Quarter 1, FY 2007 – Quarter 3, FY 2010

Total Factor Productivity (TFP), which measures postal output in relation to input, provides an additional indication of the Postal Service's ability to cope with volume declines over time. TFP improved steadily between FY 2000 and FY 2007, before declining in FY 2008 and FY 2009 due to volume losses. The Postal Service reports: "So far in 2010, even though workload continues to decrease, the Postal Service has been able to make more than proportionate reductions in labor, and the year-to-date labor productivity growth is approximately 2.5 percent." Postal Service Response to Motion to Dismiss at 52. This development is a positive sign as well of the Postal Service's ability to cut costs over time in response to volume declines.

In sum, the Postal Service's current cost structure presents great challenges. With the tools available to it, however, the Postal Service has shown an ability to respond relatively effectively to declines in volumes, both immediately and over time. The results provide affirmation that the price cap is incenting the Postal Service to reduce costs and improve efficiency.

V. ORDERING PARAGRAPH

It is Ordered:

The Exigent Request of the United States Postal Service, filed July 6, 2010, is denied as inconsistent with 39 U.S.C. § 3622(d)(1)(E).

By the Commission.

Shoshana M. Grove
Secretary

Concurring Opinion of Commissioner Blair

I support the Commission's denial of the exigency increase requested by the Postal Service. However, I offer a concurring opinion which would deny the Postal Service the requested increase because it did not meet the threshold test of showing the existence of "extraordinary or exceptional circumstances" as required by the Postal Accountability and Enhancement Act.

In the instant case, the Postal Service argues that the current financial crisis is a result of a broken business model dependent on volume growth.¹ The Postal Service points to the steep volume decline over the past three year period as meeting the "extraordinary or exceptional circumstances" threshold.

In my view, a broken business model evidenced by a volume decline is not an "extraordinary or exceptional circumstance." This volume decline, while significant, was brought on by the recession and the continuing trend of electronic diversion. The country has weathered periodic recessions in the past and predictions regarding decline in mail volumes due to electronic diversion have been made by the Postal Service and others for at least two decades.² While the drop in volume due to electronic diversion occurred sooner than expected, it clearly had been contemplated by policy makers and the Postal Service for some time.

¹ Statement of Joseph Corbett, Executive Vice President and Chief Financial Officer, United States Postal Service, July 6, 2010, at 3 (Corbett Statement).

² United States Postal Service Five Year Strategic Plan FY 2001-2005, Executive Summary, page vii.

I believe the term “extraordinary or exceptional circumstances” contemplates the imposition of new, additional or unexpected costs on the Postal Service. The Postal Service argues the bulk of its costs are fixed by law, contracts or regulations and that such costs are the root cause of the Postal Service’s financial problems.³ Most of these costs were well established prior to the period of the claimed exigency.

Over the past decade, Congress has taken action to address some of these legacy costs. For example, in 2003 Congress reworked the Postal Service’s retirement obligations which resulted in reduced future pension payments of approximately \$78 billion to the Civil Service Retirement and Disability Trust Fund. When it enacted the PAEA, Congress included a provision waiving an additional \$27 billion in future retirement payments associated with CSRS military service credit. Last year, Congress deferred \$4 billion in statutory payments scheduled to be made to the Retiree Health Benefit Fund.

Prefunding future retiree health benefits is unique to the Postal Service and Congress understood that. Congress imposed this obligation to address an estimated \$78 billion in unfunded liabilities. The Postal Service’s financial circumstances have changed since enactment of the PAEA, but these congressionally mandated obligations are not the “extraordinary or exceptional circumstances” Congress envisioned as a basis to break the price cap and grant an exigent rate increase.

Congress adopted a price cap system as a means of forcing the Postal Service to engage in more efficient behavior. Evidence of this more efficient behavior can be found in the Postal Service’s efforts to trim more than \$6 billion in costs during 2009.⁴ Were it not for the discipline the price cap imposes, I doubt the Service would have achieved such significant cost reductions.

³ Corbett Statement at 2.

⁴ *Id.* at 5.

At the end of the day, the inability of the Postal Service to respond to and plan for predictable and periodic changing market conditions has resulted in this financial crisis. The Postal Service is facing serious financial hurdles when it comes to generating sufficient revenues to recover costs and/or generate a profit. But raising rates above and beyond inflation, based on claims of a flawed business model dependent on volume growth, is not sufficient to meet the test of extraordinary and exceptional in this case.

Dan G. Blair, Commissioner

Concurring Opinion of Commissioner Langley

I concur with the Commission's determination that the drop in mail volume attributed to the recent recession constitutes an extraordinary or exceptional circumstance, but that the Postal Service fails to demonstrate that its liquidity crisis is due to the recession. I believe the recession-driven volume declines experienced by the Postal Service probably had measurable financial impact that may warrant some financial relief. It is unfortunate the Postal Service did not identify any such impact and design a rate request to recover such funds.

I recognize the difficulty that the Postal Service and all parties encountered in this first proposal to utilize and interpret the exigency provision. All are to be congratulated for their valuable contributions to the record especially in highlighting the importance of the price cap system which promotes an effective and efficient mail system. The in-depth analysis provided by the parties further illuminates the unique conditions that must exist in order to pierce the cap through an exigent request.

I am disappointed that the Postal Service's submission failed to show how the overall request, and the specific rate increases proposed, relate to the exigent circumstance. It did not meet the prerequisites required to grant its revenue requests. The Postal Service did not identify the revenue shortfall that was due to the recession in terms of amount or impact.

The written and oral testimonies of Witnesses Corbett, Masse, and Kiefer did not demonstrate that the proposed rates are intended to offset the financial harm caused by the exigent circumstance or that the rate adjustments are reasonably related to the financial harm caused by that circumstance. Documentation of how the recession specifically impacted each class of mail for these and subsequent years would have been invaluable to the Commission's deliberations.

The Postal Service incorporated the need for an exigent rate adjustment in its seven-prong plan presented in March 2010. During oral testimony, it became apparent that the Postal Service's Request was designed to be a part of its long-term recovery plan, not to deal with an emergency situation.

Additionally, given the precedential nature of this first filing under 39 USC § 3622(d)(1)(E), I wish to have my view of the legislative history relating to the development of the exigent clause on record. I believe the compromise language embodied in the PAEA was truly a bipartisan, bicameral compromise. As noted by the detailed initial comments of the National Postal Mail Handlers Union, "after almost two years of congressional debate and consideration, this compromise language essentially incorporated the standard originally contained in H.R. 22, and combined that House-initiated standard with a substantially more flexible version of the standard that was originally contained in S. 662." (NPMHU Comments at 8). The compromise balanced the objectives of the differing House and Senate provisions relating to exigent situations. While my observations do not alter the Commission's decision, they do provide additional guidance for future discussions.

Nanci E. Langley, Commissioner

COMMENTS AND REPLY COMMENTS

COMMENTS		
PARTICIPANT	TITLE	FILING DATE
Affordable Mail Alliance, The (AMA Comments)	Comments of the Affordable Mail Alliance	August 4, 2010
Affordable Mail Alliance, The (AMA Additional Comments)	Comments of Affordable Mail Alliance Mailer Impact Statements	August 18, 2010
Alliance of Nonprofit Mailers and Magazine Publishers of America, American Business Media, National Newspaper Association, American Catalog Mailers Association, Inc., Direct Marketing Association, Inc. (ANM/MPA, et al. Comments)	Comments of Users of Flat-Shaped Mail	August 17, 2010
American Bankers Association (ABA Comments)	Comments of the American Bankers Association	August 17, 2010
American Catalog Mailers Association (ACMA Comments)	Initial Comments of the American Catalog Mailers Association (ACMA)	August 17, 2010
American Postal Workers Union, AFL-CIO (APWU Comments)	Initial Comments of American Postal Workers Union, AFL-CIO on the United States Postal Service Exigent Request	August 17, 2010
Association for Postal Commerce (PostCom Comments)	Comments of the Association for Postal Commerce	August 17, 2010
Jason Cabot (Cabot Comments)	Comments of Jason Cabot	July 12, 2010
Catalogue Marketing Economics Catalogue Marketing Economics Comments)	Comments of Jim Coogan, Catalogue Marketing Economics	August 9, 2010
Catalogue Marketing Economics (Catalogue Marketing Economics Additional Comments)	Comments of Jim Coogan, Catalogue Marketing Economics	August 9, 2010
Gerald E. Connolly (Connolly Comments)	Comments of Gerald E. Connolly, Member of Congress 11 th District, Virginia	July 20, 2010

COMMENTS (CONT'D)		
PARTICIPANT	TITLE	FILING DATE
DHL Global Mail (DHL Global Mail Comments)	Comments of DHL Global Mail	August 18, 2010
Direct Marketing Association (DMA Comments)	Additional Comments of the Direct Marketing Association (also commented in Affordable Mail Alliance and Users of Flat-Shaped Mail)	August 17, 2010
Direct Marketing Association Additional Comments (DMA Additional Comments)	Additional Comments of the Direct Marketing Association	August 17, 2010
Discover Financial Service (DFS Comments)	Comments of Discover Financial Service	August 17, 2010
eBay Inc. (eBay Comments)	Comments of eBay Inc.	August 17, 2010
Envelope Manufacturers Association (EMA Comments)	Comments of Envelope Manufacturers Association	August 13, 2010
Financial Services Roundtable and National Association of Mutual Insurance Companies, The (FSR/NAMIC Comments)	Comments of Financial Services Roundtable and National Association of Mutual Insurance Companies	September 8, 2010
Thomas A. Ginster (Ginster Comments)	Comments of Thomas A. Ginster	July 19, 2010
Greeting Card Association (GCA Comments)	Initial Comments of the Greeting Card Association; Greeting Card Association Detailed Analysis	August 17, 2010
Homeland Security and Governmental Affairs (Homeland Security and Governmental Affairs Comments)	Comments of Susan M. Collins, Homeland Security and Governmental Affairs, United States Senate	August 9, 2010
IDEAlliance-Mail Software Development Group (IDEAlliance Comments)	Comments from IDEAlliance-Mail Software Development Group in Docket No. R2010-4	August 17, 2010

COMMENTS (CONT'D)		
PARTICIPANT	TITLE	FILING DATE
Mark Jamison (Jamison Comments)	Comments submitted by Mark Jamison	August 23, 2010
Journal of Anthropological Research (Journal of Anthropological Research Comments)	Comments of Ann Braswell, Journal of Anthropological Research	August 6, 2010
Mailing Software Development Group (MSDG Comments)	Comments of Mailing Software Development Group	August 17, 2010
Mail Order Association of America (MOAA Comments)	Initial Comments of Mail Order Association of America	August 17, 2010
National Association of Presort Mailers (NAPM Comments)	Comments of the National Association of Presort Mailers on the Rate Adjustments Requested by the United States Postal Service Due to Extraordinary or Exceptional Circumstances	August 16, 2010
National Postal Mail Handlers Union (NPMHU Comments)	Initial Comments of the National Postal Mail Handlers Union Regarding Postal Service Request for a Rate Adjustment Due to Extraordinary or Exceptional Circumstances	August 18, 2010
National Postal Policy Council (NPPC Comments)	Comments of the National Postal Policy Council in Opposition to Exigent Rate Increase	August 17, 2010
Newspaper Association of America (NAA Comments)	Comments of the Newspaper Association of America	August 16, 2010
North American Equipment Dealers Association (NAEDA Comments)	Statement of the North American Equipment Dealers Association	August 18, 2010
Pain Solution Magazine (Pain Solution Magazine Comments)	Comments of James Lung, Art Director, Pain Solutions Magazine	July 20, 2010
Parcel Shippers Association (PSA Comments)	Comments of the Parcel Shippers Association	August 17, 2010
Pitney Bowes, Inc. (Pitney Bowes Comments)	Comments of Pitney Bowes, Inc.	August 17, 2010

COMMENTS (CONT'D)		
PARTICIPANT	TITLE	FILING DATE
Linda L. Pope (Pope Comments)	Comments of Linda L. Pope	August 2, 2010
David B. Popkin (Popkin Comments)	Initial Brief of David B. Popkin	August 17, 2010
Public Representative (PR Comments)	Public Representative Comments in Response to the Exigent Request of the United States Postal Service	August 17, 2010
Publishers Clearing House (Publishers Clearing House Comments)	Comments of Publishers Clearing House	August 18, 2010
Wayne Robey (Robey Comments)	Comments of Wayne Robey	July 15, 2010
Ross & Simons (Ross & Simons Comments)	Comments of Ross & Simons	August 26, 2010
Saturation Mailers Coalition and Valassis Direct Mail, Inc. (SMC/Valassis Comments)	Initial Comments of the Saturation Mailers Coalition and Valassis Direct Mail, Inc.	August 17, 2010
Stamps.com (Stamps.com Comments)	Initial Comments of Stamps.com	August 17, 2010
Halstein Stralberg in Behalf of Time Warner Inc. (Stralberg Comments)	Comments of Halstein Stralberg in Behalf of Time Warner Inc. on Reasons Why the Large Periodical's Rate Increase Proposed in Docket R2010-4 Should be Denied	August 17, 2010
Time Warner Inc. (TW Comments)	Initial Comments of Time Warner Inc. on United States Postal Service Exigent Request	August 17, 2010
Users of Flat-Shaped Mail Users of Flat-Shaped Mail Comments	Comments of Users of Flat-Shaped Mail	August 17, 2010
Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association Inc. (Valpak Comments)	Initial Comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc.	August 17, 2010

REPLY COMMENTS		
PARTICIPANT	TITLE	FILING DATE
Affordable Mail Alliance (AMA Reply Comments)	Reply Comments of the Affordable Mail Alliance	September 2, 2010
Alliance of Nonprofit Mailers, Magazine Publishers of America, American Business Media, National Newspaper Association, American Catalog Mailers Association, Inc., Direct Marketing Association, Inc. (ANM, et al. Reply Comments)	Reply Comments of Users of Flat-Shaped Mail	September 2, 2010
American Catalog Mailers Association (ACMA Reply Comments)	Reply Comments of the American Catalog Mailers Association (ACMA)	September 2, 2010
Association for Postal Commerce (PostCom Reply Comments)	Reply Comments of the Association for Postal Commerce	September 2, 2010
Discover Financial Service (DFS Reply Comments)	Reply Comments of Discover Financial Service	August 17, 2010
Greeting Card Association (GCA Reply Comments)	Reply Comments of the Greeting Card Association	September 2, 2010
Mail Order Association of America (MOAA Reply Comments)	Reply Comments of Mail Order Association of America	September 2, 2010
Nation Company L.P., The and Magazines of Politics, Policy, and Current Events Coalition (Nation Company/MPPACE Reply Comments)	Reply Comments of the Nation Company and of the Magazines of Politics, Policy, and current Events Coalition (MPPACE)	September 2, 2010
National Association of Letter Carriers, AFL-CIO (NALC Reply Comments)	Reply of Intervenor National Association of Letter Carriers, AFL-CIO to Comments of Affordable Mail Alliance and Senator Collins	September 2, 2010
National Association of Postmasters of the United States (NAPUS Reply Comments)	Reply Comments of the National Association of Postmasters of the United States	September 2, 2010

REPLY COMMENTS (CONT'D)		
PARTICIPANT	TITLE	FILING DATE
National Association of Presort Mailers (NAPM Reply Comments)	Reply Comments of the National Association of Presort Mailers on the Rate Adjustments Requested by the United States Postal Service Due to Extraordinary or Exceptional Circumstances	September 2, 2010
National Postal Mail Handlers Union (NPMHU Reply Comments)	Reply Comments of the National Postal Mail Handlers Union Regarding Postal Service Request for a Rate Adjustment Due to Extraordinary or Exceptional Circumstances	September 2, 2010
National Postal Policy Council (NPPC Reply Comments)	Reply Comments of the National Postal Policy Council	September 2, 2010
Parcel Shippers Association (PSA Reply Comments)	Reply Comments of the Parcel Shippers Association	September 2, 2010
Parcel Shippers Association (PSA Further Comments)	Further Comments of the Parcel Shippers Association	September 10, 2010
QVC, Inc. (QVC Reply Comments)	Reply Comments of QVC, Inc.	September 3, 2010
Saturation Mailers Coalition and Valassis Direct Mail, Inc. (SMC/Valassis Reply Comments)	Reply Comments of the Saturation Mailers Coalition and Valassis Direct Mail, Inc.	September 2, 2010
Time Warner Inc. (TW Reply Comments)	Reply Comments of Time Warner Inc. on United States Postal Service Exigent Request	September 2, 2010
United States Postal Service (Postal Service Reply Comments)	Reply Comments of the United States Postal Service	September 2, 2010
Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. (Valpak Reply Comments)	Reply Comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc.	September 2, 2010
Users of Flat-Shaped Mail (Users of Flat-Shaped Mail Reply Comments)	Reply Comments of Users of Flat-Shaped Mail	September 2, 2010

Summary of the Postal Service's Pricing and Classification Proposals and Commenter Views

Introduction

The sections below discuss the Postal Service's pricing and classification proposals for each of the five classes of market dominant mail. The sections are divided into two parts: (1) the Postal Service's pricing and classification proposals, and (2) comments and reply comments. Because the Postal Service has failed to demonstrate that the requested price adjustments are due to the exigent circumstances it relies upon, there is no need to address the pricing and classification issues raised by the commenters.

First Class Mail

Postal Service Proposals

The Postal Service proposes to increase rates for First-Class Mail, as a class, by 5.4 percent. Kiefer Statement at 9. The proposed increases vary somewhat by product, with a 4.7 percent increase for Single-Piece Letters/Postcards, a 5.9 percent increase for Presort Letters/Postcards, a 6.3 percent increase for Flats, a 5.4 percent increase for Parcels, and a 5.0 percent increase for Single-Piece FCM International.¹ Kiefer Statement at 10. For the most part, changes in rates below the product level do not vary greatly from the average increases. Two notable exceptions are lightweight parcels, with increases between 15 and 50 percent, and presort flats which have a proposed increase of about 12 percent. The proposals include several classification changes, including a separate rate for commercial single-piece parcels, a single combined rate for parcels weighing less than 3 ounces, a reduction in the Move Update

¹ The proposed changes in Single-Piece First-Class Mail International prices are discussed in the section on International Mail.

Assessment Charge tolerance from 30 percent to 25 percent, and the introduction of a “Reply Rides Free” incentive pricing initiative. *Id.* at 21-23, 26-28, Appendix A.

In the 2009 ACD, the Commission identified five worksharing discounts that exceeded avoidable costs and are not justified by one of the statutory exceptions in 39 U.S.C. § 3622(e)(2)(B). The Postal Services proposes to reduce two (automation 3-digit cards and automation 5-digit cards) of them to 100 percent of avoidable cost. Two others (automation mixed AADC letters and automation ADC flats) are reduced, but would remain in excess of the avoidable cost. The fifth discount (automation AADC letters) is proposed to increase by 0.2 cents. The Postal Service contends that further reductions in the discounts would induce rate shock and thus meets the exceptions in section 3622(e)(2)(B). *Id.* at 23-26.

Comments and Reply Comments

Several participants comment on various aspects of the proposal, including the design of worksharing discounts, the potential volume effects of the price changes, the timing of implementation, and the proposed classification changes. ABA, DFS, NPPC, NAPM, APWU, and the Public Representative discuss how the design of worksharing discounts should be viewed and applied in this case. ABA, DFS, NAPM and NPPC oppose the proposed First-Class presort letter rates, and ABA also opposes the proposed increase for single-piece letters. ABA Comments at 5-8; DFS Comments at 2-6; NAPM Comments at 4-6; NPPC Comments at 24-35. APWU urges the Commission to require the Postal Service to submit a firm timetable for the phase out of discounts that exceed avoided costs. APWU Comments at 1-6. The Public Representative agrees that the Postal Service should provide such a schedule. Public Representative Comments at 52.

GCA opposes the proposed increase in additional ounce rates. GCA Comments at 12; GCA Reply Comments at 13-14. NAPM proposes an alternative set of letter

rates, which Pitney Bowes endorses as superior to those proposed by the Postal Service. NAPM Comments at 8-10; Pitney Bowes Comments at 5-6; NAPM Reply Comments at 4-6. Pitney Bowes also opposes the proposed increases for First-Class presort flats. Pitney Bowes Comments at 6-8. Several participants, including Popkin, PostCom, and the Public Representative oppose some of the more significant proposed classification changes such as the “Reply Rides Free” initiative. Popkin Comments at 1; PostCom Comments at 7-9; PostCom Reply Comments at 2-13; Public Representative Comments at 62-63.

First-Class Mail International

Postal Service Proposals

The Postal Service proposes an increase of 5.0 percent, on average, for First-Class Mail International (FCMI). For outbound FCMI letters, flats, and small parcels, prices increase 6.8 percent, while outbound card prices increase 2.8 percent. Prices for FCMI letters subject to the nonmachinable surcharge increase 5.0 percent. For inbound FCMI (*i.e.*, letter post and all other items, weighing up to 4 pounds), prices decrease 1.1 percent.²

Only one classification change is proposed for First-Class Mail International—moving Israel from Country Group 8 to Country Group 5. This change would place Israel with other industrialized countries that are paid the maximum terminal dues for delivering U.S. origin mail under the UPU Terminal Dues Target System. Kiefer Statement at 23.

² Library Reference USPS-R2010-4/1 (Revised August 6, 2010), at 8. The decrease in prices for inbound FCMI, established by the Universal Postal Union, reflects an exchange rate fluctuation.

Comments and Reply Comments

Popkin notes that for one-ounce FCMI machinable and non-machinable letters, the Postal Service proposes different prices for Country Groups 3, 4, and 5 than for Country Groups 6 through 9. This represents an 8.2 percent increase for machinable letters in Country Groups 3, 4 and 5. He asserts that abandoning a uniform rate structure will be confusing to the public. Popkin Comments at 1.

Periodicals

Postal Service Proposals

The Postal Service proposes to increase rates for Periodicals, on average, by 8.0 percent, with increases ranging from 5.8 percent for 5-Digit Automation Flats, 9.0 percent for Basic Carrier Route Flats, and 21.2 percent for Origin-entered Pallets. Kiefer Statement at 40. Most price increases are close to the average. The Postal Service justifies its above-average price increase for Periodicals as one component of a plan to gradually improve Periodicals cost coverage. *Id.* at 39. Five proposed worksharing discounts exceeded avoidable costs in the 2009 ACD. In this Postal Service Request, the same five discounts remain greater than avoidable costs, and four additional discounts are greater than avoidable costs.³ *Id.* at 41. There were no classification proposals.

Comments and Reply Comments

Participants commented on the four Periodical pricing issues: efficient pricing structure; cost attribution in a period of excess capacity; stimulation of demand for other classes of mail (*i.e.*, the multiplier effect); and the equity of proposed price increases.

³ These discounts are commonly referred to as a “passthrough greater than 100 percent.” The “five” referred to are: Non-machinable Nonautomation 3D/SF Flats; Non-machinable Automation 3D/SF Flats; ADC Automation Letters, 3-Digit Automation Letters; and 5-Digit Automation Letters. The four new, problematic, discounts are Machinable Nonautomation 5-Digit Flats; Machinable Automation 5-Digit Flats; Nonmachinable Nonautomation ADC Flats; and Machinable Automation Mixed ADC Flats.

Time Warner and Stralberg argue that setting different price increases for closely related CR Basic and 5-Digit Automation Flats rates does not send efficient pricing signals for these piece sorting presort levels. Stralberg Comments at 12-13; TW Reply Comments at 17. They also note that the higher increases are proposed for origin pallets than origin sacks, yet most sacks, but not pallets, are entered at origin. Stralberg Comments at 12-14; TW Reply Comments at 10. Nation Company/MPPACE disagrees with Time Warner's criticisms, arguing that small publishers are not able to take advantage of an efficient price structure. Nation Company/MPPACE Reply Comments at 2.

The Users of Flat-Shaped Mail (UFSM) argue that if the Commission used short run attributable costs, Periodicals would make a positive contribution to institutional costs. Users of Flat-Shaped Mail Comments at 19-22. Valpak contends that the Commission may only consider this proposal in a special docket on methodology changes, not in one addressing a proposal for an exigent rate increase. Valpak Reply Comments at 12.

UFSM also notes that 40 percent of Periodical mailers' postal costs are spent on products that make positive contributions. UFSM and Nation Company/MPPACE argue that if the Commission were to allocate these positive contributions to Periodicals, its cost coverage would be greater than 100 percent. Users of Flat-Shaped Mail Comments at 25; Nation Company/MPPACE Reply Comments at 2. But Valpak finds little merit in this argument, stating that the same profit can not support cost coverage for two products. Valpak Reply Comments at 32-33. Finally, the Public Representative believes that the above-average increase for Periodicals is equitable since it reduces the subsidy that negative cost coverage imposes on other classes of mail. Public Representative Comments at 44, 47-48. Time Warner counters that for a class to receive an above-average increase in an exigent rate case, the negative cost coverage

of the class must be the justification for the need to file such a case. It contends the Postal Service has not shown this to be so. TW Reply Comments at 3.

Standard Mail

Postal Service Proposals

The Postal Service proposes an overall increase of 5.6 percent for the Standard Mail class. Kiefer Statement at 28. Increases for individual products in Standard Mail range from 4.9 percent to 23.2 percent. *Id.* The Postal Service realigned discounts with avoided costs for all five discounts the Commission identified as exceeding avoided costs and lacking justification for a section 3622(e) exception. Three proposed Standard Mail discounts exceed avoided costs: the presort discounts for Network Distribution Center (NDC) (formerly BMC) machinable parcels and 5-digit irregular parcels, and the automation (prebarcoding) discount for flats. The Postal Service justifies these discounts under Section 3622(e)(2)(D), *i.e.*, that reducing or eliminating the discounts would impede efficient operations. *Id.* at 34; Postal Service Response to Presiding Officer Information Request No. 1, Question 8.

Two Standard Mail products failed to cover their attributable costs in FY 2009—Flats, and NFMs and Parcels. In the 2009 ACD, the Commission determined that the Postal Service must devise a plan to improve the cost average of these products. 2009 ACD at 86-87. In this price adjustment, the Postal Service proposes a 5.1 percent increase for the Flats product citing concern for the health of catalog industry as a motivating factor in taking a cautious approach in moving towards covering cost. The Postal Service presents plans for cost reductions outlined in Operations Strategies for Capturing Flats Efficiencies.⁴ It also states that additional price increases would be

⁴ Library Reference USPS-R2010-4/9, July 6, 2010.

considered if the cost reductions were not enough to achieve full cost coverage. Kiefer Statement at 29-30, 32.

For Standard Mail NFMs and Parcels, the Postal Service proposes a 23.2 percent increase to move towards covering cost and to bring Standard Mail NFMs and Parcels in line with the parcel product offerings of its competitors. Given expected improvements in economic conditions and planned cost reduction and efficiency measures, the Postal Service expects NFMs and Parcels revenue to cover their cost with these rate increases. *Id.* at 30-32.

The Postal Service introduces four classification changes that affect Standard Mail products: an initiative for growth of the High Density and Saturation Mail products, a change to the threshold below which the Move Update Assessment Charge applies, rearranging the Standard Mail NFMs and Parcels product into Fulfillment Parcels and Marketing Parcels categories, and modification of the heavy letter formula. *Id.* at 35-37.

Comments and Reply Comments

Most commenters take issue with the price increases for the Standard Mail Flats and the Parcels and NFMs products. They also address the Saturation and High Density Incentive Program and workshare discounts.

Those commenting on the price increase for the Standard Mail Flats product offer contrasting views. Valpak, MOAA, ABA, and the Public Representative assert that flats rates do not comply with 39 U.S.C. § 3622(c)(2) and contend that a higher increase is warranted for the Flats product. Valpak Comments at 39-42; MOAA Comments at 2-3; ABA Comments at 9; Public Representative Comments at 47-49. Conversely, ACMA and Users of Flat-Shaped Mail defend the value of catalogs, the primary users of Flats. ACMA Comments at 3-8, 13-14; Users of Flat-Shaped Mail Comments at 2, 29. In support, these commenters address, *inter alia*, the alignment of

flat-shaped Standard Mail postal products with the market and the relevance of a multiplier effect. *Id.*

Several commenters discuss the Saturation and High Density Incentive Program. The Public Representative, PostCom, and Popkin contend that mail classification changes should not be considered during exigent rate cases. Public Representative Comments at 64; PostCom Comments at 9-12; Popkin Comments at 1. However, NAA and SMC/Valassis support the incentive. NAA Comments at 6-7; SMC/Valassis Comments at 3.

A number of commenters (PSA, Publishers Clearing House, DMA, QVC, DHL) object to the proposed increase for Standard Mail NFM's and Parcels citing rate shock and inequity between products among the rationales. PSA Comments at 13-14; Publishers Clearing House Comments at 4, 7; DMA Comments at 2-3; QVC Reply Comments at 2-3; DHL Comments at 2. The Public Representative supports the increase. Public Representative Comments at 47.

Finally, the Public Representative comments on workshare discounts. He contends that the Postal Service should in some cases improve costing, reduce excessive discounts, and provide better justification for discounts above avoided cost. Public Representative Comments at 56-60.

Package Services

Postal Service Proposals

For the Package Services class, the Postal Service proposes an overall 6.8 percent price increase and one classification change (the elimination of the ½ pound price for single-piece non-presort Bound Printed Matter Parcels). Kiefer Statement at 42, 49. In response to the Commission's direction in the 2009 ACD concerning products for which revenue does not cover costs, the Postal Service proposes to

increase the rates of Single-Piece Parcel Post, BPM Parcels, and Media Mail/Library Mail by 7.0 percent, above the average for products that cover their costs. 2009 ACD at 95; Kiefer Statement at 63.

In the 2009 ACD, the Commission identified seven worksharing discounts that exceed avoidable costs. 2009 ACD at 48. Of the seven, the Postal Service proposes to realign five of the discounts to equal 100 percent of the avoidable costs. The other two discounts (5-digit Media Mail and 5-digit Library Mail) remain above 100 percent. *Id.* at 49. For these discounts, the Postal Service claims the ECSI and rate shock statutory exceptions. Kiefer Statement at 63-64.

Comments and Reply Comments

Comments regarding Package Services were filed by eBay Inc., the Public Representative, and Popkin. eBay contends that a rate increase for Package Services is not the solution to the Postal Services financial situation. eBay Comments at 3. The Public Representative argues that the price increases will assist in making the class more profitable, but voices a concern that some Single Piece Parcel Post proposed rates exceed corresponding Priority Mail rates. Public Representative Comments at 50. Popkin states that it is inappropriate to eliminate half pound BPM rates during the proceeding. Popkin Comments at 1.

Special Services

Postal Service Proposals

For the Special Services class, the Postal Service proposes an average increase of 5.3 percent. Revised Kiefer Statement at 50. On a product level, the proposed prices range from 5.0 percent to 12.9 percent. *Id.* at 51. In addition, the Postal Service addresses the four mail categories that did not cover their attributable costs in FY 2009: Registered Mail, Stamped Cards, Confirm Service, and International Ancillary Services. *Id.* at 51-52. For Registered Mail and Stamped Cards, the Postal Service argues that

only modest increases are necessary since the services are projected to have positive contributions in FY 2010 and FY 2011. However, for Confirm Service and International Ancillary Services, the Postal Service proposes substantially above average increases. *Id.* at 52. Further, the Postal Service proposes one classification change. *Id.* at 53. The Postal Service proposes to eliminate Stamped Envelopes that bear Standard Mail stamps due to the small volume of envelopes sold. *Id.*

Comments and Reply Comments

For the Special Services class, only the Public Representative provided comments on the proposed prices, and no participant provided reply comments. He notes that two Special Services products received an above average increase: Confirm and International Ancillary Services. Public Representative Comments at 51. However, he considers these increases reasonable since both products did not cover their costs in FY 2009. *Id.*