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

Rate Adjustment due to Extraordinary or	)	
Exceptional Circumstances	)	Docket No. R2013-11

INITIAL COMMENTS

OF

VALPAK DIRECT MARKETING SYSTEMS, INC., AND
VALPAK DEALERS' ASSOCIATION, INC.
(November 26, 2013)

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COURSE OF PROCEEDINGS

On September 26, 2013, the Postal Service filed its "Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059."[1] The Postal Service's filing was submitted in Docket No. R2010-4(R). It was supported by the statements of three witness: Stephen J. Nickerson, Manager, Finance; Altaf H. Taufique, Pricing Economist; and Thomas E. Thress, Vice-President of RCF Economic and Financial Consulting, Inc. The Postal Service also provided three nonpublic library references, and 11 public library references.

On September 30, 2013, the Commission issued Order No. 1847, "Notice and Order Concerning Exigent Request," opening a new docket, Docket No. R2013-11, to consider the request. Presiding Officer's Ruling No. R2013-11/1 revised the procedural schedule, including three technical conferences and two days of public hearings for the three Postal Service witnesses, and established a deadline of November 26, 2013 for Initial Comments and December 6, 2013 for Reply Comments.

The Commission held three technical conferences:

Witness Taufique	October 24, 2013
Witness Thress	October 31, 2013
Witness Nickerson	November 1, 2013

Valpak submitted five motions for information requests, or, in the alternative, proposed questions to be asked by the Commission at hearings. Most of the questions included in those

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1 Simultaneously with the filing of the exigent request, the Postal Service filed a CPI-based price adjustment in Docket No. R2013-10. The proposed price increase in the instant docket is designed to go into effect on January 26, 2014, in addition to the CPI price increase that was designed to go into effect on the same date. The Commission issued its decision in that docket on November 21, 2013.

motions were incorporated into various Presiding Officer's Information Requests ("POIRs") and questions posed by Commissioners at the hearings.

Public hearings for Commission questioning of Postal Service witnesses were held, as follows:

Witness Taufique	November 19, 2013
Witness Thress	November 19, 2013
Witness Nickerson	November 20, 2013

STATEMENT OF VALPAK'S INTEREST

Valpak Direct Marketing Systems, Inc. is a heavy user of Standard Mail, primarily the High Density/Saturation Letters product. Valpak Dealers' Association, Inc. is an association of about 175 independently owned franchises across North America, assisting more than 50,000 small business advertisers in promoting their products and services. (Hereinafter both entities will be referred to as "Valpak.") Valpak's annual volume has declined somewhat in recent years to 466.0 million pieces in 2012, approximately 93 percent of which is at the saturation rate, and over 99 percent of which is SCF-entered. The **High Density/Saturation Letters** product primarily used by Valpak had one of the highest cost coverages of any product in FY 2012 — 222.2 percent. The Postal Service's proposals in Docket No. R2013-10 and R2013-11, if approved, will increase that product's coverage to an astonishing **251.3 percent**.

Valpak has participated actively in Commission dockets for nearly 20 years, and cooperates in various Postal Service initiatives. For example, Valpak was the first mailer to use XML messaging to submit data to the Postal Service, and one of the first mailers to participate in pilot programs for eInduction and Seamless Acceptance. In addition, 100 percent of Valpak's mail is full-service IMb.

COMMENTS

Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. (hereinafter "Valpak") hereby submit these joint comments.

I. Under PAEA, Numerous Statutory Requirements Must Be Met before the Commission May Approve an Exigent Price Increase, and Commission Rules Establish Additional Standards.

The Postal Service's request was filed pursuant to the exigent circumstances provision of the Postal Accountability and Enhancement Act of 2006 ("PAEA"), codified as 39 U.S.C. section 3622(d)(1)(E). PAEA, which required the establishment of a "modern system for regulating rates and classes for market-dominant products,"[2] included, as the centerpiece,[3] a cap on price adjustments that was tied to the change in the Consumer Price Index for All Urban Consumers, or CPI-U. Congress also identified nine "objectives" and 14 "factors" to guide the operation of that "modern system." *See* 39 U.S.C. § 3622(b) and (c). Additionally, all of the policies of Title 39 apply to exigent rate increases under PAEA.

The PAEA price cap is set out in 39 U.S.C. section 3622(d)(1)(A) and (D):

> (d) Requirements.—
>
> (1) In general.— The system for regulating rates and classes for market-dominant products shall—
>
> (A) include an **annual limitation** on the percentage changes in rates to be set by the Postal Regulatory Commission that will be **equal to the change in the Consumer Price Index** for All Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates....

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2 39 U.S.C. § 3622(a).

3 *See generally* Order No. 547, pp. 10-13.

> (D) establish procedures whereby the Postal Service may adjust rates not in excess of the annual limitations under subparagraph (A)….

That statute also contains a narrow exception set out in 39 U.S.C. section 3622(d)(1)(E) which authorized the Commission to allow Postal Service prices to breach the cap in exigent circumstances, but only when numerous preconditions are all met.[4]

> (E) notwithstanding 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) (emphasis added).]

In addition to the statutory requirements, Commission Rules require the Postal Service's exigent request to include the following items:

(1) A schedule of the proposed rates;

(2) Calculations quantifying the increase for each affected product and class;

(3) A full discussion of the extraordinary or exceptional circumstances giving rise to the request, and a complete explanation of how both the requested overall increase and the specific rate adjustments requested **relate to** those circumstances;

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[4] *See* the Commission's discussion of the term "exigent" in Docket No. R2010-4, Order No. 547, p. 13, n.12.

(4) A full discussion of why the requested rate adjustments are **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;

(5) A full discussion of why the requested rate adjustments are **reasonable** and **equitable** as among types of users of market dominant products;

(6) An explanation of when, or under what circumstances, the Postal Service expects to be able to **rescind the exigent rate adjustments** in whole or in part;

(7) An analysis of the circumstances giving rise to the exigent request, which should, if applicable, include a discussion of whether the circumstances were **foreseeable** or **could have been avoided** by reasonable prior action; and

(8) Such other information as the Postal Service believes will assist the Commission to issue a timely determination of whether the requested rate adjustments are consistent with applicable **statutory policies**. [39 C.F.R. § 3010.61(a) (emphasis added).]

Most notably, the Commission Rules anticipate that exigent rates would only be in effect for a period necessary to allow the Postal Service time to recoup demonstrated losses, after which they would be rescinded. *See* 39 C.F.R. § 3010.61(a)(6). And the Commission Rules strongly imply that the Commission will not approve an exigent rate increase if "the circumstances were foreseeable or could have been avoided by reasonable prior action…." *See id.*, § 3010.61(a)(7). Commission Rules also address how the Postal Service must address the price cap under an exigent request:

> (a) Each exigent request will identify the unused rate adjustment authority available as of the date of the request for each class of mail and the available amount for each of the preceding 5 years.

> (b) Pursuant to an exigent request, rate adjustments may use existing unused rate adjustment authority in amounts greater than the limitation described in §3010.28 of this subpart.
>
> (c) Exigent increases will exhaust all unused rate adjustment authority for each class of mail before imposing additional rate adjustments in excess of the maximum rate adjustment for any class of mail. [39 C.F.R. § 3010.63.]

Although these may be stated in different ways, it is suggested that the statute and rules establish the following seven, distinct requirements.

1. "[S]ufficient unused rate authority" must not exist.

2. The Commission must determine that there must exist "either extraordinary or exceptional circumstances."[5]

3. There must be a causal link[6] between the harm suffered by the Postal Service as a result of the exigent circumstances and the price change sought, *i.e.*, the "due to" standard.

4. The Commission must determine that the adjustment is:
   a. "reasonable";
   b. "equitable";
   c. "necessary to enable the Postal Service … to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States"; and
   d. unforeseeable and unavoidable.[7]

5. The Commission must determine whether the Postal Service is exercising "best practices of honest, efficient, and economical management."

6. The adjustment must meet the qualitative limitations of 39 U.S.C. sections 3622(e) and 3626.

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[5] *See* Order No. 547, pp. 21-22.

[6] *See* Order No. 864, pp. 30-52.

[7] *See* 39 C.F.R. § 3010.61(a)(7).

7. The adjustment must be consistent with the seven objectives in subsection (b), taking into account the nine objectives and 14 factors in subsection (c) (which includes all the policies of Title 39, including, *inter alia*, 39 U.S.C. section 101(d) and 39 U.S.C. section 403(c)).

The way in which the Postal Service and the Commission identified those statutory requirements in Docket No. R2010-4 is addressed in Section II, *infra*. In Docket No. R2010-4, the Commission agreed with the Postal Service that the recession of December 2007 to June 2009 (hereinafter "2008-2009 recession") constituted either an extraordinary or an exceptional circumstance. However, the Commission rejected the proposed price increases because the Postal Service failed to demonstrate which losses were "due to" that recession, and which were caused by other factors, such as electronic diversion. As the Commission's decision in Order No. 547 was grounded in the "due to" requirement, none of the other statutory issues were ever reached. Order No. 864 ("[I]t was unnecessary for the Commission to determine whether the proposed adjustments met the 'reasonable and equitable and necessary' tests….", p. 30). Therefore, the Commission will need to address these other requirements for the first time in this docket. Each of these requirements is discussed in the following comments.

II. Important Lessons Can Be Learned from the Litigation of the Only Prior Exigent Rate Case, Docket No. R2010-4.

Docket No. R2010-4 is the only prior exigent rate case that was filed under PAEA, and therefore provides the only clear precedent applicable to the current docket.[8]

[8] The Postal Service's attempted to file its exigent request in the post-remand continuation of Docket No. R2010-4R. However, the Commission changed the docket designation to Docket No. R2013-11. *See* Order No. 1847, pp. 2-3.

A. Docket No. R2010-4.

The Postal Service initiated the first exigent rate case, Docket No. R2010-4, on July 6, 2010, by filing the "Exigent Request of the United States Postal Service." The Postal Service filing suggested that all of the statutory criteria of 39 U.S.C. section 3622(d)(1)(E) would fit into two small baskets:

> First, there must be "**extraordinary** or **exceptional** circumstances."
>
> Second, the requested adjustments must be not only **reasonable** and equitable, but also "necessary" to enable the Postal Service to maintain and continue the development of postal services.... [T]he "**necessary**" standard is met **if something less would not** "enable the Postal Service, under best practices of **honest, efficient, and economical management**, to maintain and continue the development of postal services...." [USPS Request, pp. 5-6 (emphasis added).]

This statement leaves much to be desired. For example, as to the Postal Service's first criterion, the Postal Service initial filing completely omitted any reference to the statutory phrase "due to," which language was of central importance to the Commission's decision in that docket. As to the Postal Service's second criterion, the Postal Service's effort to subordinate the "honest, efficient, and economical management" standard to an isolated "necessary" standard that could be met whenever the Postal Service needs money to pay its bills, fundamentally departs from the statutory text.

After litigation of the docket, in ruling on the proposal, the Commission explained the main statutory standards quite differently, generally tracking Commission regulations (39 C.F.R. § 3010.60), in three parts:

- **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. [Commission Order No. 547 (Sept. 30, 2010), p. 2 (emphasis added).]

B. "Extraordinary or Exceptional Circumstance" Test.

During litigation of the case, the Postal Service urged the Commission to find that the "extraordinary or exceptional circumstance" test was met based on, at least, five different theories.

1. It argued that the Postal Service was "on the brink of financial insolvency." Docket No. R2010-4, Statement of Joseph Corbett, p. 4.

2. It stated that its "business model" was no longer viable, as it depended on "an ever-rising tide of mail volume…." *Id.*, p. 3.

3. The Postal Service blamed its problems on "new costs imposed by postal legislation…." *Id.*, p. 4.

4. And the Postal Service asserted "a lack of operating flexibility" under applicable law. *Id.*, p. 5.

5. It quantified the total loss in explaining that "[o]ver the period FY 2007 – FY 2009, mail volume fell a total of 17 percent. Most alarmingly, volume fell an extraordinary 26 billion pieces in FY 2009, representing nearly three-quarters of that 17 percent…" *Id.* This the Postal Service termed a "precipitous and historic decline[] in mail volumes and revenues…." *Id.*, p. 4.

By a vote of 4 to 1,[9] the Commission concluded:

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[9] *See* Concurring Opinion of Commissioner Blair, p. 2 of 3 ("I believe the term 'extraordinary or exceptional circumstances' contemplates the imposition of new, additional or unexpected costs on the Postal Service…. 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.") Commissioner Blair also commented on the need for and success of a price cap: "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

> Mr. Corbett argues that the Postal Service experienced a **volume decline** of over 20 percent during the **last 3 years** [FY 2007 - FY 2009], a decline greater than the cumulative decline associated with all other recessions experienced in the last 35 years. **Given these facts**, the Commission concludes that the recent recession and its impact on postal volumes is an "extraordinary or exceptional" circumstance.... [Order No. 547, p. 50 (emphasis added).]

It is highly significant that the Commission based its finding on only the last of the five factors suggested by the Postal Service, and only based on the volume losses during FY 2007 - FY 2009. The "extraordinary or exceptional" circumstance was **not** based on (i) a liquidity crisis and the approaching financial insolvency,[10] (ii) the supposedly broken business model,[11]

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found in the Postal Service's efforts to trim more than $6 billion in costs during 2009.... Were it not for the discipline the price cap imposes, I doubt the Service would have achieved such significant cost reductions." *Id.*

[10] The Commission clearly stated that "the issue presented to the Commission by the Postal Service filing is **not** the Postal Service's **current financial condition** [the stark picture presented by Mr. Corbett], 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." Order No. 547, p. 61 (emphasis added). "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." *Id.*, p. 65. On remand, the Commission described its prior finding, as follows: "In Order No. 547, for example, the Commission did not find that the financial crisis facing the Postal Service was an extraordinary or exceptional circumstance." Order No. 864, p. 42.

[11] The Commission stated "[t]he Postal Service can not resolve severe shortcomings in its **business model** by resorting to the exigent rate provision." Order No. 547, p. 63 (emphasis added).

(iii) the new costs imposed by PAEA,[12] or (iv) the constraints on cost cutting.[13] It was only the 2008-2009 recession and its precipitous[14] decline in postal volumes, when volumes fell faster than the Postal Service claims that it could react, that constituted the "extraordinary or exceptional" circumstance. Accordingly, it would appear logical that under PAEA the only losses that could be recoverable from this "extraordinary or exceptional" circumstances could not exceed the losses from the dramatic volume losses during 2007-2009 and their immediate aftermath.[15] Thereafter, the Commission appeared to believe that the Postal Service would have had sufficient time to cut its costs to adjust to the "new normal" volume. *See* Tr. ___ (Nov. 19, 2013). If the period of time for which the Postal Service could recover lost revenues were extended beyond such a limited period, an exigent rate case would return the Postal Service to "cost of service ratemaking" that was rejected in PAEA. Order No. 547, p. 65. Indeed, after the Commission made its determination, it immediately recognized that not even all of the losses from this recession were "extraordinary or exceptional," as some would

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[12] "The Postal Service is not claiming that … any statutory provision, including its obligation to prefund the RHBF, qualifies as an extraordinary or exceptional circumstances." Order No. 547, p. 62 n.50.

[13] The Commission even agreed "that change is warranted regarding certain of the **constraints** cited by the Postal Service [but] [t]hose issues, however, must be decided in a different forum." Commission Order No. 547, p. 65 (emphasis added; note omitted).

[14] "The statement of Joseph Corbett submitted on behalf of the Postal Service effectively demonstrates that the recent recession was unprecedented … in terms of its suddenness…." Order No. 547, p. 50.

[15] As discussed in section VII, *infra*, the Postal Service had net operating profit (excluding RHBF) of $3.031 billion in FY 2007, $2.794 billion in FY 2008, and a loss of $2.340 billion in FY 2009. In the aggregate, over this three-year period, the Postal Service enjoyed a profit of $3.485 million.

be considered "normal."[16] Order No. 547, pp. 50-51. Confirming this understanding, the Commission then based its decision to deny the request solely on the Postal Service's failure "to demonstrate that the specific rate adjustments it proposes are **due to** those [extraordinary or exceptional] circumstances." *Id.*, p. 27 (emphasis added).

C. Issues Never Reached.

Having reached its decision on the threshold "due to" issue, the Commission never reached the other statutory and regulatory preconditions set out in the statute. Therefore, should the Commission reach those issues in this docket, it would do so for the first time. (As the Commission explained in part: "[a]s 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." *Id.*)[17] Indeed, the Commission explained that even if the "extraordinary or exceptional circumstances" test is met, "the Commission must then evaluate factors taken from the House bill to determine whether to permit the adjustment." *Id.*, p. 20.

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[16] In the current docket, the Postal Service's testimony relies heavily on the existence of a liquidity crisis which, in Order No. 547, the Commission previously found would have occurred even if the extraordinary or exceptional circumstance had not occurred. Order No. 547, pp. 68-69.

[17] In its decision, the Commission concluded that although "[c]urrent law does not specifically state who determines whether circumstances are 'either extraordinary or exceptional,'" but then ruled that the statutory scheme requires this decision to be vested in the Commission, not the Governors. Order No. 547, pp. 21-22. (Other mailers, including Valpak had previously commented on the absence of clear statutory language on this point. *See* Valpak Topics for Discussion at June 16, 2010 Technical Conference (June 9, 2010), pp. 2-3.)

D. Commission Observations about PAEA.

In its analysis of the legislative history of PAEA, the Commission did make important observations that inform the current docket. First, the Commission focused on the Congressional purpose in imposing the price cap.

> A price cap also provided the Postal Service with the **proper incentives to control costs**.... The economic theory is reflected in the major goals of PAEA. Its objective "is to position the Postal Service to operate in a **more business-like manner**".... 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**. [Order No. 547, pp. 11, 38 (emphasis added).]

Second, as to the meaning of the "best practices" language, the Commission explained:

> Adding "best practices of" requires the 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.".... [*Id.*, pp. 23-24 (footnote to Report of the President's Commission on the United States Postal Service omitted).]

E. Valpak Comments.

Valpak's Initial Comments and Reply Comments in Docket No. R2010-4 addressed a number of issues, including the ability of the Postal Service to generate operating income both before PAEA (FY 2005 and FY 2006) and after PAEA (FY 2007 and FY 2008). Substantial losses did not occur until FY 2009 and FY 2010. Valpak Initial Comments, pp. 1-7. Valpak discussed the problems posed by PAEA, as well as a variety of Congressional constraints on cost cutting, and its imposition of unrealistic burdens to prefund the Postal Service Retirement Health Benefits Fund ("RHBF"). Valpak Initial Comments, pp. 7-9; SMC/Valassis and

Valpak Answer to AFMA Motion to Dismiss, p. 2. And Valpak disagreed with certain other mailers, disputing allegations of gross mismanagement by senior postal managers. Valpak Initial Comments, pp. 6-7.

Valpak devoted most of its attention to criticizing Postal Service pricing, which created recurring heavy losses for the Postal Service, by protecting underwater products (such as Standard Flats) at the expense of highly profitable products (such as HD/Saturation Letters). Valpak Initial Comments, pp. 9-44; Valpak Reply Comments, pp. 10-38. While Valpak did not specifically oppose all rate adjustments (Valpak Reply Comments, pp. 1-9), it insisted that they must be reasonable, equitable and necessary. Accordingly, Valpak strongly opposed the near across-the-board pricing adjustments within Standard Mail, urging that prices for Standard Flats be increased by at least 8 percent. Valpak Initial Comments, pp. 44-45. Thereafter, Valpak neither participated in the appeal from the Commission's decision nor in the Commission proceedings on remand. These comments continue and expand on the Postal Service's failure to properly price its products in a more business-like manner, which have led directly to losses that completely eclipse the effects of the recession. *See S*ections VI and VI, *infra*.

F. U.S. Court of Appeals.

It should be noted that, on appeal, the U.S. Court of Appeals for the D.C. Circuit never ruled on legality of the Commission's finding that "extraordinary or exceptional circumstances" have occurred. *See* U.S. Postal Service v. Postal Regulatory Commission, 640 F.3d 1263 (D.C. Cir. 2011). Indeed, that was a finding which the Postal Service, understandably, did not challenge. The court addressed the issue raised by the Postal Service concerning the "due to" language, and upheld the Commission's finding that the Postal Service would be required to make a showing of causality between the "recent recession and the decline in mail volume experienced during the recession" and the rate adjustment requested. *Id.* at 1267. The court remanded to the Commission the issue of "determining how closely the amount of the adjustments must match the amount of the revenue lost as a result of the exigent circumstances…." *Id.* at 1268.[18]

G. Post-Remand Proceedings.

Thereafter, the Commission solicited comments on remand, and the Postal Service filed reply comments which urged the Commission to "adopt a standard requiring the Postal Service to demonstrate that the requested increase is 'generally proportional' to the impact of the exigent circumstances…." Postal Service Response (Aug. 1, 2011), p. 3. In those reply comments, the Postal Service expressed its position on two legal issues which are involved in the current docket.

First, with respect to what it calls "the 'necessary under honest, efficient, and economical management' prong of the exigency provision…" the Postal Service offered its legal analysis:

> To the extent the Postal Service has failed to control costs in a manner that is inconsistent with this standard, the Commission

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[18] The court incorrectly noted that the Commission previously had decided that "the 'principal cause of the Postal Service's impending liquidity crisis' is PAEA's mandate that the Postal Service make a $5 billion payment each September through 2016 to prefund its Retiree Health Benefits Fund…." The Commission never determined those payments to be the cause of an "extraordinary or exceptional circumstance." *See* PRC Order No. 864, p. 3 ("[T]he Commission … reiterates … its finding in Order No. 547 that the 2007-2008 recession and its impact on postal volumes constituted exigent circumstances….").

> has a statutory basis to deny or reduce the Postal Service's request. [*Id.*, pp. 7-8.]

Valpak fully agrees with this statement, as discussed in Section IX, *infra*.

Second, the Postal Service states:

> it is not the role of the Commission, or any administrative agency to interpret a statute that it administers so as to incent Congress to take certain legislative action, or to dictate to Congress what an "optimal balance" is when it comes to policy. [*Id.*, p. 8.]

Again, Valpak fully agrees, as discussed in Section III.B., *infra*.

H. Commission Decision on Remand.

In its decision on remand, the Commission concluded that "due to" requires what it called a "close causal nexus" allowing rate adjustments, as follows:

> (1) Exigent rate adjustments are permitted only if, and to the extent that, they compensate for the **net adverse financial impact** of the exigent circumstances;
>
> (2) To quantify the net adverse financial impact of the exigent circumstances, the Postal Service does not have to quantify such impact with absolute precision, but must:
>
> (a) under the circumstances presented, justify its quantification through **supportable methods** commensurate with the amount of the proposed adjustment; and
>
> (b) demonstrate that the amount of the proposed adjustment does **not exceed** the **net adverse financial impact** of the exigent circumstances. [Order No. 864 (Sept. 20, 2011), pp. 2-3 (emphasis added).]

After a series of other procedural developments, including denial of the Postal Service's motion to stay proceedings largely due to pending legislative proposals, and filing of supplemental statements by Thomas E. Thress and Virginia J. Mayes, that docket ended with Order No. 1059, issued December 20, 2011, which authorized certain Postal Service filings.

It should be noted that these supplemental statements by Thress and Mayes were never subjected to questioning, or comments, or Commission rule, thereby playing no role in the litigation of that docket. No further filings occurred in that docket for nearly two years — until the Postal Service unsuccessfully sought to recommence the current exigent rate case within the context of this docket on September 26, 2013.

I. Lessons from Docket.

As explained below, even if a basis for an "extraordinary or exceptional circumstance" loss existed in Docket No. R2010-4, as informed by the Commission's order on remand, Valpak believes that the record now shows that the Postal Service has (i) deliberately ignored major cost-cutting initiatives, and (ii) deliberately chosen to lose money on favored underwater products, which individually and in the aggregate dwarf losses from the 2008-2009 recession, and that by these actions has no longer entitlement to any "extraordinary or exceptional" revenue bump. These comments also address the flaws in the nexus asserted by the Postal Service between the price increase requested in this docket and the Commission's prior finding of an "extraordinary or exceptional" circumstance. *See* Section VII, *infra*.

III. The Postal Service Governors Primarily Based Their Proposed Exigent Rate Increase on two Grounds, Liquidity and Legislation, both of which Are Improper.

During public hearings in this docket, all three Postal Service witnesses at some point demurred to responding to certain questions about the Postal Service Governors, feeling they could not speak to the Governors' decisions in approving the exigent price request.[19] Thus, it might appear difficult for the Commission to ascertain what information the Governors had

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[19] *See also, e.g.*, POIR No. 9, Q. 1.

before them when they authorized the request. However, no speculation is required, as on the day before this case was filed the Governors issued both a letter and a press release to explain their reason for submitting the exigent case. The press release quoted the Governors' letter, stating:

> In a letter disseminated to customers today, Board of Governors Chairman Mickey Barnett described [i] the 'precarious **financial condition**' of the Postal Service and [ii] the 'uncertain path toward enactment of **postal reform** legislation' as primary reasons for seeking price changes above the CPI increase. [Release No. 13-077, "U.S. Postal Service Announces New Prices for 2014" (Sept. 25, 2013) (emphasis added).[20]]

However, neither of the two "primary reasons" relied on by the Postal Service is a permissible ground for filing an exigent case.

A. The Postal Service Governors Based the Exigent Increase Primarily on the Liquidity Crisis.

The Postal Service Request states that witness Nickerson "explains why the requested increases are necessary for the Postal Service to continue providing adequate postal services. As witness Nickerson explains, this wholly inadequate level of liquidity puts the Postal Service in an intolerably precarious position."[21] Request, p. 13.

Witness Nickerson repeatedly relies on alleged Postal Service liquidity problem in his written statement, at one point succinctly asserting:

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[20] http://about.usps.com/news/national-releases/2013/pr13_077.htm.

[21] Of course, the Postal Service attempts to couch the discussion of liquidity in terms of "necessity," and attempts to differentiate that from the "due to" requirement. *See id.*, pp. 15-16. However, the Postal Service is continuing to conflate the two requirements, believing that **any** revenue can be recovered in an exigent increase, whether due to the exigency or not, so long as those revenues are necessary to operate the Postal Service.

> The Postal Service's problem is a lack of adequate liquidity. [Nickerson Statement, p. 5.]

Indeed, the largest portion of witness Nickerson's statement focuses on the Postal Service's past, current, and upcoming liquidity issues, and spending over seven pages of his 18-page statement attempting to demonstrate the "necessity" of the exigent rates, based on the Postal Service lack of liquidity, employing the word "liquidity" 45 times. And, witness Nickerson again confirmed in response to a question of Commissioner Acton at the public hearing that the primary driver of the exigent price increase request is the liquidity crisis. *See* Tr. ____ (Nov. 20, 2013).

If a CPI-based price increase is insufficient for the Postal Service to pay its bills, then it would seem logical that the Postal Service would seek to utilize the only statutory provision which allows it to raise prices. However, this justification for a price increase has been foreclosed. In Docket No. R2010-4, the Commission has already determined that liquidity problems alone are not sufficient reason to trigger the exigent relief valve of 39 U.S.C. section 3622(d)(1)(E):

> [F]or 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. [Order No. 547, p. 60 (emphasis added).]

The Commission confirmed this on remand: "In Order No. 547, for example, the Commission did not find that the financial crisis facing the Postal Service was an extraordinary or exceptional circumstance." Order No. 864, p. 42. Along these same lines, at the hearing, Chairman Goldway explained that Congress did not empower the Commission to cure all of the Postal Service's financial ills by use of an exigent price adjustment. *See* Tr. ____ (Nov. 20, 2013).

In Docket No. R2010-4, the Commission made clear that "the issue presented to the Commission by the Postal Service filing" was "**not** the Postal Service's **current financial condition** [the stark financial picture then presented by Mr. Corbett], 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." Order No. 547, p. 61 (emphasis added). The Commission completely rejected the use of an exigent rate case to return to pre-PAEA ratesetting, saying, "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." *Id.*, p. 65 (emphasis added).

Indeed, the Governors' letter, the Postal Service Request, and witness Nickerson's statement and testimony all demonstrate that this docket is indeed another attempt to return to pre-PAEA cost-of-service ratemaking, seeking to obtain more money from mailers primarily because its cupboards are nearly bare. If indulged here, the Postal Service strategy would result in a complete undoing of the price cap. Once that pricing genie is out of the bottle, it will be impossible to recapture it.

Indeed, the amount of mailers' money at stake is not only the amount of additional revenue sought by the Postal Service — $1.6 billion. POIR No. 5, question 2 asked, "Does the Postal Service intend to 'bank' the $3.64 billion in contribution not requested in this case [from the $6.6 billion alleged loss], possibly to be requested in a future request?" By the careful wording of its response, the Postal Service reserves the right to come back for other alleged losses:

> the Postal Service has no present intention to pursue the balance of the estimated exigent harm (in terms of lost contribution) not requested in this case, assuming that the Commission grants the combined price increases requested in the market-dominant prices cases currently pending.... we hope to be able to maintain sufficient liquidity through 2017 such that the gains from this case would represent the full and final amount of net contribution that the Postal Service expects to request for volume losses from the 2008 – 2012 period. [Postal Service Response to POIR No. 5, Q. 2.]

Moreover, the Postal Service asserts that it could return to seek revenues even beyond $6.6 billion in the **future**. Indeed, Mr. Thress and Mr. Nickerson at the public hearings admitted that they could envision the Postal Service returning to the Commission to recover continuing losses from the 2008-2009 recession for **as long as 20 years**. Tr. ____ (Nov. 19, 2013); Tr. ____ (Nov. 20, 2013).

B. The Pursuit of Postal Reform Legislation Is the Other Primary — but Impermissible — Reason for the Exigent Price Increase Request.

The Governors' second reason for seeking an exigent increase was "the 'uncertain path toward enactment of postal reform legislation.'" *See* Postal Service press release (Sept. 26, 2013). In his "letter to postal customers," Board of Governors Chariman Mickey Barnett told mailers:

> if these financial challenges were alleviated by the timely enactment of laws that close a $20 billion budget gap, the Postal Service would reconsider its pricing strategy. We are … hopeful that legislation can be enacted this year.

A letter to mailers telling them that the exigent case could be avoided by legislation which met the Postal Service's demands would appear to be an open invitation to those mailers to put pressure on Congress to grant those requests.

Throughout the Postal Service's request, the theme of the need for Congressional action is repeated again and again:

- As demonstrated by the materials accompanying the Request, the additional $1.78 billion in contribution is "necessary" for the Postal Service to continue providing effective and adequate postal services, potentially **until such time that Congress** makes fundamental changes to the postal business model. [Request, p. 2 (emphasis added).]

- [T]he additional contribution that would be provided by this increase, in combination with continued efforts to reduce costs, should, it is hoped, ensure that the Postal Service has sufficient liquidity to continue operating in accordance with the statute (except with respect to the retiree health benefits prefunding payments) **until such time as Congress** makes fundamental changes to the Postal Service's business model. [*Id.*, pp. 14-15 (emphasis added).]

- The Postal Service does not expect to be able to rescind the requested increases **until Congress** makes fundamental changes to the postal business model that render the additional contribution provided by this increase no longer necessary. Therefore, a determination of whether and when to rescind the increases must be deferred **until such time as Congress** enacts comprehensive reform legislation. [*Id.*, p. 17 (emphasis added.]

- If the Postal Service's costs reflect constraints **imposed by Congress**, then, by definition, the incurrence of those costs is outside of the Postal Service's control and is not inconsistent with the "honest, efficient, and economical management" standard…. The **political context must also be taken into account**, considering that the Postal Service is not only a governmental entity subject to Congressional control and oversight, but also a governmental entity that is **seeking comprehensive reform legislation** to restore its financial viability. [*Id.*, pp. 18-19 (emphasis added).]

- The Postal Service will also continue to **urge Congress to enact** comprehensive postal reform legislation, because it is **only through such legislation** that the Postal Service can restore its long-term financial viability.... Until the time that reform legislation is enacted, and can be evaluated, it is enough simply to note that the Postal Service, in keeping with its responsibilities of prudent management, is **very active in urging Congress** to authorize measures to enable the Postal Service to truly restore its long-term financial viability. [*Id.*, pp. 34-35 (emphasis added).]

- While the Postal Service has diligently sought comprehensive reform legislation that adequately addresses the shortcomings in its business model, and will continue to do so, the **prospects for such legislation remain uncertain**. [*Id.*, p. 44 (emphasis added).]

Likewise, Mr. Nickerson's statement put the exigent rate increase into the context of its request for legislative action:

- The Governors have therefore determined that, **in the absence of legislation**, it is necessary to seek additional contribution through an exigent price increase. [Nickerson Statement, p. 4 (emphasis added).]

- In fact, **without legislative relief** and/or an exigent price increase, the Postal Service will likely reach a point of insolvency (even putting aside continuing defaults on RHB prefunding) even assuming that significant adverse conditions do not arise. [*Id.*, p. 9 (emphasis added).]

- As the **timely passage of comprehensive postal reform legislation** that adequately addresses the shortcomings in our business model has not occurred in the past three years, nor can it be assured to occur at any time in the future, the Postal Service must consider additional actions to assure that it has sufficient liquidity to continue operations, which is why this increase is being proposed. [*Id.*, p. 14 (emphasis added).]

Lastly, in his statement, Mr. Taufique stated:

- Because of the **slow pace of needed legislative changes**, the Postal Service has developed a pricing proposal that more broadly may be thought of as an **alternative component** to help resolve our financial difficulties. [Taufique Statement, p. 2 (emphasis added).]

- The Postal Service believes that a long-run solution to its financial condition will require **legislative changes** to allow it return to the path of profitable long-term operations and provision of postal services. [*Id.*, p. 3 (emphasis added).]

All of this focus on legislative change might seem reasonable as mere commentary, but the degree of emphasis on this point, plus the manner in which the Postal Service has spoken publicly about it, makes it seem that the Postal Service filing was designed to force Congress' hand to enact legislation the Postal Service desires. Just a week before the Governors approved the exigent price proposal, Postmaster General Patrick R. Donahoe told the Senate Homeland Security and Governmental Affairs Committee:

> **unless** the Postal Service is **given the legal authority** to close the budget gap, an **exigent price adjustment** may be necessary in order to ensure that the Postal Service will be able to maintain and continue the development of postal services of the type and quality the country needs. [Statement of Postmaster General and Chief Executive Officer Patrick R. Donahoe Before the Committee on Homeland Security and Governmental Affairs, Sept. 19, 2013 (emphasis added).] [22]

Through the exigent case filing, pressure is also directed on mailers to get mailers to pressure Congress to pass a bill favorable to Postal Service demands, or their rates will increase. Deputy Postmaster General Ronald A. Stroman, who is in charge of Congressional relations, was hardly subtle when he:

> **urged mailers to assume a larger role in educating their congressional representatives about how an exigent increase would affect their businesses** and local economies back home. ["Deputy PMG: 'Exigent Increase Not a Done Deal,'" Direct Marketing News (Oct. 17, 2013) (emphasis added).]

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[22] http://www.hsgac.senate.gov/download/?id=6c89ea3a-93c8-48cb-b54b-a0ed8b2e1ab1.

The Commission already has determined that pressuring Congress directly, or indirectly, is not a permissible reason for an exigent rate case. In Order No. 864, the Commission stated:

> It is not the Commission's role in an exigent rate proceeding to provide **incentives to Congress**, but rather to apply the law in a manner that is consistent with congressional intent. [Order No. 864, p. 42.]

Then, after the remand of Docket No. R2010-4, the Postal Service sought to stay proceedings pending enactment of legislation the Postal Service wanted in 2011. The Commission rejected that approach out of hand:

> The pending Exigent Request has as its basis the 2008-2009 recession and the impact of that recession on postal volumes. It is those historic circumstances … and their consequences [only] on which a decision will depend. [Order No. 937, p. 9.]

The Postal Service Response to the Commission request for comments on remand (filed Aug. 1, 2011) as much as admitted the flaws of its approach:

> it is not the role of the Commission, or any administrative agency to interpret a statute that it administers so as **to incent Congress** to take certain legislative action, or to dictate to Congress what an "optimal balance" is when it comes to policy. [*Id.*, p. 8 (emphasis added).]

The current exigent price request is being filed, in primary part, to achieve a legislative objective, rather than being based on proper statutory criteria. The Postal Service's continuing attempt to pressure Congress, both directly and through mailers, is designed to enact postal reform sooner. For this reason, the Commission should deny the Postal Service's request.

IV. Witness Thress Has Failed to Provide the Commission with a Reliable Estimate of Volume Losses that Were Due to either Extraordinary or Exceptional Circumstances.

A. The Estimated Decline in Standard Mail Volume Blamed on the 2008-2009 Recession Grossly Overstates the Actual Decline.

The Further Statement of Witness Thress (hereinafter "Thress Statement") supporting information in his sponsored library references, as well as his explanatory responses to Commission inquiries, constitute the only evidence the Postal Service puts forward to estimate the decline in the volume of Standard Mail[23] that is "due to," or can be linked causally to, or blamed on, the recent recession. Witness Thress has been parsing mail volume data for over 25 years, which itself is no small feat. If the Thress estimate of volume lost does not withstand scrutiny, however, the computation of financial loss by witness Nickerson, which is wholly dependent on witness Thress' estimates, also fails and the Postal Service's request cannot be approved by the Commission.

According to the U.S. National Bureau of Economic Research ("NBER"), the recent economic recession officially began in December 2007 and ended in June 2009, lasting approximately 18 months. Witness Thress and the Postal Service embrace, indeed insist on using, the grandiose phrase "The Great Recession," perhaps in a rhetorical effort to invoke thoughts of the "The Great Depression." Instead, the terminology used herein to describe that

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23 These comments address witness Thress' statement with respect to Standard Mail, but the fundamental problem discussed in Part B, *infra*, applies to his entire analysis.

recession is the same as the terminology used by the Commission in its Order Resolving Issues on Remand — "the 2008-2009 recession." Order No. 864, pp. 28-29 (Sept. 20, 2011).[24]

Witness Thress acknowledges the NBER's official dates for the recession,[25] but then suggests a wildly expansive view of that recession, as having had a negative effect on mail volume beginning well before December 2007, with those effects continuing for nearly three decades, including:

(i) **past** volume losses he estimates in his statement until the end of FY 2012 (the five-year past period for which he claims "due to" volume losses), and

(ii) **present** volume losses continuing in FY 2013 and FY 2014,[26] and

(iii) likely continuing into the **future**, for as long as 20 more years. Tr. ___ (Nov. 20, 2013).

Briefly, witness Thress uses an econometric technique which he describes as "decomposition analysis." The Exigent Impact spreadsheet contained in his USPS.R2010-4(R)-10 employs the term "Macro Factors," and the decline in volume attributed by witness Thress to these "Macro Factors" is said to be the volume lost on account of the recession. An examination of the data reveals that an air of unreality, or at least wild speculation, pervades

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24 In its earlier order denying the Postal Service's request, the Commission had referred to it as "the recent recession." *See, e.g.,* Order No. 547, p. 50 (Sept. 30, 2010).

25 Thress Statement, p. 6.

26 Thress Statement, p. 6. ("[T]he **Postal Service's financial losses due to** factors related to and triggered by the **Great Recession continue** to accrue even now, **four years after** the general U.S. economy has been in recovery." (emphasis added).)

witness Thress' estimate of the decline in Standard Mail volume "due to" the 2008-2009 recession.

Sections 1-7 which follow examine and critique the Thress econometric methodology and results as they apply to Standard Mail. Part B comments on a final, fundamental, and fatal flaw in the approach used by witness Thress.

1. Actual Volume Changes, FY 2007 – FY 2012.

It is useful first to review not what witness Thress postulates, but what actually happened during the 2008-2009 recession, and the period immediately following. These comments focus on FY 2008 – FY 2012 — the five years examined by witness Thress.

Table IV-1, *infra*, shows RPW volume data for the five major Standard Mail products during the years FY 2007 to FY 2012.[27] The penultimate row shows the actual change in volume over the entire period, from FY 2007 to FY 2012. On the last row is shown the percentage change from FY 2007 which displays the wide disparity of changes in actual volume of the different products. For example, in FY 2012, the volume of HD/Saturation Letters (column 1) was actually above the 2007 level by a small percentage (2 percent). The Flats product (column 2), on the other hand, was down almost 64 percent, followed by Carrier Route (the other Flats product, shown in column 3), which was down 54 percent. The 2012

[27] The analysis by witness Thress pertains only to the years FY 2008 – FY 2012, but data for the year FY 2007 are shown here because the mail volume in that year is the "starting volume" in his spreadsheet Exigent Impact in USPS.2010-4R.10. (During the period FY 2007 – FY 2012, Standard Mail also contained another product, NFMs/Parcels, as shown in Table 1, column 7. The volume of that product will be omitted from further discussion here because it always was small, and virtually all of that volume now has been shifted to the competitive products category.)

volumes of the other two products (columns 2 and 4) were down by lesser amounts. Collectively, the volume of these five Standard Mail products declined by some 24.3 billion pieces, which was 24.7 percent (column 6) below FY 2007 volume.

Table IV-1

Actual RPW Standard Mail Volumes, FY 2007-FY 2012 (Millions)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Fiscal Year	HD & Sat. Letters	HD & Sat. Flats	Carrier Route	Standard Letters	Flats	Subtotal	NFMs & Parcels	TOTAL
2007	5,449	13,736	15,662	55,085	12,924	102,854	663	103,518
2008	5,599	13,584	12,070	57,086	10,011	98,352	734	99,086
2009	4,996	11,845	9,953	47,109	7,858	81,390	679	82,069
2010	5,428	11,408	9,428	48,508	7,068	81,570	682	82,252
2011	5,654	11,456	9,336	50,720	6,792	83,784	734	84,518
2012	5,564	11,770	9,120	47,103	5,940	78,545	304	78,489
1. Change FY 2007-FY 2012	114	-1,966	-6,542	-7,982	-6,984	-24,309		
2. Percent change	2.0%	-14.5%	-54.2%	-14.0%	-63.8%	-24.7%		

2. Using the Thress Method to Attribute Volume Changes to the 2008-2009 recession.

The Thress analysis includes many variables and employs a large data set that spans far more years than just FY 2007 – FY 2012. Witness Thress uses econometric analysis in an attempt to untangle the major factors which, in his view, explain the volume decline in Standard Mail products. To distinguish the volume changes considered to be (i) "due to" the 2008-2009 recession from those (ii) caused by all other causes, witness Thress classified a number of variables as macro-economic, called here "Macro Factors." Only declines in mail volume statistically associated with these collective Macro Factors are attributed to the 2008-2009 recession. Volume declines associated with non-Macro Factors (*e.g.*, diversion) are not so attributed to the recession.

The actual changes in volume as measured by RPW data are compared with the changes in volume attributed by witness Thress to the 2008-2009 recession in Table IV-2.

- The first row of Table IV-2 repeats the actual decline in volume from the penultimate row of Table IV-1, for the five major Standard Mail products.

- The second row of Table IV-2 shows the change in volume attributed by witness Thress to his Macro Factors, which by his reasoning are attributable to the 2008-2009 recession, including some lingering effects through FY 2012.

- The third and bottom row of Table IV-2 compares the estimates of volume decline attributed to the 2008-2009 recession with the actual decline in volume.

On an aggregate basis, the Thress decomposition analysis blames the 2008-2009 recession for a decline in volume of 29.0 billion pieces of Standard Mail, **25 percent more than the actual decline** of 23.4 billion pieces. That is a strange conclusion, but a closer examination of each of the Standard Mail products makes that conclusion look tame by comparison. The Thress decomposition analysis results in percentages on row 3 of Table IV-2 that vary quite widely, and strangely. The **smallest** percentage decline in volume — only **27.5 percent** — attributed by these products to the 2008-2009 recession occurs in **Carrier Route** (Table IV-2, column 3). The **largest** percentage change in volume is with **Letters**, where the 2008-2009 recession is blamed for an astounding **262 percent** of the volume decline. Since Letters constitute over half of all Standard Mail, this bizarre result makes a huge difference in

Thress' conclusions. More detailed analysis of each Standard Mail product is contained in the following sections.

Table IV-2

Actual Change in Standard Mail Volume, FY 2007-FY 2012, Compared with Volume Change Attributed by Thress to the 2008-2009 Recession
(Millions)

	(1) HD & Sat Letters	(2) HD & Sat Flats	(3) Carrier Route	(4) Letters	(5) Flats	(6) TOTAL
1. Actual volume change, FY 2007-FY 2012	114	-1,966	-6,542	-7,982	-6,984	-23,360
2. Volume change attributed to Macro Factors	-769	-2,006	-1,798	-20,889	-3,592	-29,054
3. Row 2 as a percent of Row 1	n.a.	102.0%	27.5%	261.7%	51.4%	124.4%

3. HD/Saturation ECR Letters.[28]

The year-to-year change in the volume of HD/Saturation Letters is compared with the volume change attributed to Macro Factors in Table IV-3. Part IV-3A shows **Commercial** HD/Saturation Letters, part IV-3B shows **Non-profit** HD/Saturation Letters, and data in the two preceding tables are combined in part IV-3C to show **all** HD/Saturation Letters.[29]

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[28] The category "ECR" has not been used generally by the Postal Service since 2006. The term is retained here to correlate with the terminology in the spreadsheet Exigent Impact. Witness Thress also uses "Basic," another term no longer in use, to refer to the Carrier Route product; *see* response to POIR No.7, Q. 11a.

[29] The source of the data in all Tables here is USPS.2010R.10, spreadsheet Exigent Impact.

In FY 2008, actual volume of both regular and non-profit HD/Saturation Letters actually increased, by a relatively small amount to be sure, while the Thress Macro Factors in the decomposition analysis paradoxically indicate a **decline** in volume that is about equal to the actual **gain** in volume (Table 3C).

In 2009, actual volume of **Commercial** HD/Saturation Letters declined by almost 400 million, but Macro Factors credit the Postal Service with an even larger amount, a decline of 559 million, almost **140 percent** of the actual decline in volume (Table IV-3A). By way of contrast, for **Non-profit** HD/Saturation Letters, the decline in the actual volume was just over 200 million pieces of mail, but Macro Factors are credited with only 57 million pieces, or just **27 percent** of the decline in mail volume (Table IV-3B). The Commission is left with no explanation of these radically different results generated by the Thress decomposition analysis, as he neither acknowledges nor explains this wide divergence in his results between Commercial and Nonprofit HD/Saturation Letters.

Combining Commercial and Nonprofit (Table IV-3C), the actual decline in volume was just over 600 million, while Macro Factors blame the 2008-2009 recession for a loss of 616 million in 2009. On a combined basis, this estimate represents only 103 percent of the actual decline in volume, a much closer correspondence between the econometric estimate and RPW figures (assuming that all of the decline in actual volume during those two years could be attributed to the 2008-2009 recession). Considering the wide divergence between Commercial and Nonprofit, this rather close correspondence in the aggregate numbers for all High-Density and Saturation Letters might be best explained by what econometricians and many accountants sometimes refer to as the law of compensating errors — never thought of as a reliable indicator of statistical or financial accuracy.

Witness Thress attributed none of the change in the volume of HD/Saturation Letters in FY 2010, FY 2011, or FY 2012 to Macro Factors. This, perhaps, is one of the more reasonable, and credible, outcomes of the entire Thress econometric decomposition exercise.

Table IV-3A
Volume of Standard Commercial ECR HD/Saturation Letters
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	4,666.666	4,741.207	74.541	-148.585
2009	4,741.207	4,341.402	-399.805	-559.193
2010	4,341.402	4,736.279	394.877	0.000
2011	4,736.279	4,846.768	110.490	0.000
2012	4,846.768	4,699.118	-147.650	0.000

Table IV-3B
Volume of Standard NP ECR HD/Saturation Letters
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	782.548	857.706	75.159	-4.004
2009	857.706	655.067	-202.639	-57.242
2010	655.067	691.764	36.696	0.000
2011	691.764	807.107	115.343	0.000
2012	807.107	864.440	57.334	0.000

Table IV-3C
Volume of TOTAL ECR HD/Saturation Letters
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	5,449.214	5,598.913	149.699	-152.589
2009	5,598.913	4,996.469	-602.444	-616.435
2010	4,996.469	5,428.043	431.574	0.000
2011	5,428.043	5,653.875	225.832	0.000
2012	5,653.875	5,563.559	-90.316	0.000

4. HD/Saturation Flats & Parcels.

Year-to-year changes in the volumes of HD/Saturation Flats & Parcels are compared with the volume change attributed to Macro Factors in Table IV-4. (The results are similar to those for HD/Saturation Letters, discussed *supra*.)

In FY 2008, HD/Saturation Flats & Parcels saw actual volume decline by the 152 million pieces, whereas the Thress econometric analysis credits the Postal Service with a much larger decline, 415 million pieces, due to the 2008-2009 recession (Table IV-4C). For FY 2008, the Thress Macro Factors thus blame the 2008-2009 recession for an astonishing **273 percent of the actual decline** in volume. (If the 2008-2009 recession somehow truly had caused the Postal Service to lose this much more volume than it actually lost, perhaps it would deserve the "Great Recession" moniker insisted on by the Postal Service.)

In FY 2009, the actual decline in volume was 1,739 million pieces. However, witness Thress blames the 2008-2009 recession for a loss of only 1,590 million pieces, or 91 percent of the actual decline in volume.

For FY 2008 – FY 2009 combined, the Postal Service blames the 2008-2009 recession for 106 percent of the actual decline in volume (perhaps yet another example of compensating errors when the data are aggregated).

In FY 2010 – FY 2012, the Thress Macro Factors did not cause witness Thress to blame the 2008-2009 recession for any volume losses of HD/Saturation Flats & Parcels.

Table IV-4A
Volume of Standard Commercial ECR HD/Saturation Flats & Parcels
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	13,257.358	13,044.284	-213.074	-413.110
2009	13,044.284	11,335.684	-1,708.600	-1.536.928
2010	11,335.684	10,910.173	-425.512	0.000
2011	10,910.173	10,954.802	44.629	0.000
2012	10,954.802	11,230.374	275.572	0.000

Table IV-4B
Volume of Standard NP ECR HD/Saturation Flats & Parcels
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	478.788	539.775	60.987	-2.504
2009	539.775	509.649	-30.126	-53.326
2010	509.649	498.606	-11.043	0.000
2011	498.606	501.599	2.993	0.000
2012	501.599	539.901	38.302	0.000

Table IV-4C
Volume of TOTAL ECR HD/Saturation Flats & Parcels
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	13,736.146	13,584.059	-152.087	-415.614
2009	13,584.059	11,845.333	-1,738.726	-1,590.254
2010	11,845.333	11,408.778	-436.555	0.000
2011	11,408.778	11,456.401	47.622	0.000
2012	11,456.401	11,770.275	313.874	0.000

5. Standard Letters.

Table IV-5 breaks down the yearly volume of Standard Letters as between Commercial and Non-profit. About 80 percent of Standard Letters are regular commercial letters, with the balance consisting of non-profit letters. In FY 2008, FY 2010, and FY 2011, the actual change in the volume of Regular Letters was positive, *i.e.*, volume increased (Table IV-5, part 5A). In each of those years, however, Macro Factors in the Thress decomposition analysis blamed the 2008-2009 recession for significant losses in volume. In FY 2008, for example, actual volume of Standard Letters **increased by just over 2 billion** pieces, but the decomposition analysis “explains” this gain in volume by **blaming the 2008-2009 recession** for a volume **decline of 5 billion** pieces (Table IV-5C).

The actual change in volume of all Standard Letters (column 3) for all five years, taking into account all gains (+) and losses (–) amounts to a decline of about **8 billion** pieces, while the decomposition analysis amazingly reckons that the 2008-2009 recession should be blamed for a loss of almost **21 billion** Standard Letters. Never explained is how witness Thress could decompose an actual decline of 8 billion pieces into a “virtual” decline of 21 billion pieces. *See* Part B, *infra*, for further discussion concerning the premises that underlie such an extraordinary estimate.

Table IV-5A
Volume of Standard Regular Letters
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	44,941.125	46,197.938	1,256.813	-4,927.767
2009	46,197.938	37,088.028	-9,109.910	-10,256.350
2010	37,088.028	38,630.495	1,542.467	-1,478.754
2011	38,630.495	40,817.766	2,187.271	-1,184.301
2012	40,817.766	37,325.745	-3,492.021	-1,167.245

Table IV-5B
Volume of Standard Non-profit Letters
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	10,143.898	10,888.483	744.585	-98.293
2009	10,888.483	10,021.143	-867.340	-1,085.888
2010	10,021.143	9,878.091	-143.052	-288.973
2011	9,878.091	9,901.848	23.757	-45.937
2012	9,901.848	9,776.946	-124.902	-355.923

Table IV-5C
Volume of TOTAL Standard Mail Letters
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	55,085.023	57,086.421	2,001.398	-5,026.060
2009	57,086.421	47,109.171	-9,977.250	-11,342.238
2010	47,109.171	48,508.586	1,399.415	-1,767.726
2011	48,508.586	50,719.614	2,211.028	-1,230.239
2012	50,719.614	47,102.691	-3,616.923	-1,523.168

6. Carrier Route and Standard Flats.

Data for Carrier Route and Flats are shown, respectively, in Tables IV-6 and IV-7. Each of these two products consists largely, perhaps almost entirely, of various types of catalogs. On more than one occasion, the Postal Service and American Catalog Mailers

Association ("ACMA") have explained that catalogers typically use both products, and try to enter as much of their mail as possible at the lower Carrier Route rate, with any residual being mailed at the higher Flats rate.[30]

Comparing data in the two tables for the post-recession years, FY 2010–FY 2012, no lingering effects are attributed to the Carrier Route product (Table IV-6C), whereas the Thress econometric analysis decomposes, or blames, a loss of an amazing 660 million Flats during those same years on the 2008-2009 recession. Table IV-7C. Considering the alleged joint use of these two products by catalogers, it is baffling that the Thress econometrics concludes that **catalogs in the Flats product are profoundly affected** by supposed lingering effects of the 2008-2009 recession, while **catalogs in the Carrier Route product are completely unaffected**. (This observation applies to both Regular and Nonprofit Flats.)

[30] Docket No. ACR2012, ACMA Initial Comments, p. 4.

Table IV-6A
Volume of Standard Regular Basic (Carrier Route)
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	14,253.287	11,141.178	-3,112.109	-376.002
2009	11,141.178	9,027.516	-2,113.662	-1,312.280
2010	9,027.516	8,728.199	-299.316	0.000
2011	8,728.199	8,497.152	-231.048	0.000
2012	8,497.152	8,421.354	-75.797	0.000

Table IV-6B
Volume of Standard Non-profit Basic (Carrier Route)
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	1,408.549	928.999	-479.550	-2.456
2009	928.999	925.831	-3.167	-106.998
2010	925.831	700.084	-225.747	0.000
2011	700.084	838.777	138.693	0.000
2012	838.777	698.592	-140.185	0.000

Table IV-6C
Volume of TOTAL Standard Basic (Carrier Route)
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	15,661.835	12,070.176	-3,591.659	-378.458
2009	12,070.176	9,953.347	-2,116.829	-1,419.279
2010	9,953.347	9,428.283	-525.064	0.000
2011	9,428.283	9,335.928	-92.355	0.000
2012	9,335.928	9,119.946	-215.982	0.000

Table IV-7A
Volume of Standard Regular Flats
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	10,995.633	8,441.165	-2,554.468	-952.666
2009	8,441.165	6,459.261	-1,981.905	-1,809.769
2010	6,459.261	5,748.778	-710.482	-247.867
2011	5,748.778	5,467.345	-281.433	-169.378
2012	5,467.345	4,730.068	-737.277	-152.172

Table IV-7B
Volume of Standard Non-profit Flats
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	1,928.309	1,569.692	-358.617	-16.284
2009	1,569.692	1,399.131	-170.561	-152.445
2010	1,399.131	1,318.876	-80.254	-40.040
2011	1,318.876	1,324.325	5.449	-5.356
2012	1,324.325	1,209.567	-114.759	-46.218

Table IV-7C
Volume of TOTAL Standard Mail Flats
(Millions)

Fiscal Year	Starting Volume	Ending Volume	Actual Change in Volume	Macro Factors
2008	12,923.942	10,010.857	-2,913.085	-968.950
2009	10,010.857	7,858.391	-2,152.466	-1,962.214
2010	7,858.391	7,067.654	-790.737	-287.906
2011	7,067.654	6,791.671	-275.983	-174.735
2012	6,791.671	5,939.635	-852.036	-198.390

7. Thress' Estimates Do Not Withstand Scrutiny and Cannot Be Relied Upon.

To wrap up the Standard Mail product-by-product analysis, just three of witness Thress' conclusions deserve a second mention.

- Witness Thress blames the 2008-2009 recession for an astounding **262 percent of the actual volume decline in Letters**, which constitute over half of all Standard Mail.
- In FY 2008, actual volume of Standard Letters **increased by just over 2 billion** pieces, but witness Thress blames the 2008-2009 recession for a volume **decline of 5 billion** Standard Letters.
- Witness Thress concludes that catalogs in the Flats product are **profoundly affected** by the 2008-2009 recession, while catalogs in the Carrier Route product are **completely unaffected**.

It is submitted that if the Commission is not prepared to accept each of these three specific results of the Thress analysis as being true, then it cannot accept the methodology that generated those results, and must reject the proposed estimate of volume lost based on that methodology, as well as estimates of financial losses derived from the estimate of volume lost.

B. The Assumed Scenario from which Volume Losses Are Estimated Is Supremely Optimistic and Fundamentally Flawed.

1. Growing Imbalances in the Economy Leading Up to the Start of the 2008-2009 Recession.

During the years leading up to start of the 2008-2009 recession, a number of changes occurring in the general economy could be considered unusual, if not extraordinary or exceptional. Examples include: liar's loans; bad mortgages considerably below the level of "junk," which were sliced and diced into tranches, then bundled into packages with fancy acronyms, and, finally, given a AAA rating by credit agencies with huge conflicts of interest; people cashing out equity in their home as though it were an ATM; etc. Looking back, those halcyon days indeed could be referred to as a party in high gear.[31] Unfortunately, as we now

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[31] The analogy brings to mind an earlier chairman of the Federal Reserve, who said that the Fed's job was to remove the punch bowl before the party really got going. Also

know, that party was totally unsustainable. Like a house built on a foundation of sand, it was only a question of when — not if — a correction would occur. As Chairman Goldway asked, should the Postal Service now be required to return the excess profits it earned during the boom years, if it is asking for payment of its losses during the bust years? Tr.____ (Nov. 21, 2013).

Of relevance to the discussion here is that the sophisticated, high-powered econometric models then in use all extrapolated from their extensive data base, but not one predicted any recession, much less a "Great Recession." The business cycle has never been repealed. "Normal downturns" cannot be considered "extraordinary" or "exceptional" circumstances. Recessions, which are really corrections brought on by a build up of imbalances in the economy, have been a recurring fact of life for many generations.[32] The imbalances existing when the 2008-2009 recession began have been well-documented and much discussed.[33] Since the end of World War II, each recession has differed in terms of timing and severity, although

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Charles "Chuck" Prince, then CEO of CitiBank, who famously said "As long as the music is playing you have to get up and dance. And we're still dancing."

[32] For a serious study of the lengthy history of financial crises that predate even the discovery of America by Columbus, see This Time Its Different: Eight Centuries of Financial Folly, by Kenneth Rogoff and Carmen M. Reinhart.

[33] A number of books have been written about the events of those times. See, for example, Henry M. Paulson, Jr., On the Brink; Michael Lewis, The Big Short; Paul Krugman, The Return of Depression Economics; Andrew Ross Sorkin, Too Big to Fail; Joseph E. Stiglitz, Freefall; Alan S. Blinder, After the Music Stopped.

it is true that none was as bad as the 2008-2009 recession. Importantly, the Postal Service has made no effort whatsoever to offset in its model the effect of a more normal recession.[34]

If the Commission were to determine that some amount of losses from the 2008-2009 recession were recoverable, it should never allow recovery for:

(i) theorized losses of mail volume due to the 2008-2009 recession which exceed actual loss of mail volume;

(ii) losses that would occur during a "normal" recession; and

(iii) losses that occur more than one year outside the time span of the official recession as defined by the NBER.

With these constraints, the Postal Service might have sought a price increase carefully designed to recoup "exigent" losses somewhere in the range of $220 million to $420 million, but it did not.[35] In any event, as explained in other sections, the statutory standards for an exigent rate case are not met.

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[34] The 2008-2009 recession is said to have been extraordinary or exceptional because it caused mail volume to decline faster than the Postal Service could reduce its costs. The Postal Service's ability to reduce labor-related costs, which historically have accounted for about 80 percent of total costs, were severely hampered by the inflexibility that resulted from having granted career employees lifetime tenure, coupled with a guarantee of full time (40 hours per week) work. The Postal Service spends significant funds on economic modeling and forecasting, but it too was caught flat-footed.

[35] Excluding payments to the RHBF, the Postal Service had an operating profit of $2,794 million in FY 2008, and operating losses of $2,340 million and $2,874 million in, respectively, FY 2009 and FY 2010, for a cumulative net operating loss during those three years of $2,420 million. *See* Docket No. ACR 2012, Valpak Initial Comments, Table I-1 at 5 (Feb. 1, 2013). http://www.prc.gov/Docs/86/86405/VP%20Complete%20Initial%20Comments.pdf. During those same three years, the Postal Service also had cumulative net losses on underwater products of $4,457 million. *See id.*, Table II-2, at 35. Assuming that approximately half of those losses on underwater products could have been avoided — perhaps $2,000 million to $2,200 million — that would leave $220 million to $420 million of losses that might be considered unavoidable due to the exigent circumstances of the recession.

2. Witness Thress Uses Rosy Baseline Estimates for Volume Lost on Account of the 2008-2009 Recession.

When one conclusion emanating from an elaborate econometric decomposition analysis is that the volume lost "due to" the 2008-2009 recession in a major Standard Mail product such as Letters amounted to fully two and one-half times the actual decline in volume (*see* Table IV-2 or Table IV-5, *supra*), an appropriate inquiry should be: What's going on? If nothing else, it should be abundantly clear that something far more esoteric than the actual decline in mail volume is being "decomposed" by the witness Thress model.

The answer to the preceding question lies in the fundamental assumptions underlying the model used by witness Thress, more than in the manner or details with which he manipulates the equations in his models. Essentially, the baseline from which he estimates lost mail volume results from the scenario he has elected to postulate, which is only one of many possible scenarios that he might have assumed. For reasons discussed below, witness Thress has chosen to model a supremely optimistic scenario from which to estimate volume lost due to the recession. The problem with his estimate of lost volume lies not in his econometrics so much as in his assumed economic scenario. Diligently parsing witness Thress' equations and data for what is essentially the wrong scenario will provide little insight on other scenarios that are (i) considerably more realistic for the circumstances of 2008–2012, and (ii) more pertinent by far to an estimation of volume lost due to an exigent event. Not one of those possible scenarios is mentioned in his statement.

Witness Thress uses his econometric model to extrapolate the "Great Party" scenario to the end of 2012.[36] This baseline from which losses in mail volume are estimated is purely hypothetical — and relies on an assumption of truly heroic scope. With the advantage of hindsight — *i.e.*, a retrospective view of the then-existing imbalances running rampant through the economy — it would not be a stretch to assume that the country was ripe for some kind of correction. However, it is beyond logic and experience to assume, as does witness Thress, that the Great Party which preceded the "Great Recession" was never-ending, and would have continued rolling on unabated right through 2012, along with ever more: (i) liar's loans; (ii) homes sold to purchasers with no job, no income, no assets, and no down payment;[37] and (iii) cash-outs via home-equity loans, etc., perhaps all growing at some compound rate. To assume that the Great Party might have continued unimpeded for another five years through 2012 takes things to a truly extraordinary and exceptional length. In his response to POIR No. 6, Q. 1, for example, witness Thress states:

> The **blue line** in the graph above is **actual mail volume** for First-Class single-piece letters, cards, and flats, **from FY 1992 through FY 2007.**
>
> The **green line** in the graph shows **actual mail volume from FY 2008 through FY 2012.**

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[36] Econometric models rarely exhibit with any degree of accuracy turning points in the economy, especially when more, or even all, of the data series are pointing up. If they could do that with any reasonable degree of accuracy, then all econometricians likely would be wealthy beyond belief.

[37] The acronym "NINJA" — standing for No Job, No Income or Assets — was coined to describe such loans, which obviously had little prospect of ever being repaid.

> The **red** (middle) **line** in the graph removes the mail volume loss attributable to the Great Recession that was identified in my Further Statement in this case. The combined **blue and red lines**, hence, represent my **best estimate** of the path which First-Class single-piece letters, cards, and flats volume would have taken from FY 1992 **through FY 2012 in the absence of the Great Recession.** [Emphasis added.]

Considering the non-sustainable path of the economy in the years immediately preceding the 2008-2009 recession, a far more realistic scenario for developing a baseline would have been to assume a recession, albeit one with characteristics similar to, say, an average of the immediately preceding three, four, or five recessions. Under such an assumed baseline, the decline in volume claimed to be extraordinary or exceptional — *i.e.*, the volume loss attributed to the exigent circumstances of the "super recession" — then would be the difference between (i) the volume the Postal Service would have been expected to lose (and to which the Postal Service presumably could adjust without an exigent rate increase) in a more "typical" recession and (ii) the volume it actually lost.[38] That amount would not even be in the same ballpark as the spurious estimate presented by the Postal Service in this docket.

It is Thress' fundamental assumption about the arrival of economic nirvana and suppression of the laws and experience of the business cycle — at least "through FY 2012 in the absence of the Great Recession" — that enables the econometric model to decompose the data on Standard letters and declare that the "best estimate" is a hypothetical decline in volume that exceeds the actual change in volume by 2½ times. Although not readily apparent, the rosy scenario and estimating procedure of witness Thress embody a host of implicit

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[38] *See* Section II.b, *supra*, noting that the Commission previously found that some losses from a recession would be considered "normal." Order No. 547, pp. 50-51.

assumptions. With those assumptions, an econometrician can reach just about any desired result, as has been proven in this docket.

Econometrics never has been an exact science, and any estimate — be it retrospective or prospective — necessarily involves a degree of uncertainty and inexactitude.[39] However, if the Commission accepts the Thress Statement, it will have attributed to the 2008-09 recession blame for volume losses that never occurred, and hold the Postal Service harmless from the duty to adjust to normal swings in the business cycle. Neither is the Commission entitled to do.

V. Improper Pricing of Underwater Products Has Caused Enormous Losses which Led to the Request in this Exigent Docket, and which Require It to Be Denied.

A. Postal Service Product Losses on Underwater Products since PAEA Have Been Enormous.

The Postal Service's request in this docket is based on its estimated **$6,644 million** loss during the five-year period FY 2008 - FY 2012 allegedly "due to" the 2008-2009 recession. It seeks to recover $1,780 million of that loss by raising the price of market dominant products by an average 4.3 percent. The Postal Service's estimated losses on a cumulative basis are set out in Table V-1.

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[39] For a discussion of fundamental problems with econometrics, see David Hendry, "Econometrics: Alchemy or Science," *Economica*, 47(188):387-406; Edward E. Leamer, "Let's Take the Con Out of Econometrics," *American Economic Review*, 73(1):31-43; Edward E. Leamer, "Tantalus on the Road to Asymptopia," *Journal of Economic Pespectives* 24(2):31-46.

Table V-1
Postal Service Estimated Contribution Losses from 2008-2009 recession
(Millions)

	Cumulative Exigent Contribution Losses[40]
2008	($1,246)
2008-2009	($3,634)
2008-2010	($4,816)
2008-2011	($5,770)
2008-2012	($6,644)

By restricting its focus to estimating losses which it asserts are "due to" the recession, the Postal Service tells only part of the story, ignoring the role of underwater products in causing enormous annual, and cumulative, Postal Service losses. While witness Taufique mentions underwater products only briefly,[41] neither he nor witness Nickerson touches upon how the Postal Service's own pricing choices have created much, if not all, of its current liquidity problem, the consequences of which it now seeks to foist onto all users of market dominant products.

As shown in Table V-2, the Postal Service reports that it lost a cumulative total of **$7,533 million** on underwater products during the same five-year period, FY 2008 - FY 2012, for which it estimates recession-related losses. The bulk of those losses occurred in (i) the two Periodicals products, where it had as a partial excuse that the price cap constrained its ability

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[40] Nickerson Statement, p. 3, Table 2.

[41] Taufique Statement, pp. 6-8.

to increase prices in CPI-increase dockets, and (ii) Standard Flats, where it had no such excuse.

Table V-2
Loss-Generating Market Dominant Products, FY 2008-2012
(Exclusive of Special Services)
(Millions)

Product	FY 2008 Deficit (million)	FY 2009 Deficit (million)	FY 2010 Deficit (million)	FY 2011 Deficit (million)	FY 2012 Deficit (million)	Total (million)
First-Class Parcels	—	—	$1	—	$10	$11
Inbound Int. Single-Piece First-Class Mail	$53	$105	$53	$36	$66	$313
Standard Mail Flats	$228	$622	$582	$652	$532	$2,616
Standard Mail NFMs and Parcels	$167	$208	$178	$117	$53	$723
Periodicals Within County	$5	$15	$25	$20	$29	$94
Periodicals Outside County	$450	$643	$598	$597	$649	$2,937
Single-Piece Parcel Post	$66	$62	$134	$89	$66	$417
Bound Printed Matter Parcels	—	$9	$28	$5	—	$42
Media and Library Mail	$60	$75	$90	$99	$56	$380
Total	**$1,029**	**$1,739**	**$1,689**	**$1,615**	**$1,461**	**$7,533**

Sources: FY 2008-2012 ACRs.

Table V-3 presents both sets of financial loss data side by side, on a cumulative basis, and a remarkable fact emerges. During the same period, the Postal Service actually lost almost **$1 billion more** on its underwater products than it estimates to have lost from the 2008-2009 recession. From FY 2008 - FY 2012, the Postal Service's losses from underpriced underwater products totaled **$7,533 million**, while its estimate of contribution losses from the 2008-2009 recession is **$6,644 million**. Particularly to the extent that the Postal Service identifies liquidity as a primary cause for filing the exigent case (*see* Section III.A, *supra*), had the Postal Service used its pricing flexibility to pare losses on underwater products significantly, it likely would not have any need to seek an exigent price increase at this time. Had the Postal Service merely halved the cumulative losses on its underwater products, liquidity would have been increased by over $3,700 million — which is almost **$2 billion more** than the $1.78 billion it now seeks from the proposed exigent increase.

Table V-3
Contribution Effects of Recession and Underwater Products Compared
(Millions)

	Cumulative Exigent Contribution Losses	Cumulative Underwater Product Losses
2008	($1,246)	($1,029)
2008-2009	($3,634)	($2,768)
2008-2010	($4,816)	($4,457)
2008-2011	($5,770)	($6,072)
2008-2012	($6,644)	($7,533)

B. Prior Comments about Underwater Products under PAEA.

The problem of severe losses from underwater products is certainly not new to the Commission. Valpak has brought to the Commission's attention the problem of products or classes not covering their attributable costs in every Annual Compliance Review. *See* Docket No. ACR2007, Valpak Initial Comments, pp. 44-48; Docket No. ACR2008, Valpak Initial Comments, pp. 12-24; Docket No. ACR2009, Valpak Initial Comments, pp. 9-21; Docket No. ACR2010, Valpak Initial Comments, pp. 23-55; Docket No. ACR2011, Valpak Initial Comments, pp. 41-82; Docket No. ACR2012, pp. 31-59, 122-34. Valpak has made similar comments in every pricing adjustment docket after PAEA. *See* Docket No. R2008-1, Valpak Comments, pp. 9-11; Docket No. R2009-2, Valpak Comments, pp. 24-34; Docket No. R2010-4, Valpak Initial Comments, pp. 16-45 and Valpak Reply Comments, pp. 19-35; Docket No. R2011-2, Valpak Comments, p.4-15; Docket No. R2012-3, Valpak Comments, p. 1-26; Docket No. R2013-1, Valpak Comments, p. 9-41; Docket No. R2013-10, Valpak Comments, pp. 2-4;

The Commission has found noncompliance with respect to Standard Mail Flats in Annual Compliance Determinations for FY 2010, FY 2011, and FY 2012. However, the Commission has made no similar finding of noncompliance for any other product.

C. The Postal Service's Proposed Periodicals Pricing Demonstrates Serious Inconsistency with Prior Actions, and Inconsistency in Dealing with the Commission.

Losses from Periodicals have continued for 13 years, totaling $5,600 million over this period, with $2,183 million of these losses occurring since enactment of PAEA.

Table V-4

Periodicals Class — Revenue, Cost, Coverage, and Cross-Subsidies
FY 1997 — 2012

	(1)	(2)	(3)	(4)
PRC CRA	Revenue	Costs	Coverage	Revenue – Costs
Year	($, mill.)	($, mill.)		($, mill.)
Under PAEA				
2012	1,731.5	2,401.6	72.10%	-670.1
2011	1,821.1	2,430.0	74.94%	-608.9
2010	1,878.8	2,489.8	75.46%	-611.0
2009	2,038.0	2,680.0	76.04%	-642.0
2008	2,294.9	2,732.1	84.00%	-437.2
2007	2,187.9	2,635.6	83.01%	-447.7
Subtotal	**11,952.2**	**15,369.1**	**77.77%**	**-3,416.9**
Under PRA				
2006	2,124.8	2,487.6	85.42%	-362.8
2005	2,068.9	2,431.6	85.08%	-362.7
2004	2,100.0	2,323.3	90.39%	-223.3
2003	2,139.6	2,196.2	97.42%	-56.6
2002	2,066.9	2,280.4	90.64%	-213.5
2001	2,106.9	2,367.1	89.01%	-260.2
2000	2,076.3	2,354.8	88.17%	-278.5
1999	2,017.7	2,213.1	91.17%	-195.4
1998	1,972.8	2,129.0	92.66%	-156.2
1997	1,964.6	2,038.5	96.37%	-73.9
Subtotal	**20,638.5**	**22,821.6**	**90.43%**	**-2,183.1**
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TOTAL	**32,590.7**	**38,190.7**	**85.34%**	**-5,600.0**

The Postal Service repeatedly has explained to the Commission that it considers itself powerless to address the problem of underwater Periodicals in an annual CPI-based pricing adjustment because the price cap operates at the class level, and both Periodicals products are underwater.

However, in Docket No. R2010-4, the first post-PAEA exigent request, the price cap constraint was not applicable. Accordingly, the Postal Service responsibly sought a meaningful **8.035** percent increase on Periodicals. Docket No. R2010-4, USPS Request, p. 15. In the instant case, however, the increase on Periodicals is only about half of that previously requested — **4.297 percent** — essentially the same as for all other classes and products. *See* Docket No. R2013-11, USPS Request, p. 8; Witness Taufique Response to POIR No. 3, Q. 12. What could have led to such a radical change in postal pricing policy?

In Docket No. R2010-4, the Postal Service explained its position at that time as follows:

> This [R2010-4] exigent price request is **not** structured as an **across-the-board** increase similar to the increase proposed in Docket No. R2005-1....
>
> **In developing these prices**, a wide range of considerations were evaluated. These include: the adverse impacts of prices on the demand for mail, particularly for vulnerable customer segments; the tradeoff between market impacts and postal finances; the need to reposition products or categories to meet future demand; promoting operational efficiency; **restoring products or categories to full compensatory status**; and **meeting regulatory requirements**. [Docket No. R2010-4, Exigent Request (July 6, 2004), p. 8.]

For reasons that have not been explained in this docket, it would appear that the Postal Service is now considerably less concerned than it was in Docket No. R2010-4 about "restoring products or categories to full compensatory status" and "meeting statutory requirements." *See, e.g.,* 39 U.S.C. § 3622(c)(2) ("the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail … plus that portion of all other costs of the Postal Service reasonably assignable to such class or type.")

In **Docket No. ACR2010**, the Postal Service recognized that Periodicals would never achieve full cost coverage without above-CPI pricing, and tried to shift responsibility to the Commission for continuing subsidies:

> With the **Commission's denial** of the Postal Service's exigent rate increase request in Docket No. R2010-4, the **Postal Service's plan** for bringing the fourteen products to full attributable cost coverage is **no longer workable**…. [I]t seems most appropriate for the **Commission to determine** whether it can exercise any of its powers to remedy the cost coverage shortfall of the products in question. [FY 2010 ACR, pp. 7-8 (emphasis added).]

The Commission did make the requested determination as to whether it had the authority to order above-cap increases for an entire class, stating that it simply "need not address the scope of remedial powers under section 3653," given that "management has not yet fully brought to bear efficiency enhancements, network adjustments, and related changes…." FY 2010 ACD, p. 17.

The Postal Service repeated its request to the Commission in **Docket No. ACR2011**: "Thus, the Postal Service again encourages the Commission to determine whether it has the authority under the PAEA to raise rates beyond the price cap." Docket No. ACR2011, Postal Service Reply Comments, p. 7. In response, the Commission said that, since it had not made a finding of noncompliance for Periodicals, it need not comment on suggested remedies. FY 2011 ACD, p. 106.

In **Docket No. ACR2012**, the Postal Service did not raise the issue on its own, but after urging from Valpak, the Postal Service in reply comments again agreed that the Commission should determine the scope of its remedial powers:

> Valpak urges the Commission to finally determine what its remedial powers are under title 39 and act accordingly, as repeatedly deferring the issue until 2016 would be irresponsible. The Postal Service **concurs**, but takes exception to Valpak's criticism of the Postal Service for not advising the Commission to do so in the ACR. The **Postal Service has twice asked** the Commission to determine what its remedial powers are, and **twice the Commission has declined** to do so. At this point, the issue is obvious, and hardly needs pointing out. [Docket No. ACR 2012, Postal Service Reply Comments, pp. 4-5 (emphasis added).]

Nevertheless, despite higher unit losses and total losses from Periodicals, the Commission still did not find Periodicals to be out of compliance. *See* FY 2012 ACD, pp. 96-97.

Now the Postal Service is only proposing an average increase for Periodicals, after proposing an 8 percent increase for Periodicals in Docket No. R2010-4. In Docket Nos. ACR2010, ACR2011, and ACR2012, the Postal Service gave the Commission the impression that it believed that Periodicals needed a more significant price increase, and urged the Commission to take on that job. But now, when the Postal Service can follow its own path from Docket No. R2010-4, not bound by the class-wide price cap, it changes direction 180 degrees. Just as it asked the Commission to do, the Postal Service should have used its pricing tools to incentivize more efficient mailer behavior, to impose above-average increases on Periodicals. If the Postal Service were serious about addressing the serious financial drain imposed by Periodicals — a problem on which it sought to pass to the Commission — it would in this docket be requesting a much higher increase for both products in that class.

If the Postal Service's proposed rate increase is not rejected altogether (as it should be), then the case should be remanded with instructions to give a significantly above-CPI increase to Periodicals and move the class much closer to 100 percent coverage of attributable costs.

D. The Postal Service Has Again Chosen Not to Comply with the Commission's FY 2010 ACD Directives for Price Adjustments to Standard Flats.

In the FY 2010 ACD, the Commission ordered the Postal Service: "to increase the cost coverage of the Standard Mail Flats product through a combination of above-average price adjustments, consistent with the price cap requirements, and cost reductions until such time that the revenues for this product exceed attributable costs." FY 2010 ACD, p. 106. When the Postal Service finally provided the also required "schedule of future above-CPI price increases" (*see id.*, p. 107), it stated that it would provide three years of increases for Standard Flats of at least CPI x 1.05. *See* FY 2012 ACR, p. 19. Although the CPI cap does not apply in an exigent case, in the instant docket the Postal Service is giving no extra increase to Standard Flats. Rather than fulfil the Commission's directive to give an above-average increase in each Docket, the Postal Service is relying on another pricing docket (Docket No. R2013-10) for compliance with the policy that each increase is to give a significantly above-average increase for Standard Flats in each pricing docket.[42] The 4.283 percent increase for

[42] The Postal Service's entire discussion of Standard Mail Flats can be narrowed down to two statements by witness Taufique: (i) "The Postal Service is using the CPI case (Docket No. R2013-10) to address most of these underwater products," and (ii) "An above-CPI increase is proposed for both Standard Mail Flats and Standard Mail Parcels, with increases of 1.809 and 1.820 percent, respectively." Taufique Statement, pp. 6-7.

Standard Flats is 0.4 percent above the Standard Mail Class average increase of 4.264 percent, (*i.e.*, average x 1.004). The Postal Service continues to impose as small an increase as it can for Standard Flats, choosing to perpetuate the cross-subsidies extracted from mailers such as Valpak that caused the Commission to find Flats out of compliance in each of the last three ACDs. If the Postal Service feels it has sufficient liquidity to continue the subsidy to Flats, that alone should be sufficient reason to reject the exigent request.

In FY 2012, Flats had unit revenue of 37.6 cents with a unit cost of 46.5 cents, resulting in a cost coverage of 80.9 percent. In Nickerson Statement attachment 25, the Postal Service estimates that Flats' unit revenue will be 40.4 cents with unit costs magically dropping to 43.8 cents, resulting in a cost coverage of 92.2 percent. The Postal Service does not provide sufficient support for its decrease in unit costs, and will not submit FY 2013 cost data by product until its ACR is filed in late December. However, using known costs for FY 2012, it is evident that the cost coverage of Flats appears dramatically overstated in Nickerson's projection. With the increased revenue from the requested exigent and CPI price adjustments, cost coverage only will increase to 86.8 percent (based on FY 2012 unit costs).

The Postal Service gave barely above-average increases in Dockets Nos. R2011-2 and R2012-3 following the FY 2010 ACD remedial order, and the Commission allowed them as "technical compliance." The same has just happened in Docket No. R2013-10, with the Commission stating that it "finds that the Postal Service's proposed price increase for Standard Mail Flats is consistent with the Commission's Directive.... The Postal Service has provided an explanation of how the proposed increases will move the product toward 100 percent cost coverage...." Order No. 1890, pp. 68-69.

If the Commission finds exigent circumstances that justify an exigent increase, the Commission should reject the Standard Mail increase as an unfair perpetuation of an unlawful condition of cross-subsidy.

The FY 2010 ACD remedial order required the Postal Service to "present a schedule of future above-CPI price increases for Standard Mail Flats … **updated with each subsequent Market Dominant Price Adjustment** and ACR until the revenue of the Flats product exceeds its attributable cost." FY 2010 ACD, p. 107 (emphasis added). The Postal Service's recalcitrance towards providing the information sought by the remedial order is well-established. In all five pricing and annual compliance dockets since the FY 2010 ACD,[43] the Postal Service has disregarded the Commission's remedial order. Valpak's Initial Comments in Docket No. ACR2012 provided the history of that noncompliance. *See* Docket No. ACR2012, Valpak Initial Comments, pp. 41-45. Now onto the sixth docket later, the Postal Service again ignores the Commission directive. In this docket, the Postal Service again failed to provide an updated schedule of future above-CPI price increases, failed to explain "how the proposed prices will move the Flats cost coverage toward 100 percent," and failed to provide "a statement estimating the effect that the proposed prices will have in reducing the subsidy of the Flats products."[44] The Commission was again forced to seek information about Standard

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[43] Docket Nos. R2012-3, ACR2011, R2013-1, ACR2012, and R2013-10.

[44] The Postal Service has repeatedly demonstrated "deliberate noncompliance," which authorizes the Commission to levy a penalty against the Postal Service. *See* 39 U.S.C. § 3662(d).

Flats pricing in this docket in POIR No. 2, Q. 9. The Postal Service's institutional response, filed November 8, 2013, was typically devoid of reliable information.

E. Postal Service Improper Pricing of Underwater Products also Demonstrates Lack of Compliance with Preconditions for an Exigent Rate Increase.

In this docket, the Commission's consideration of underwater products is not limited to determining whether prices proposed for underwater products sufficiently improve their coverage. The Postal Service's improper pricing of these underwater products over the years, and continuing even now, undermines the very rational for any price increase at all. It is submitted that when the Postal Service deliberately underprices major products, thereby choosing to lose money in the upcoming fiscal year, it intentionally triggers the following findings in an exigent rate case:

(i) incurring losses which are entirely predictable and avoidable, up to the amount of such losses, other recession-related losses do not qualify as "extraordinary or exceptional;" and

(ii) increasing rates on profitable products to further cross-subsidize losses on underwater products inevitably leads to the finding that those losses are not "reasonable and equitable and necessary"; and

(iii) demonstrating that it is not operating under "honest, efficient, and economical management."

In addition, under Commission regulations, deliberately choosing to incur losses that were (and are) avoidable makes it impossible for the Postal Service to deny that "the circumstances were foreseeable or could have been avoided by reasonable prior action." 39 C.F.R. § 3010.61(a)(7).

For all these reasons, the Postal Service request should be denied.

VI. Nothing Is Extraordinary or Exceptional about a Liquidity Problem Caused by Improper Pricing of Underwater Products over an Extended Period of Time.

The Postal Service's liquidity problem is discussed in Section III.A in the context of the Commission's determination in Docket No. R2010-4 that liquidity problems cannot provide the basis for an exigent pricing adjustment. This section explains why liquidity problems arising from underpricing of underwater products cannot meet the "extraordinary or exceptional" criteria for an exigent case.

Whenever private sector firms do not make wise product, marketing, or pricing choices, and certain of their products do not cover costs, they can encounter liquidity problems. Most firms are highly sensitive to any product which generates losses (and are even sensitive to products which fail to generate reasonable profits), quickly realize the error of their ways, change course (*e.g.*, Ford Motor Company discontinued its ill-fated Edsel), and survive. Sometimes, however, firms continue in denial, never correct their mistakes, and, almost inevitably, end up in bankruptcy, followed either by restructuring or liquidation. The Postal Service, to avoid dealing with what is perhaps the major source of its liquidity problem — underwater products which generated $7,533 million in losses over the five years FY 2008–FY 2012 — now asks the Commission to grant it a cash infusion in the form of an above-CPI price adjustment, largely so that it can be spared the consequences of, and be allowed to continue, its foolish pricing ways.

A. Cash Balances Determine Financial Liquidity.

Cash flows and end-of-year cash balances before and after the proposed exigent rate increases are shown in Attachment 18 to the Nickerson Statement (errata were filed on Nov.

22, 2013). The Postal Service's end-of-year cash balance, or liquidity, is said by Witness Nickerson to be the *raison d'etre* for the exigent rate increase request. An understanding of Attachment 18, along with the supporting documentation, is thus critical to an evaluation of the Postal Service request in this case.

End-of-year cash balances are shown on the bottom row of Attachment 18. Columns 1–5 show, respectively, FY 2012 Actual, FY 2013 Forecast, FY 2014 Forecast Before Rates (BR), FY 2014 Forecast After Rates (AR) from the 1.6 percent CPI increase and the exigent rate increase, assuming implementation on January 26, 2014; and column 5 is a hypothetical for the full fiscal year, *i.e,* assuming implementation of both increases on October 1, 2013.

What should seem obvious is that operating losses reduce liquidity. Table VI-1 shows the Forecast Net Operating Loss derived from Nickerson's Attachments 23-26 (revised Nov. 22, 2013). Each of these four attachments is titled "Contribution by Class of Mail." Despite their title, they do not display the total contribution for any class of mail, nor the total operating loss. Both can computed be readily, however. The Net Operating Losses in Table VI-1 are identical to the top row in Attachment 18, Statement of Cash Flows.

Table VI-1
Forecast Revenues, Costs and Operating Loss
(millions)

(1) Attachment No.	(2)	(3) Total Revenues (millions)	(4) Net Costs (millions)	(5) Operating Loss[45] (millions)
23	FY 2013	$66,102	$71,659	$5,557
24	FY 2014BR	$65,863	$72,566	$6,703
25	FY 2014AR, 1/26/2014	$67,915	$72,507	$4,592
26	FY 2014AR, 10/13/2013	$68,599	$72,343	$3,744

B. Reducing Losses Is Fundamental to Improving Liquidity.

Once the relationship between (i) the Postal Service's net losses shown in Attachments 23-26, and (ii) end-of-year cash balance shown in Attachment 18 is understood, it should be clear that any change in the Postal Service's net operating loss has a direct dollar-for-dollar impact on its end-of-year cash balance, or liquidity. When the net loss is reduced, liquidity is increased. And, conversely, liquidity declines whenever the net loss increases. Consequently, reducing the Postal Service's net loss should be viewed as fundamental to increasing and improving its liquidity.

In Attachments 23-26, total contribution is simply the sum of contributions from (i) each class of market dominant mail, (ii) competitive products, and (iii) special services.

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[45] The figures in this column are computed from the revenues and costs shown here in columns 1 and 2. The Postal Service's net operating loss, *per se*, does not appear in any of the respective attachments. (N.B. The last three rows in each of Attachments 23-26 are mis-labeled. The row labeled "TOTAL ATTRIBUTABLE COSTS" should read simply "Subtotal," the row labeled "OTHER COSTS" should read "Other," and the row labeled "TOTAL COSTS" should read simply "Total." Column headings define the entries on the bottom rows.)

Thus, each dollar of increase in the contribution from a class of mail, *ceteris paribus*, will help improve the Postal Service's total contribution and liquidity by a like amount. With that understanding, we now direct attention to the Standard Mail Section of Attachments 23-26.

Contributions from each product, along with total contribution, are shown here in Table VI-2, below. Two products, Flats and Parcels, have a negative contribution — *i.e.*, they are "underwater."[46] Of late, the loss on market dominant Standard Parcels has been reduced to a *de minimis* amount because the Postal Service has reclassified most Standard Parcels as competitive products. That leaves Flats as the primary drag on contribution from within Standard Mail. All other Standard Mail products make a positive contribution, and the class as a whole makes a substantial contribution.

The fact that prior pricing dockets have operated under a price cap is no excuse for the continuing sustained losses from Standard Flats. As the Valpak revised Contribution Model for Optimizing Contribution from Standard Mail[47] demonstrates conclusively, the first step to improving liquidity now should be — and for at least the last five years should have been — to reduce dramatically and seek to eliminate altogether the annual negative contribution from Standard Flats. Within each class of mail, the price cap limits price increases. It should come as no surprise that using limited cap space to increase prices on underwater products gives the greatest increase in contribution, and liquidity, per unit of cap space utilized.

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[46] Witness Nickerson's projections for FY 2013 include an almost unprecedented across-the-board decline in unit costs. Yet even with this highly speculative costs forecast, cumulative losses on Flats for 2014 and the years beyond 2014 can be projected to continue at hundreds of million of dollars annually.

[47] *See* Section X, *infra*, and the Appendix.

Table VI-2
Contribution from Standard Mail Products
($, millions)

	2012	2013	2014BR	2014AR Exigent w/CPI 1/26/14	2014AR Exigent w/CPI 10/01/13
HD & Sat Letters	420	464	478	495	504
HD & Sat Flat & Parcels	1,051	1,168	1,189	1,240	1,263
Carrier Route	524	679	715	797	836
Letters	3,391	4,484	4,745	5,061	5,061
Flats	**-532**	**-322**	**-276**	**-188**	**-146**
NFMs & Parcels	-53	-6	-5	-2	0
Subtotal	5,341	6,467	6,846	7,403	7,568
Fees	62	58	57	58	59
TOTAL	5,403	6,525	6,903	7,461	7,717

Sources: 2012, FY 2012 CRA.
2013, Attachment 23 to Nickerson Statement (revised 11/22/13).
2014, Attachments 24-26 to Nickerson Statement (revised 11/22/13).

C. Losses on Underwater Products in Standard Mail Are Avoidable.

PAEA gives the Postal Service considerable pricing flexibility within each class of mail. In view of that, losses incurred on underwater products such as Flats are entirely avoidable by responsible Postal Service pricing decisions in the annual rate adjustments. The flexibility afforded by an exigent price increase is not necessary. This means that continuing losses on products, such as Flats, are incurred at the Postal Service's option, *i.e.*, it is (and has been) within the Postal Service's power to eliminate those losses.

If the losses on underwater products were borne solely by the Postal Service, mailers of other products whose rates were protected by the price cap might simply shrug and say, "I am protected by the price cap, so it doesn't hurt me." But when such losses mount, and the Postal

Service requests an exigent rate increase that would be unnecessary but for those losses on underwater products that could and should have been avoided — the short term thinking of the mailers is exposed. In an exigent case, the Postal Service seeks to stick mailers of profitable products with the bill for its bad judgment and improvident management. Good customers get punished unfairly once by being forced to cross-subsidize underwater products, and then are punished unfairly a second time by being forced to restore liquidity to the Postal Service. This could be viewed as both illegal and immoral, a "double whammy," so to speak.

D. Subsidies are the Business of Congress, Not an Organization that Seeks to Be Financially Self-sufficient.

Subsidizing favored postal products is not consistent with financial self-sufficiency. The Postal Service's reticence to impose significant price increases on its underwater products, even as its liquidity steadily eroded, indicates an apparent belief that certain of its products deserve a continuing subsidy. Subsidies, however, are properly seen to be a matter for Congress and the public purse. They are not for an organization that (i) is supposed to be financially self-sustaining, and (ii) suffers from a self-created liquidity problem. If the Postal Service wanted to continue purposely subsidizing its underwater products, it should have sought an appropriation from Congress for that purpose. The Postal Service has no statutory prerogative to pick winners and losers among its customers, deliberately overcharging profitable mailers so it can dole out special favors to underwater mailers, as it has done.

E. Management Failure Lies at the Root of the Postal Service's Liquidity Problem, Not the 2008-2009 Recession.

The $7,533 million in accumulated losses from underwater products did not occur overnight, nor were these losses magnified by the 2008-2009 recession. Table V-3, *supra*, shows that although the Postal Service claims to be the victim of declines in mail volume blamed on the 2008-2009 recession, it intentionally was choosing to incur losses from underpricing products. The Postal Service prefers not to see or discuss the error of its ways. However, by the end of FY 2012, this loss already exceeded the entire amount the Postal Service claims to have lost from the recession over a five-year period. The cumulative loss, of course, will be even higher when the Postal Service reports results for FY 2013 in December. Still further losses are baked into the FY2014AR forecasts in Nickerson Attachments 25 and 26. Since an exigent rate increase is not constrained by the price cap limitation, one purpose should be to bring all underwater products up to 100 percent cost coverage.

Although the Postal Service took some cost-reducing actions in response to the 2008-2009 recession, it did virtually nothing to stem the accumulating loss from underwater products.[48] Both during and following the 2008-2009 recession, prudently managed private sector firms took aggressive action to reduce losses and maintain liquidity. In light of the Postal Service's prior failure to do likewise, it should be seen as having brought upon itself the liquidity problem about which it now complains.

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48 *See* Section VIII, *infra*, for discussion of important cost-reducing actions not taken by the Postal Service.

In prior years, prudent management clearly should have been alerted by losses then being incurred. By taking appropriate action, those losses probably could have been avoided altogether, and could have at least forestalled the current shortfall in liquidity. At a minimum, even now prudent management should be taking much stronger measures to improve the Postal Service's liquidity by reducing losses from underwater products.[49] Under no circumstances should it be proposing an across-the-board price increase designed to penalize equally its most profitable and most unprofitable customers, along with every customer in between. Simply put, that is no way to run a profitable business. It certainly is no way to make the business financially self-sustaining over the long pull.[50] Nor does it satisfy the statutory criterion of "honest, efficient, and economical management."

F. The Liquidity Problem Could and Should Have Been Avoided, and Was Not the Result of Extraordinary or Exceptional Circumstances.

The Postal Service steadfastly declines to use its pricing flexibility in a manner designed to improve its liquidity by reducing and eliminating losses on underwater products. In fact, the Commission's attempt to prod the Postal Service to do so resulted not even in

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[49] The Postal Service request asserts (p. 42) that it has been "diligently pursuing means to avoid an exigent increase following the occurrence of exigent circumstances." So long as it strenuously resists economically efficient pricing of its products, any such claim must be seen as specious.

[50] Ironically, witness Nickerson compares the Postal Service's low level of liquidity with that of two successful private sector firms — FedEx and UPS. He does not, of course, compare the Postal Service's pricing strategy with those two firms, nor for that matter with any other successful private sector company.

grudging acquiescence, but rather in outright resistence and an appeal to the courts.[51] Under the circumstances, the fact that the Postal Service now claims to have a liquidity problem should elicit no surprise. Nothing is extraordinary, exceptional — or even unusual — about a shortfall in liquidity after consciously, knowingly, and deliberately continuing to lose money on underwater products year after year.

The liquidity problem described by witness Nickerson most certainly is not the result of any extraordinary or exceptional circumstance. Nor should it be considered as such, at least not until after the Postal Service has exhausted its options by using its pricing flexibility in a far more rational and businesslike manner to solve its financial problems. The Postal Service needs to be held accountable for its actions and forced to live within its means. That, after all, is the purpose of the price cap. A major cause of the Postal Service's current liquidity shortfall is its previous failure to make **necessary** changes to the prices of underwater products. Even now, the exigent price increase would **not be necessary** if the Postal Service would begin to price its underwater products in an economically efficient manner, which it refuses to do. By its continuing refusal in that regard, the Postal Service should be disqualified from seeking any exigent rate increase. The Postal Service's exigent price request should be denied.

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[51] The Postal Service has failed repeatedly to use its pricing flexibility in a manner that would better protect its liquidity by eliminating losses on underwater products. It has perversely cross-subsidized underwater products at the expense of far more profitable products. Despite these failures, as recently as October 15, 2013, in an appearance before the U.S. Senate Committee on Homeland Security & Governmental Affairs, Postmaster General Patrick R. Donahoe nevertheless testified that "Giving the Postal Service greater flexibility over pricing and product innovation would further advance the goal of providing universal service in a financially sustainable manner." Before the Postal Service seeks even greater pricing flexibility, it should first demonstrate that it has used the pricing flexibility it already has to build a financially successful enterprise.

VII. The Postal Service Cannot Recover for Losses "Due to" Any Reason other than Extraordinary or Exceptional Circumstances.

A. An Exigent Increase Is Not to Be Used as a General Revenue Enhancement Mechanism.

The Postal Service never has identified the full amount that it believes it lost, or will lose, due to the 2008-2009 recession. The Postal Service sought recovery of $1.78 billion from rates in this case. Request, p. 2. It claims, however, that to date it has lost $6.6 billion from the 2008-2009 recession. Nickerson Statement, p. 3. It believes that it could have sought the full amount of this loss, but in order to protect mailers, chose not to do so at this time. Postal Service request, pp. 16-17. However, the Postal Service says that it believes that its losses from the 2008-2009 recession are continuing and will be much larger. Witnesses Thress (Tr. ___, Nov. 19, 2013) and Nickerson (Tr. ___, Nov. 20, 2013) each stated his belief that the Postal Service likely will continue to lose money from this recession for as long as 20 years or even more. The Postal Service never put forth any estimate of what it believed these past, present, and future losses will amount to, but reserved the right to seek exigent price increases based on them for decades to come. Response to POIR No. 5, Q. 2.

The Commission must confront the question as to whether these asserted losses are "due to" the 2008-2009 recession, in accordance with the terms of its order on remand of Docket No. R2010-4 (Order No. 864, pp. 45-52).

In determining that the Postal Service must address when an exigent price increase would be rescinded (39 C.F.R. § 3010.61(a)(6)), the Commission indicates that increases cannot be unlimited in time.[52] Moreover, under 39 C.F.R. § 3010.61(a)(2)-(3), increases cannot be unspecified as to amount. In that the Postal Service violates both of these principles, the request cannot be approved. To violate these principles would allow the Postal Service to escape completely from the discipline of price cap regulation, which the Commission has described as the cornerstone or "centerpiece" of modern rate regulation. *See* Order No. 547, p. 38.

The Commission based its rejection of the first exigent price request solely on the fact that the Postal Service did not tie the requested prices to the exigent circumstances:

> [T]he 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....
>
> 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....
>
> Section 3622(d)(1)(E) does not, however, authorize such open-ended adjustments.... [Order No. 547, pp. 27, 55.]

The Commission explained that the purpose of such an interpretation is that "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." *Id.*, p. 56 (emphasis added).

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[52] Although the Commission did not specify, presumably it intended months, maybe a few years. The Postal Service, on the other hand, sees the "limit" in terms of decades.

The Commission's analysis of the Postal Service's original request is equally applicable to the instant request:

> 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 propose rate increases, **the Postal Service conflates the two** and, as a consequence, fails to demonstrate the nexus between the additional [amount] in annual revenues it seeks, and the exigent circumstances that purportedly give rise to the need for it. [Order No. 547, p. 58 (emphasis added).]

On petition for review from Order No. 547, the Postal Service argued that the Commission requirement of a nexus between the exigent prices and the exigent circumstances was in error. The Postal Service explained its view that once it establishes the existence of exigent circumstances, it is entitled to recover whatever amount it deems "reasonable and equitable and necessary" from an exigent price increase:

> The PRC demanded that the Postal Service look backward at the extraordinary or exceptional circumstances and justify the rate increase as a finely calibrated response to those circumstances. The standard Congress actually supplied entails a broader inquiry with a more practical focus. It asks whether the request is "necessary" to enable the Postal Service to continue to provide quality services.... [USPS v. PRC, U.S.C.A.-D.C. No. 11-1117, Postal Service Brief, pp. 27-28.]

In rejecting this argument, the court of appeals could not have been more clear, "conclud[ing] that the plain meaning of [PAEA] section 201 requires a causal relationship between the exigent circumstances and the proposed rate adjustments...." USPS v. PRC, 640 F.3d 1263, 1267 (D.C. Cir. 2011). The court ordered a remand to the Commission to determine only how closely — not whether — an exigent increase must be tied to the circumstances giving rise to the increase.[53]

On remand from the court of appeals, in Order No. 864, the Commission clarified its interpretation of the nexus required between exigent circumstances and requested price increases. In addition to requiring the Postal Service to quantify the "net adverse financial impact of the exigent circumstances," the Commission requires the Postal Service to "[d]emonstrate that the amount of the proposed adjustment **does not exceed** the net adverse financial impact of the exigent circumstances." Order No. 864, p. 25 (emphasis added). The Commission clearly explained its ruling:

> the Commission concludes that there should be a **close causal nexus** between the **amount** of the proposed adjustment and the net adverse financial impact of the exigent circumstances. This interpretation would best implement the purposes and policies of the PAEA. The words "due to" in the exigency provision prevent the Postal Service from misusing *bona fide* exigent circumstances as a **general revenue enhancement mechanism** that circumvents the price cap. [*Id.*, p. 35 (emphasis added).]

In the instant docket, the Postal Service has attempted to re-litigate an issue that was before the court of appeals as well as the Commission's determination on remand, which the Commission resolved in Order No. 864 (and the Postal Service did not appeal). It would appear that the Postal Service nevertheless continues to believe that once it has made the

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[53] *Id.* at 1268. "We also grant the petition in part, rejecting the Commission's *Chevron* step 1 interpretation of 'due to' as requiring that the Postal Service match the amount of the proposed adjustments *precisely* to the amount of revenue lost as a result of the exigent circumstances."

threshold showing of an exigent circumstance, and having met that test, it now is entitled to whatever price adjustment is "necessary":

> This standard [of necessity] is both expansive in phrasing and fundamentally forward-looking.... Mr. Nickerson's statement explains why the requested increases are **necessary** for the Postal Service to continue providing adequate postal services. In short, the Postal Service's present and forecasted **liquidity position** is dangerously low.... [Postal Service Request, p. 13.]

The Postal Service gives lip service to the Commission's interpretation, but continues to push its expansive interpretation:

> [The Nickerson Statement's] discussion of the Postal Service's overall financial situation is furnished solely to demonstrate why this increase is "necessary" under that aspect of the exigency provision.... While the "due to" clause of the exigency provision has a narrow focus on identifying the "net adverse financial impact of the exigent circumstances" to ensure that the requested increase does not exceed that impact, the "necessary" clause plainly has an expansive scope. [*Id.*, pp. 15-16.]

Elsewhere, the Postal Service explains that it does not need to limit the increases to the exigent circumstances by seeking to have the above-cap prices remain in effect indefinitely: "The Postal Service does not expect to be able to rescind the requested increases until Congress makes fundamental changes to the postal business model that render the additional contribution provided by this increase no longer necessary." *Id.*, p. 17.

The Postal Service stated that the Commission Rules require the explanation relative to rescission "[a]s a corollary to the 'necessary' requirement." *Id.* This erroneous view by the Postal Service helps explain why it refused to provide the required explanation. However, the need to rescind exigent prices does not stem from the "necessary" requirement, but rather is a corollary to the "due to" requirement. The justification for above-CPI prices exists only because of losses sustained on account of extraordinary or exceptional circumstances.

When the Commission created its rules, it was cognizant that an exigent increase could be misused as a general revenue enhancement mechanism. It did not require a more explicit termination of an exigent price increase in its rules, probably because it considered an exigent increase as highly unlikely, declining to adopt "policy statements or specific regulations" regarding rescission of exigent increases because "the state of the record … makes such actions premature." *See* Docket No. RM2007-1, Order No. 43, pp. 72-73.

However, with the record before it in Docket No. R2010-4 and on remand, the Commission was able to conclude that the specific prices in an exigent price increase must have a nexus to the exigent circumstances, and once those demonstrated losses have been recovered, the exigent increases must end, and the Postal Service must return to the CPI-based price cap.

The Postal Service's analysis of "necessary" is entirely detached from the exigent circumstances, and, as the Commission explained in its denial of the first exigent request, "**the Postal Service conflates the** [the exigent circumstance and its liquidity crisis] and, as a consequence, fails to demonstrate the nexus between the additional [amount] in annual revenues it seeks, and the exigent circumstances that purportedly give rise to the need for it." Order No. 547, p. 58 (emphasis added).

B. An Exigent Recovery Must Be Subjected to Limiting Principles.

In Docket No. R2010-4, the Commission rejected the Postal Service's request because it had failed "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." Order No. 547, p. 4.

In the instant docket, the Postal Service postulates the exigent circumstances that necessitate breaching the price cap as being a loss of contribution from a loss of mail volume due to the 2008-2009 recession. It relies on witness Thress to quantify the volume lost due to that recession. However, witness Thress uses a procedure (which he describes as decomposition analysis) that allows the estimated volume lost to greatly exceed the actual decline in volume. Some of his estimates exhibit an air of unreality that borders on flights of fancy. For example, in Standard Mail, witness Thress' model asserts that the Postal Service suffered a volume loss due to the recession of 29.1 billion pieces during FY 2008 – FY 2012, but that is 125 percent of the **actual** volume that was lost (23.4 billion pieces) over that period. Table IV-2, *supra*. *See* Section IV.B, *supra*, for more discussion concerning the estimating procedure used by witness Thress.

Further, the Postal Service attempts to recover lost contribution for years where the Postal Service actually had an operational profit (ignoring the RHBF contribution).

Assuming, *arguendo*, that the Commission determines that there were limited exigent circumstances and that the Postal Service can recover some amount of revenue above the CPI price cap, it then must determine how much revenue can be recovered. It is submitted that an exigent price case should be subject to certain limiting principles:

- The Postal Service should not be allowed to recover losses based on more volume than it actually lost. (*See* Section IV, *supra*.)

- The Postal Service should not be allowed to recover for losses of volume that occurred more than one year after the end of the exigent circumstances.

- The Postal Service should not be allowed to recover more than its operating loss (disregarding RHBF) for a period that does not exceed one year after the end of the exigent circumstances.

- The amount of Postal Service recoverable operating losses should have a 100 percent offset for losses from underwater products. (*See* Sections V and VI, *supra*.)

The reason for recovering no more than actual operating losses is simply to comply with the purpose of the exigent statute. For example, assume that the Postal Service had been profitable for every year for the last five years. Under that circumstance, it should not be allowed to recover revenue lost from a recession-related decline in volume merely because that caused it to lose some contribution. The Commission has clearly stated that the exigent price increase exception cannot be used as a "general revenue enhancement mechanism." Therefore, for example, if the Postal Service is considered to have lost $350 million in operating revenue, the maximum it should be allowed to recover from an increase that breaks the price cap should not exceed $350 million.

As shown in Table VII-1, the Postal Service had a net operating profit of $454 million between FY 2008 – FY 2009. As the Commission already determined that the RHBF prefunding requirement is not an exigent circumstance, and as the Postal Service has demonstrated that it can forgo paying the RHBF payments without immediate legal consequences, in light of the Postal Service's liquidity, those payments that it actually made should not be considered losses that can be recovered by exigent pricing.

Table VII-1
Postal Service Operating Revenue and Expenses
FY 2007 – FY 2013
($, millions)

	FY '07	FY '08	FY '09	FY '10	FY '11	FY '12	FY '13
1. Operating Revenue	74,778	74,932	68,090	67,052	65,711	65,223	67,318
2. Operating Expenses, Ex-Retiree Health Benefits	70,021	70,331	68,440	67,679	68,193	67,235	63,678
3. Op. Profit (Loss) Before Retiree Health Benefits	**4,757**	**4,601**	**(350)**	**(627)**	**(2,482)**	**(2,012)**	**3,640**
4. Health Benefits for Current Retirees	1,726	1,807	1,990	2,247	2,441	2,629	2,850
5. Net Op. Profit (Loss), excluding RHBF	**3,031**	**2,794**	**(2,340)**	**(2,874)**	**(4,923)**	**(4,641)**	**790**
6. Funding of RHBF	8,358	5,600	1,400	5,500	------	11,100	5,600
7. Seven-year net **operating loss**, excluding RHBF							8,163
8. Seven-year cost of RHBF							**37,558**
9. Seven-year total **reported loss**							45,721

Sources: USPS FY 2013, 10-K, pp. 21, 27; USPS FY 2012 10-K, p. 78; USPS FY 2011 10-K, pp. 80 and 89, n.7; and USPS FY 2009 10-K, pp. 63 and 71.

As shown in column 2 of Table VII-2, during 2008-2012, the Postal Service lost $7,533 million on underwater products, $879 million more than it claims to have lost on hypothetical volume. The Postal Service offers an explanation for its difficult liquidity position and the claimed exigent circumstances, but it does not assign the portion of its reduced liquidity due to underwater products. If it had, it would show much less of its loss as attributable to the recession than it claims it experienced.

Table VII-2
Recession Losses vs. Underwater Products vs. Operating Revenue

	Cumulative Exigent Contribution Losses[54]	Cumulative Underwater Product Losses	Cumulative Operating Revenue[55]
2008	($1,249)	($1,029)	$2,794
2008-2009	($3,642)	($2,768)	$454
2008-2010	($4,825)	($4,457)	($2,420)
2008-2011	($5,780)	($6,072)	($7,343)
2008-2012	($6,654)	($7,533)	($11,984)

C. The Postal Service Failed to Address the Treatment of Unused Negative Rate Adjustment Authority.

Should the Commission determine that the Postal Service can recover some revenue from exigent circumstances, it will need to determine for the first time what effect an exigent increase has on the "unused rate authority," *i.e.*, "banked" authority, when it is negative.

Commission Rules require that an exigent request provide, *inter alia*: "An explanation of when, or under what circumstances, the Postal Service expects to be able to rescind the exigent rate adjustments in whole or in part." 39 C.F.R. § 3010.61(a)(6). The Postal Service

[54] Nickerson Statement, p. 3, Table 2.

[55] The Commission determined that the RHBF payments could not be considered an exigent circumstance, and the Postal Service is not intending to use the exigent increase to raise sufficient revenue to make overdue or upcoming RHBF payments. *See* Nickerson Statement, p. 5.

avoided compliance with this requirement by stating that it does not expect to rescind increases absent Congressional action. *See* Request, p. 17.

The requirement of section 3622(d)(1)(E) that there not be "sufficient unused rate authority" before the Postal Service can request an exigent increase implies that the Postal Service must use up any banked authority. The Commission's rules codified this understanding in 39 C.F.R. § 3010.63(c): "Exigent increases will **exhaust all unused rate adjustment authority** for each class of mail before imposing additional rate adjustments in excess of the maximum rate adjustment for any class of mail." (Emphasis added.) The Postal Service filing never addresses compliance with Rule 3010.63(c).

If the Postal Service adopts the suggestion of the Commission in its order approving the pricing changes in Docket No. R2013-10 without Full Service IMb, and subsequently rescinds the requirement to use Full Service IMb, then prices emanating from that CPI-increase docket will form the baseline for any increase in this docket. If any exigent increases are to be allowed under the Commission's rule, it would appear that the negative banked authority must be used first, and then the percentage price increases calculated from that level, not just from the Docket No. R2013-10 rates.

As it does not address the issue, the Postal Service appears to view the negative banked authority as irrelevant. This may be because it hopes the Commission will not address the issue. On the other hand, witness Nickerson explained that the Board of Governors had firmly ruled that the price increase from both dockets not exceed 6.0 percent. However, including the negative banked authority would exceed the Governors' standard, as shown in Table VII-3. Tr. ___ (Nov. 20, 2013). Or it may be possible that the Postal Service does not believe the issue needs to be addressed because it has no intention of ever rescinding any price increase from this docket that breaches the price cap. *See* Request, p. 17. It does not appear, however, that any exigent increases were intended to operate in this manner.

First, assuming all statutory requirements are met, once the exigent rate increase has made the Postal Service whole for whatever prior loss is "due to" the exigent circumstance, the Postal Service would have no entitlement to any continuation of the exigent rate increase, and it should be rolled back. Such a rollback could occur (i) between annual CPI rate increases or (ii) at the next CPI rate increase, but regardless of when it occurs, the pertinent question would be: to what level would the rates be rolled back? It would appear logical that since the effect of an exigent increase on the price cap is to absorb the unused rate adjustment authority (be it positive or negative), rates would be rolled back to a new level below the then-existing rates. At minimum, when the exigent increase is rescinded, the Postal Service either must restore any unused pricing authority — even the negative authority — in the "bank" or prices will have to be decreased by the full percentage increase over authority (thus resetting the bank to zero).

Table VII-3
Proposed Exigent Price Adjustments

Class	Unused Authority[56]	Exigent Increase	Increase Over Authority	CPI Incr.[57]	Total[58]
First-Class	-0.435%	4.280%	4.716%	1.587%	6.370%
Standard Mail	-0.354%	4.264%	4.618%	1.607%	6.294%
Periodicals	-0.429%	4.095%	4.726%	1.664%	6.256%
Package Services	-0.424%	4.308%	4.727%	1.453%	6.248%
Special Services	1.814%	4.318%	2.504%[59]	2.500%	5.112%

Table VII-3 shows banked authority prior to the exigent case, the percentage of the exigent case, and the column labeled "Increase Over Authority" is the total of these two numbers. The Postal Service provided a similar table in its request in Docket No. R2010-4, but failed to provide it in this case. *See* Docket No. R2010-4, Statement of James M. Kiefer, p. 9, Table 1. The CPI increase and the total increase are shown, demonstrating for all products that both price increases exceed the 6 percent maximum approved by the Board of Governors.

"Increase Over Authority" would appear to be the actual level of the price increase from this docket. And, once the "due to" losses are recouped, by law, prices would need to be

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56 From Postal Service Request, Table 3, p. 37.

57 *See* Order No. 1890.

58 CPI Increase x Exigent Increase - Unused Authority.

59 The situation of Special Services demonstrates the need to recognize the impact of an exigent increase on the cap. The Commission must determine that any recision will restore prices to cap compliance. Thus, Special Services prices will need to decrease only 2.504 percent because the Postal Service has unused authority for that class.

decreased by this percentage amount, which would be a price level below current rates. Alternatively, the Commission might allow the Postal Service to return the unused rate authority to the bank. However, if the rescission of the exigent rate increase coincides with an annual CPI-based increase, then those amounts could be offset by any new CPI pricing authority available at that time.

The price cap was explicitly connected to changes in CPI, both increases and decreases. If the Commission does not properly recognize the effect of an exigent increase on the price cap, then it will not know what the price cap is, and it has failed to protect the price cap which is central to the ratesetting system of section 3622.

VIII. The Proposed Exigent Rate Increase Is neither Reasonable nor Equitable.

A. Exigent Rate Increases Must Be Reasonable and Equitable.

PAEA requires that, prior to approving an exigent rate increase, the Commission must determine, *inter alia*: "that such adjustment is **reasonable and equitable**...." 39 U.S.C. § 3622(d)(1)(e).

Commission regulations require that the "exigent request" include "[a] full discussion of why the requested rate adjustments are reasonable and equitable as among types of users of market dominant products." 39 C.F.R. § 3010.61(a)(5). The Postal Service filing addressed this requirement in two paragraphs, with the following summary of the testimony of witness Taufique.

> Mr. Taufique explains in his statement why the requested increases are reasonable and equitable among mail users. As to **reasonable**, while the Postal Service could have requested price increases equaling several billion dollars in contribution, it has **limited itself** to increases equaling $1.78 billion in annual contribution. It did so out of an abundance of caution. The Postal Service is

> mindful that mailers are also facing a slow recovery from the recession, and therefore it is being careful to avoid significant price increases.
>
> As to the **equitable** requirement, Mr. Taufique explains that the burden of the 4.3 percent increase has been **spread equally** across all classes of mail and, as much as practicable, to all products and even to each rate cell, with the limited exceptions he notes. With an exigent circumstance as broad as the recession, the Postal Service believes that it is inherently equitable to seek recovery of lost contribution broadly and uniformly, rather than targeting particular classes or products. [Request, p. 35 (emphasis added).]

Witness Taufique addresses the "reasonable and equitable" requirement in a little over three pages. Taufique Statement, pp. 10-13.

As to the "**reasonable**" requirement, he explains that the 4.3 percent across-the-board increase from the exigent case docket generates an additional annual contribution of $1.78 billion, while the 1.6 percent increase from the CPI case generates an additional annual contribution of $0.58 billion, for a total of $2.36 billion annually from both increases, or about 6 percent in total price increase. He contrasts the annual revenue increase being sought with what he claims to be the $6.6 billion of "annual" contribution losses from the 2008-2009 recession, deeming the tempered revenue increase reasonable.

As to the "**equitable**" requirement, witness Taufique asserts that an across-the-board increase is "clearly equitable." Little more than four lines is devoted to this assertion (*Id.*, p. 11, ll. 9-12), with the balance of his discussion explaining the nuances of why small variations from the 6.0 percent price increase were necessitated in certain instances.

Lastly, witness Taufique discusses the across-the-board increase in the context of Docket No. R2010-4 (which was not across-the-board) and Docket No. R2005-1 (which was) (*id.*, pp. 3-5), and asserts that an across-the-board increase is fair even though several products remain deeply underwater (*id.*, pp. 6-8).

In its decision rejecting the Postal Service's exigent rate increase in Docket No. R2010-4, the Commission stated that the key terms of the exigent exception were "not defined in the statute," and should be given their "ordinary or plain meaning" within "the structure and purpose of the statute." Order No. 547, pp. 24-25. Of course, among the "other factors" and "applicable statutory standards" that apply to pricing adjustments are the factors and objectives of the act. *Id.*, p. 24; 39 U.S.C. § 3622(b) and (c). It is no coincidence that 39 U.S.C. section 101(d) contains a similar requirement: "Postal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis."

The Commission added that the "Postal Service must show that the adjustment is a 'reasonable and equitable and necessary' way to respond to the circumstance." *Id.*, p. 56. Illustrating this requirement with a hypothetical anthrax attack, the Postal Service would be:

> 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. [*Id.*]

B. The Proposed Rates are neither Reasonable nor Equitable nor Necessary.

The sole basis on which the Postal claims that the rates are reasonable is that the Postal Service did not ask for all that it could have. The validity of this statement depends entirely on the accuracy of the Thress forecasts. For the reasons set out in Section IV, *infra*, these inflated forecasts are highly suspect. Further, the Postal Service request is not reasonable because it has not waived the right to collect the balance of the $6.6 billion that it claims to have lost in the period FY 2008 - FY 2012 — but simply postponed that reckoning to another day.

The sole basis on which the Postal Service claims that rates are equitable is that they are being imposed on an equal across-the-board percentage basis. Although this argument has superficial appeal, an across-the-board increase is a type of increase which intentionally disregards existing problems in rates that could be improved, or even fixed completely, in an exigent rate case.

The Postal Service has not demonstrated why its proposal meets the Commission rule that it be "reasonable and equitable as among types of users of market dominant products," and for good reason, as that would be impossible to demonstrate on the facts of this case. For example, the exigent rate increase is being imposed on all mailers by an equal percentage, regardless of whether they use deeply underwater products, or highly profitable products. It is not reasonable to impose a further burden on those mailers who have been and are already carrying the burden of the Postal Service's institutional costs. And this is particularly unfair when the different products in a class are all used by mailers for the same purpose, as is true in Standard Mail, where virtually all Standard Mail is advertising content. Yet within Standard Mail the Postal Service has picked favorites to receive cross-subsidies, and victims from which to extract those cross-subsidies. An exigent increase, where the CPI cap does not apply, gives the Postal Service far more pricing flexibility to implement reasonable rates which at least cover costs. Instead, the Postal Service has chosen to perpetuate an inequitable and unreasonable rate structure which unfairly discriminates against some and unfairly subsidize others. Under proposed rates, the coverages within Standard Mail continue to vary wildly. In order for some Standard Mail users (*i.e.,* advertisers using Standard Flats) to pay below-cost rates, other mailers (*i.e.,* advertisers using the two saturation products) must have their rates surcharged substantially. It defies imagination as to why this could be considered either reasonable or equitable.

Additionally, Periodicals rates should have been adjusted higher as the Postal Service proposed in Docket No. R2010-4 (8.0 percent), but has refused to do the same here in giving only an average increase. Underwater products have caused the Postal Service to lose fully $7.5 billion since enactment of PAEA, seriously harming the Postal Service's liquidity, yet mailers of underwater products are being asked only to make up for an average share of those enormous losses that the Postal Service has incurred solely on their behalf — again, indicating that the Postal Service request is neither reasonable nor equitable.

Lastly, the Postal Service previously has defended continuing underwater losses on the theory that no mailer could be harmed from them, as prices were capped at the class level. The Postal Service's parochial view has been that if no mailer had a price increase greater than CPI, no mailer was harmed, and no mailer had the right to complain about such losses. The profound fallacy of that argument has been exposed in this docket, where the chickens finally have come home to roost. Although the Postal Service was able to cover for its underwater pricing policy for a time, finally the day of reckoning has come, and the Postal Service complains it is suffering from low liquidity. The request should be denied and the Postal Service forced to live with its repeated assertion that losses on underwater products do no harm to other mailers. But the Postal Service now seeks more money in the form of price increases which exceed the CPI cap from those other mailers. Rather than apportion the losses largely to those who caused them, it asks the profitable mailers to pay a pro rata share of the Postal Service's pricing mistakes which benefitted others at the profitable mailers' expense.

The reasonable and equitable standard also can be derived from the factors and objectives of 39 U.S.C. section 3622(b) and (c). Based on those standards, the exigent rate increase fails badly under the facts of this case.

- Rather than "maximize incentives to reduce costs and increase efficiency" it rewards, encourages and perpetuates every bad aspect of Postal Service pricing. The Postal Service will continue to send erroneous pricing signals to mailers, incentivizing them to enter mail which the Postal Service cannot handle efficiently. Objective (1).

- Exigent rate increases above the cap most certainly do not "create predictability and stability in rates." Objective (2).

- Although the Postal Service demands pricing flexibility, when it has it, its creative concept is to have an "across-the-board" increase — the antithesis of pricing flexibility. Objective (4); Factor (7).

- Perpetuating a rate structure based on cross-subsidies is the opposite of "a just and reasonable schedule for rates." Ironically, this Objective specified that it would "not be construed to prohibit the Postal Service from making changes of unequal magnitude...." Objective (8).

- Allowing a rate schedule which would impose a coverage on High Density/Saturation letter advertisers, after rates, of 251.3 percent while continuing to subsidize underwater Standard Flats advertisers — the identical type of mailers — does not have rates that reflect "the value of mail service actually provided each class...." Factor (1).

- Allowing underwater Periodicals to continue being so heavily subsidized, especially when the price cap does not apply, violates "the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service … plus that portion of all other costs of the Postal Service reasonable assignable...." Factor (2).

In addition, for the reasons set out above, not addressing and attempting to solve the problem of unlawful Standard Flats and Periodicals rates in this exigent rate case violates 39

U.S.C. section 101(d): "Postal rates shall be established to apportion the costs of all postal operations to all users of the mail on a fair and equitable basis." Indeed, this is the section of 39 U.S.C. that the Commission has already determined to be violated by Standard Flats pricing in Docket No. 2010ACD.

IX. By Failing to Achieve, or Even Aggressively Seek, Cost Savings Within its Power the Postal Service Has Not Exercised "Best Practices of Honest, Efficient, and Economical Management."

A. Witness Nickerson Has Not Demonstrated that the Postal Service Has Implemented Aggressive Cost-Cutting Measures.

Witness Nickerson's statement addressing "Contribution Lost Due to the Recession" begins with Table 1, "Exigent Volume Losses, FY 2008-FY2012," based on estimates received from witness Thress. He then presents Table 2, "Exigent Revenue and Contribution Losses," based on earlier work of witness Mayes, updated. Witness Nickerson next describes the Postal Service's primary financial problem as a shortfall in liquidity,[60] which shortfall he attributes to inadequate contribution caused by volume loss.[61] To witness Nickerson's way of thinking, Postal Service volume losses inevitably and inexorably translate into Postal Service losses of revenue and contribution. That is exactly the type of thinking that PAEA was designed to root out of the Postal Service. When a private sector firm is confronted by a

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[60] The focus in this section is the Postal Services failure to aggressively implement cost-cutting programs. These comments address elsewhere the Postal Service's "primary" reliance on its liquidity problem, explaining in Section III.A, *supra,* that the Commission already has determined that this is an insufficient basis on which to seek an exigent rate increase.

[61] Witness Nickerson confirmed this fact in a discussion with Commissioner Acton at the public hearing on his statement. Tr. ___ (Nov. 20, 2013).

downturn, it is management's responsibility to cut costs promptly and aggressively to restore the business to economic health.

Witness Nickerson was the only Postal Service witness to attempt to explain Postal Service efforts to reduce costs, however incomplete, in his Section VI, consisting of two pages of his Statement, focusing on changes between FY 2007 and FY 2012.[62] As to providing details, it was not until 4:10 pm on Friday, November 22, 2013 — two business days before initial comments were due — that he finally responded to requests for information about cost reductions which had been posed at the November 1, 2013 technical conference.[63] By any standard, complete documentation of cost savings programs should have accompanied the Postal Service's case in chief in this docket.

The Postal Service has yet to develop the private sector imperative to live within its means, taking only the "low hanging" cost-cutting measures available as volume fell from a FY 2007 high water mark, but continuing to view the exigent rate option as a way to avoid cost cutting measures deemed more difficult. As discussed *infra*, witness Nickerson fails to demonstrate that the Postal Service has come anywhere close to doing all within its power to achieve the statutory standard of having exercised "best practices of honest, efficient, and economical management." Should the Commission allow this exigent rate increase, the Postal Service will be spared the lessons of living within a price cap, and will be protected from the rigors of the marketplace and the necessities of running a lean, efficient operation.

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[62] Nickerson Statement, pp. 12-14.

[63] This filing, entitled "Explanation of Cost Reductions and Other Programs," was designed to update LR K-49 filed in the last exigent rate case.

B. A Reduction in Cost, whether Volume Variable or Fixed, Has an Equally Beneficial Impact on Improving Liquidity and the Bottom Line.

Revenue can be thought of as the Postal Service's top line, while liquidity — or cash remaining after all expenses (or operating income) — is the bottom line. A loss of mail volume and revenue on the top line conceivably could result in less liquidity on the bottom line, but this result is never accepted as a foregone conclusion by American businesses. In the private sector, efficient and economical management strives strenuously to avoid having a reduction in top line revenue cause bottom line losses.[64] In the Postal Service, the difference between revenues in the top line and contribution is attributable cost, whereas the difference between contribution and the bottom line is fixed cost. Between the top and bottom line, many possibilities for cost reduction exist.

In the FY 2012 CRA report, fixed costs accounted for almost 42 percent of total costs (excluding any payments for the RHBF), and reductions in fixed costs directly improve the bottom line. Failure of the Postal Service to consider the huge potential savings available from reducing delivery costs (discussed *infra*) that are (i) within its control, and (ii) considered to be fixed (for purposes of setting prices) is glaring. In response to POIR No. 7, Q. 3.e, discussing the ability of the Postal Service to control its costs going forward, witness Nickerson states:

> To the extent that future volume declines are likely going forward, the Postal Service expects that it **will be able to continue to reduce associated volume variable costs within its control.** However, the effects on liquidity of volume declines, combined with limitations on the Postal Service's ability to adjust

[64] Witness Nickerson points to FedEx and UPS as having more liquidity than the Postal Service.

> its cost structure due to **factors beyond its control**, will inevitably increase the pressures on liquidity. [Emphasis added.]

But the Postal Service is not doing all it can to cut costs. The Postal Service chooses to disregard all too many cost-cutting opportunities as being beyond its control.

C. Cost Reduction Efforts Have Been Pursued at a Leisurely Pace by the Postal Service.

Witness Nickerson asserts that "the Postal Service made numerous cost reductions in response to the revenue loss, which have allowed it to maintain a minimal level of liquidity." Nickerson Statement, p. 4. Certain actions taken by the Postal Service to save money are listed on page 13 of his testimony.[65] This description confirms that, despite the pattern of substantial annual volume losses for a multi-year period, all reductions in work hours were achieved by retirement and separation incentives. Nickerson Statement, pp. 12-13. Amazingly, not one Postal Service career full-time employee was terminated involuntarily. That is a claim which virtually no for-profit mailer which operated during this period could make, including Valpak, which has been forced to right size its business during this same period. Witness Nickerson's discussion of cost-cutting proposals illustrates that, even assuming some volume and revenue loss on the top line is deemed attributable to the 2008-2009 recession, the alleged shortfall in the Postal Service's liquidity is neither a necessary nor an inevitable result of any such decline in mail volume.

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[65] Witness Nickerson does not distinguishes whether those reductions were in attributable or fixed costs, nor is any such distinction necessary, because either way they enhance liquidity on the bottom line.

The requirements for an exigent price increase require the Commission to evaluate whether the Postal Service has reduced costs as aggressively or timely as would be expected from "efficient and economical management." Commission regulations clearly require the Postal Service to demonstrate that the costs incurred could not "have been avoided by reasonable prior action." 39 C.F.R. § 3010.61(a)(7). Failure to do so would also mean that the request for an exigent rate increase is not "necessary."

Without actually using words such as "dire" or "perilous," witness Nickerson implies that the Postal Service, figuratively speaking, has its back to the wall and soon might be unable to meet payroll.[66] Under conditions such as he describes, it is submitted that "best practices of honest, efficient and economical management" **would leave no stone unturned** to find meaningful sources of savings. Toward that end, the Postal Service has advanced some proposals that require Congressional approval before they can be implemented. But the test for an exigent rate case is not what Congress did or did not do, but rather whether the Postal Service did what was in its power to do. Witness Nickerson's Statement and responses appear designed to leave the impression that the Postal Service has done all that it could do, as fast as was possible, to cut costs. This contention does not withstand scrutiny.

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[66] To communicate the gravity of the situation, witness Nickerson's Statement says:

- The forecasted September 30, 2014 liquidity of $2.4 billion … remains **grossly inadequate**. [p. 7, ll. 10-11 (emphasis added).]
- Any number of possible events or circumstances could push the amount of cash at some point during the year below the payroll amount, **imperiling the continued operation** of the organization. [p. 8, ll. 2-3 (emphasis added).]

First, witness Nickerson claims credit for the Postal Service rationalizing the mail processing network by closing hundreds of mail processing facilities, which will eliminate overnight delivery for all First-Class Mail except that which can meet an early Critical Entry Time ("CET"). But witness Nickerson never addresses **when** the Postal Service took the first step to make this happen. In fact, the Postal Service **submitted its proposal** in Docket No. N2012-1, on December 5, 2011[67] — **two years and six months** after the June 2009, end of the 2008-2009 recession — and fully **four years** after the recession started.

Second, witness Nickerson claims credit for outright closure of some small post offices, coupled with reductions in the hours of service at thousands of others. But witness Nickerson also fails to address when the Postal Service took this step. In fact, the Postal Service **submitted its POStPlan** in Docket No. N2012-2, on May 25, 2012[68] — **two years and 11 months** after the June 2009 end of the 2008-2009 recession — and fully **four and one-half years** after the recession started.[69]

In order to meet the efficient and economic management precondition for an exigent rate increase, the Postal Service should be required to demonstrate not just that it has done **some things** — sooner or later — but that it has done **whatever was in its power to do expeditiously and exhaustively.** Witness Nickerson's testimony fails by a wide margin to meet this standard.

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[67] http://www.prc.gov/Docs/78/78332/Request_N2012-1_Final.pdf.

[68] http://www.prc.gov/Docs/82/82765/Request%20Final.pdf.

[69] Interestingly, one common effect of these two cost-savings initiatives is that they reduce the level of service given to **paying** customers. *See* Section IX.D., *infra*.

D. The Postal Service Has Flatly Refused to Pursue the Major Reduction in Fixed Delivery Costs Urged by the Inspector General and the House of Representatives.

The Postal Service Request in this docket asserts that"the Postal Service [has been] diligently pursuing means to avoid an exigent increase following the occurrence of exigent circumstances…." Request, p. 42. One would think that those diligently pursued means would include all cost-cutting measures at its disposal — but, for the reasons discussed herein, they cannot mean that. Neither witness Nickerson's abbreviated coverage of the issue in his Statement nor the late filed "Explanation of Cost Reductions and Other Programs" address potential measures for major savings that were considered and rejected. One such program rejected by the Postal Service is an idea that has not just been discussed extensively by the Postal Service's Officer of the Inspector General ("OIG"), but which soon may be forced on the Postal Service by the House of Representatives — converting expensive door delivery to much less expensive curbside delivery.[70]

The OIG published an extensive report **over two years ago** on this cost-cutting proposal entitled "Modes of Delivery."[71] The OIG determined that by converting existing delivery from door to curbside, the Postal Service could save an astounding **$4.5 billion annually.** Once realized, savings from converting door to curbside delivery:

- would be ongoing,

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[70] G. Strauss, "Could door-to-door Postal Service delivery end soon?" *USA Today* (July 24, 2013). http://www.usatoday.com/story/news/2013/07/23/postal-service-mail-delivery-to-your-door-could-soon-end/2580645/

[71] OIG, Modes of Delivery, DAR-AR-11-006 (July 7, 2011). http://www.uspsoig.gov/sites/default/files/document-library-files/2013/DR-AR-11-006.pdf

- would greatly exceed the $1.78 billion in additional revenues being sought through an exigent rate increase, and

- would not be limited to a one-time recovery for prior losses, as revenues from a lawful exigent rate increase should be.

Highlights from that OIG report include the following:

- "[T]he Postal Service should develop a comprehensive strategic plan to aggressively move from existing door-to-door delivery to curbside delivery, which **could save more than $4.5 billion a year.**" [*Id.*, at 2 (emphasis added).]

- This strategic plan would significantly reduce delivery costs and **could be implemented internally** through policy changes. It **would not require congressional approval,** unlike other significant cost-savings initiatives, such as moving from 6- to 5-day delivery. At the same time, these changes would increase fairness and consistency of service to customers, as curbside delivery would be the primary delivery mode. [*Id.* (emphasis added).]

- **The delivery operation is** the Postal Service's **largest cost center** with mail delivery occurring 6 days a week. **Door-to-door delivery is the most expensive mode** of delivery, costing the Postal Service as much as $353 per delivery point, **totaling $12 billion annually.** Curbside delivery is more cost effective, because it allows the carrier to remain in the vehicle and deliver mail from the street to a mailbox or grouping of mailboxes. [*Id.* (emphasis added).]

- [While] it could be difficult to make these changes, … some deliveries may never be candidates for conversion. On the other hand, **the Postal Service must take every opportunity to cut these significant delivery costs.** [*Id.* at 3 (emphasis added).]

- As of December 31, 2010, more than 35 million door-to-door delivery points exist nationwide, **costing the Postal Service billions in excess costs.** [*Id.* at 4 (emphasis added).]

According to the OIG report, some 51.1 million residences received curbside delivery in 2011 (and another 35.8 million residences received centralized delivery that year). Most of the savings from converting door-to-curb delivery likely would constitute a reduction in fixed costs[72] — not necessarily increasing contribution, but most definitely increasing liquidity.

The Postal Service generally regards both mailers and recipients of mail to be "customers." The Postal Service should note, though, that those who originate mail are **paying** customers, whereas those who receive mail (recipients or addressees) are **non-paying** customers.[73] Why the Postal Service avoids reducing the premium level of service given free to some **non-paying** customers is unclear. If the Postal Service truly were in a financial "crisis," and needed to reduce cash outlays and improve liquidity, it would seem more reasonable for the Postal Service to be concerned about preferences of its **paying** customers, who prefer to keep rates within the CPI cap and who might take their much-needed cash and go elsewhere if prices escalate above CPI.

Witness Nickerson's brief mention of initiatives or other measures to be pursued puts the ball in Congress' court.

> The Five-Year Plan also identifies a number of significant **cost saving initiatives which require legislation**, including the implementation of a Postal Service-sponsored health care plan outside of Federal Employee Health Benefit Plan (FEHBP), refund of Federal Employee Retirement System (FERS) overfunding, and transition to a six-days-per-week delivery schedule for packages and five-day mail delivery. [*Id.* at 14, ll. 3-7 (emphasis added).]

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[72] Curbside delivery would replace foot delivery, hence much of the savings would be a reduction in route time, which is a fixed cost.

[73] Postal Service management opposes the OIG suggestion, and has a ready list of reasons for why it cannot be done. *See* OIG Report, Appendix E. The House of Representatives Committee on Oversight and Government Reform appears not to be impressed.

Witness Nickerson seems to indicate that all feasible opportunities for major cost-savings initiatives are contingent upon Congressional action, but that is certainly not true with respect to conversion of door delivery to curbside delivery. The Postal Service likes to blame Congress for dragging its heels on the Postal Service's cost reduction proposals, but the feeling well could be mutual — *i.e.*, Congress may feel the Postal Service has the flexibility, but not the wherewithal, to achieve cost reductions far beyond those discussed by witness Nickerson, and as a prerequisite would like to see the Postal Service get really serious about running an efficient, lean organization, rather than relying on exigent rate increases in lieu of further cost reductions. This could help explain why Congress seemingly perceives no urgency to move pending postal reform legislation.[74]

Truly, the issue of converting delivery from door to curbside presents the Postal Service with an opportunity for enormous savings, but the Postal Service chooses not to pursue it. It seems strange that Congress may need to impose those savings on the Postal Service, over management's objections. And, in time, as both the volume and value of mail per mail stop decline, while the cost per stop for door delivery continues to creep upward, the economics of converting from door to curbside delivery inevitably will become overwhelming. By refusing to pursue these cost savings, which dwarf the revenue the Postal Service hopes to obtain from price increases sought to be imposed on **paying** customers in its docket, the Postal Service obviously considers it easier, in some sense, to ask for an exigent price increase than

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[74] Witness Nickerson appears intent on putting the blame on Congress when he notes that: "timely passage of comprehensive postal reform legislation that adequately addresses the shortcomings in our business model has not occurred in the past three years, nor can it be assured to occur at any time in the future...." Nickerson Statement, p. 14, ll. 7-10.

to face some irritated, **non-paying** customers. By preferring to impose unnecessary costs on mailers, the Postal Service fails to meet a threshold test for "efficient and economical management."

Indeed, the very filing of the pending exigent rate request indicates that the private sector imperative to do everything possible to live within one's means has not yet engrafted itself into the Postal Service's organizational DNA. Should the Postal Service receive additional funds from an exigent rate case, one can rest assured that it will use that additional revenue to continue to avoid many of the cost-cutting measures and necessary changes that it should be pursuing.

X. Postal Service Pricing Has Reflected neither Efficient nor Economical Management, as Conclusively Demonstrated by Valpak's Updated Standard Mail Contribution Maximizing Model.

A. The Postal Service Has Never Perceived Its Liquidity Problems as Being Sufficiently Serious to Force Management to Properly Price Underwater Products.

Witness Taufique refers to the Postal Service's financial needs as being "urgent." Taufique Statement, p. 2. To borrow from a familiar adage, however, the Commission should look at what the Postal Service does (and has done), not what it says. Within Standard Mail, the Postal Service's pricing decisions now are — and have been for many years — far removed from what might be described as economically efficient. They bear little resemblance to the way any efficiently and economically managed private sector firm would price its products, especially if faced with urgent financial needs. If the Postal Service truly believed that its financial needs were as urgent as asserted, the Postal Service would have proposed dramatically different prices, not only in this docket, but also in Docket No. R2013-10, as well as in prior year price adjustments. The Commission should not be persuaded by claims of financial urgency which are not embraced and acted on by Postal Service management.

As discussed in Section V and Section IX, *supra*, and this Section X, and in the Appendix, results of the Postal Service's pricing decisions fail to achieve any reasonable standard of efficient and economical management. On this ground alone the prices proposed in this docket should be sufficient to disqualify the Postal Service's exigent rate request. However, should the Commission decide to approve some pricing adjustment, it certainly should not be what the Postal Service has proposed. The current proposal should be remanded to the Postal Service with instructions to do far more to enhance liquidity by using its exigent request to propose prices designed to price underwater products at least to 100 percent of attributable costs and end their hemorrhage on Postal Service finances, and it should avoid imposing increases on highly profitable products, particularly those with high elasticity.

Conclusive evidence of the fundamental problems inherent in Postal Service pricing can be seen in Table V-2. As shown there, from FY 2008 to FY 2012 the Postal Service had products whose revenue failed to cover their attributable costs by over $7.5 billion. When Congress enacted PAEA, the Postal Service was given extensive pricing flexibility within each class of mail to encourage financial self-sufficiency. In those classes of mail where its pricing flexibility has been essentially unrestrained by the price cap, as it has been within Standard Mail, Postal Service pricing repeatedly has failed by a wide margin to achieve the contribution and extra liquidity available to it.[75] For Periodicals, the across-the-board exigent request

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[75] For an example, *see* Appendix, Section II-B.

indicates that the Postal Service is not concerned about continued losses of hundreds of millions of dollars annually from that class. Postal Service management must take full responsibility for results of its pricing decisions under PAEA, and those mailers who use products that give financial support to the Postal Service should not be compelled to provide a bailout, while other mailers do not pay a fair share, and indeed pay rates so low that they violate the law.

B. Prudent Management Would Foresee the Consequences of Continuing to Lose Money on Unprofitable Products.

As can be seen from Table V-2, most of the Postal Service's losses on underwater products have not been of a one-time happenstance nature. Instead, losses have continued year after year, for the most part, on the same products. Losses on those underwater products have accumulated steadily to the point where by the end of FY 2012 they totaled $7.5 billion.[76] That cumulative loss exceeds by a comfortable margin (i) the entire $6.6 billion which the Postal Service estimates it lost by virtue of the drop in mail volume which it attributes to the 2008-2009 recession, and (ii) the $1.78 billion sought from its proposed exigent rate increase. Losses on underwater products were neither due to, nor even exacerbated by, the 2008-2009 recession.

In fact, despite being a major source of the Postal Service's declining liquidity, those extensive losses on underwater products receive no mention whatsoever by witness Nickerson. Nevertheless, it is indisputable that from one year to the next the Postal Service clearly knew

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[76] Further serious losses from underwater products are expected to be reported when the Postal Service files its results for FY 2013; *see* Attachment No. 9 to witness Nickerson's testimony.

— or should have known, assuming efficient and economical management — that most of those losses were not only predictable, but also avoidable, hence unnecessary. Prudent management also should have known and foreseen what the cumulative results and long-run consequences would be from such continuing losses. Yet the Postal Service consistently failed to anticipate and adjust its prices in a manner designed to eliminate those losses, or at least reduce them to a bare minimum in any instance where they could not be eliminated. Those avoidable, unnecessary losses on underwater products incurred by the Postal Service — knowingly, deliberately, even purposely — have helped reduce its liquidity to the current low level described so eloquently by witness Nickerson. *See* 39 C.F.R. § 3010.61(a)(7).

Each year, within Standard Mail alone, the Postal Service's annual pricing adjustment has left many million of dollars on the table. It is impossible to reconcile the prices recommended in this docket (or in Docket No. R2013-10) with witness Nickerson's statements of grave concern that the Postal Service's liquidity "remains grossly inadequate" and could at some point "imperil[] continued operation of the organization," including reaching "a point of insolvency." Nickerson Statement, pp. 7-9. Efficient and economical management of a business facing such circumstances would give top priority to survival of the organization and continued provision of universal delivery service, and focus all price adjustments on achieving those priorities, which the Postal Service clearly has failed to do.

If the Postal Service truly feels that its liquidity is so perilously low, then economical and efficient management long ago would have exercised its pricing flexibility to implement pricing decisions aimed at maximizing contribution available within the price cap, well before allowing liquidity to decline to the current level. It most certainly would not have allowed losses due to underpricing of certain products to be perpetuated as they have. For the Postal Service to have reached a point where it feels a need to file for an exigent rate increase because it now has a low level of liquidity that has been severely aggravated by those prior losses, the continued accumulation of which it knowingly has permitted over at least six years, is the very antithesis of efficient and economical management.

C. A Price Increase to Help Management Offset Prior and Continuing Losses on Unprofitable Products Is Not the Purpose of the Exigency Escape Clause.

The Postal Service has yet to provide any rational explanation for its decisions that perpetuate the inequitable pricing of major products below attributable cost. The Postal Service's faulty rationale as to "using up precious cap space"[77] advanced in several dockets has been disproved by the revised Valpak model, discussed herein. Within Standard Mail, annual price adjustments have systematically increased prices on profitable products more than necessary so as to enable continued cross-subsidization of those products which fail even to cover their attributable cost. Rather than trying to keep the playing field level, the Postal Service instead is seen to have played favorites for many years. Now, faced with the possibility of becoming illiquid to the point of being unable to meet payroll, it seeks an exigent rate increase that would enable further perpetuation of existing inequities and cross-subsidization of products which fail to cover their attributable costs.[78] That, however, is

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[77] *See, e.g.,* Docket No. R2013-1, Postal Service Request, p. 23.

[78] The Postal Service's exigent request renders totally specious all prior assertions that the price cap protects mailers of profitable products from paying any part of losses suffered on account of any underwater class of mail.

definitely not what Congress intended when it included in the statute the possibility of a rate increase under "extraordinary or exceptional" circumstances.

D. The Valpak Model for Maximizing Contribution from Standard Mail Shows the Way Forward, while also Illustrating the Extent of Pricing Deficiencies.

To provide the Postal Service and the Commission with a more rational means by which to evaluate pricing decisions in Standard Mail, Valpak developed a model designed to enable determination of prices that would maximize contribution within the confines of the price cap. A prior version of that Valpak model was presented in Docket No. ACR2012. In response, the Postal Service offered the following criticisms of that model:

1. The model used only the elasticity of Standard Regular, as filed by the Postal Service, and failed to consider the possibility that Standard Flats elasticity may differ substantially.

2. The model did not allow for exogenous secular trends in volume, most especially the declining trend in Standard Flats.

3. The model is "static," for one period only.

To respond to those criticisms, the original Valpak model for optimizing contribution from Standard Mail was revised in the following ways, which make it more versatile and user friendly.

- Users of the model now can change the assumed elasticity of each product individually.

- The model now allows for independent secular trends in volume as optional user inputs.

- If independent secular trends are introduced, the model distinguishes between trend-induced and elasticity-induced changes in volume.

- The model now can allow unit costs to increase, and distinguish between nominal and real price adjustments.

The Postal Service was provided with the revised Valpak model on July 13, 2013, well before the commencement of Docket Nos. R2013-10 and R2013-11. The revised model itself is being filed as an Appendix to these comments, along with a complete description of the model, together with a number of sensitivity analyses. Those sensitivity analyses demonstrate that previous criticisms pertaining to elasticity and independent trends are completely without merit. The Postal Service has had no bona fide defense for allowing Standard Flats, along with many other products, to fail to cover volume variable costs year after year. The resulting drain on liquidity has been totally unnecessary. No efficiently and economically managed private sector business ever would permit the continued existence of such a state. Until the Postal Service begins to set prices on Standard Mail products more akin to private sector firms, anaolgies to liquidity maintained by such firms have no relevance, and should be disregarded.

The purpose of the Valpak model is to provide a means of determining the set of prices for Standard Mail products that maximize contribution within the price cap. For each Standard Mail product, the model begins by calculating contribution per unit of price cap space. It then uses those results in an iterative manner to get the most "bang for the buck" from price increases available within the cap.[79] At each iteration, prices are adjusted upward on products with the **highest** contribution **per dollar of price cap space utilized,** and price adjustments are restrained on products with the lowest contribution **per dollar of price cap space utilized.**

As detailed in the Appendix, the basic result remains essentially unchanged. Namely, when a product is losing money because its volume variable cost exceeds the price, increases

[79] The basic approach to maximization of contribution is generally applicable to every class of mail. A similar model could be developed readily for the other classes.

in the price of such a product virtually always and inevitably will increase contribution (and liquidity) faster than will price increases on other products that make a positive contribution. This fundamental contribution-maximizing result is instinctive to every efficiently and economically managed private sector firm. The Postal Service nevertheless perseveres in its wayward manner, never even expressing any meaningful expectation that some day underwater products will earn a sufficient contribution to justify their prior and ongoing losses, but simply hoping that some day those products simply may be able to cover their volume variable costs. Needless to say, efficient and economical management would aim for a higher goal.

To make this perfectly clear, the Valpak revised model is being offered in this docket not for direct application, as prices here are not constrained by CPI, but to inform the Commission as to the distinctively unbusinesslike pricing that has occurred at the Postal Service for a period of many years while under the price cap. For the future, it is sincerely hoped that Postal Service management will use this tool to price its products in a more economic manner in normal, annual, CPI-capped dockets. In the meantime, the Postal Service's current liquidity problem must be seen for what it is — a self-inflicted wound — and the exigent rate case provision in PAEA should not be seen as a "cookie jar" to be dipped into whenever the Postal Service suffers the consequences of its own bad decisions.

CONCLUSION

For the reasons set forth above, the Postal Service's request for an exigent price increase should be denied.

Respectfully submitted,

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