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

RATE ADJUSTMENT DUE TO EXTRAORDINARY OR EXCEPTIONAL CIRCUMSTANCES

Docket No. R2013-11

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE

UNITED STATES POSTAL SERVICE

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ELECTRONIC ATTACHMENTS

Reply Statement of Thomas E. Thress on Behalf of the United States Postal Service

Impact of the Great Recession on Postal Service Market Dominant Finances based on Sources-of-Change Decomposition presented in Response to POIR No. 6, Question 14 (Cumulative.v.Annual.Impact(2).xlsx)

I. INTRODUCTION

On September 26, 2013, the Postal Service filed its renewed Request for Exigent Relief ("Request"), which was docketed by the Commission in this proceeding. On September 30, 2013, the Commission issued Order No. 1847, which established dates for receiving comments in this docket regarding the Postal Service's exigent request. That initial schedule was superseded by Presiding Officer's Ruling R2013-11/1 (Oct. 17, 2013), which set November 26 as the date for initial comments and December 6 as the date for reply comments.

Numerous parties have filed initial comments in the instant docket.[1] With such large number of parties submitting initial comments, rather than address each party's

[1] Comments of the National Mail Handlers Union in Support of Postal Service Request for Rate Adjustment, PRC Docket No. R2013-11 (Nov. 27, 2013); Comments of the Saturation Mailers Coalition; Small Business Legislative Council; Association of Free Community Papers; Independent Free Papers of America; Free Community Papers of Florida, Inc.; Midwest Free Community Papers Association; Wisconsin Community Papers; Texas Community Newspaper Association; Free Community Papers of New York; Mid-Atlantic Community Papers Association; Minnesota Free Papers Association; Community Papers of Michigan; Southeastern Advertising Publishers Association; Pacific Northwest Association of Want Ads Newspapers; and Community Papers of New England (hereinafter "SMC et al. Comments"), PRC Docket No. R2013-11 (Nov. 27, 2013); Comments of Boardroom, Inc., PRC Docket No. R2013-11 (Nov. 27, 2013); Comments of Pitney Bowes Inc. (hereinafter "Pitney Bowes Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Initial Comments of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. (hereinafter "Valpak Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Initial Comments of MPA—The Association of Magazine Media, Association for Postal Commerce, the American Catalog Mailers Association, Inc., Direct Marketing Association, Inc., Alliance of Nonprofit Mailers, Association of Marketing Service Providers, Major Mailers Association, National Newspaper Association, Printing Industries of America, Quad/Graphics, Inc., R.R. Donnelley, Software & Information Industry Association/American Business Media, and Time Inc. (hereinafter "MPA et al. Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Comments of American Bankers Association (hereinafter "ABA Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Software & Information Industry Association and American Business Media, Initial Comments (hereinafter "SIIA/ABM Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Initial Comments of Valassis Direct Mail, Inc. (hereinafter "Valassis Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Financial Services Roundtable and National Association of Mutual Insurance Carriers, Comments in Opposition to USPS Renewed Request to Increase Postal Rates Due to Asserted Exigent Circumstances (hereinafter "FSR/NAMIC Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Public Representative Comments in Response to the Exigent Request of the United States Postal Service (hereinafter "PR Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013; revised Dec. 2, 2013); Initial Comments of the Greeting Card Association (hereinafter "GCA Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013; revised Dec. 3, 2013);

comments in turn, the Postal Service will herein discuss the key issues collectively raised by various parties. Citations to particular parties' comments are included where the Postal Service has provided a specific reply. However, if the Postal Service has failed to address a particular party's comment in any section below, it does not indicate that the Postal Service supports those views. The Postal Service submits that its position on all of the salient issues facing the Commission in this docket has been fully presented in the Postal Service's initial request, its responses to Commission inquiries, and in these reply comments. These materials demonstrate that the Postal Service's Request fully complies with the statute and the Commission's rule, and must accordingly be granted.

These reply comments are organized roughly according to the structure of the Postal Service's Request. Section II addresses criticisms of the Postal Service's quantification of the harm due to the Great Recession. Section III concerns arguments as to the role of liquidity in finding the requested price increase to be "necessary." Section IV clarifies the interaction of the Request with the possibility of postal reform legislation. Section V expands on the Postal Service's exercise of "honest, efficient, and economical management" in adjusting its operations and cost structure to post-recession realities. Section VI discusses why the across-the-board price increases

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Comments of the National Postal Policy Council, the Major Mailers Association, the National Association of Presort Mailers, and the Association for Mail Electronic Enhancement in Opposition to Exigent Rate Increase (hereinafter "NPPC/MMA/NAPM/AMEE Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers in Connection with the Attached Statement of Lawrence G. Buc (hereinafter "Buc Group Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Initial Comments of United Parcel Service on Renewed Exigent Request of the United States Postal Service (hereinafter "UPS Comments"), PRC Docket No. R2013-11 (Nov. 26, 2013); Comments of Sacred Heart Southern Missions, PRC Docket No. R2013-11 (Nov. 26, 2013); Exigent Rate Increase Comments by United States Senator Susan M. Collins (hereinafter "Senator Collins Comments"), PRC Docket No. R2013-11 (Oct. 23, 2013).

proposed here are “reasonable, equitable, and necessary,” despite some commenters’ views. Section VII deals with questions of duration, rescission, and hypothetical future exigent requests. Section VIII responds to one group of commenters’ argument that the equitable doctrine of laches somehow bars the Request. Finally, section IX counters UPS’s unfounded suggestion that the Commission should adjust competitive products’ share of the institutional cost burden as a way to raise liquidity, and section X concludes these reply comments. In addition, the Postal Service includes with this filing two electronic attachments referred to throughout these Reply Comments: a reply statement from witness Thress and a Microsoft Excel file showing contribution losses on both an annual and a cumulative basis.

II. MR. THRESS AND MR. NICKERSON RELIABLY QUANTIFY THE EXIGENT HARM AND PROVE IT TO BE WELL IN EXCESS OF THE VALUE OF THE PROPOSED EXIGENT ADJUSTMENTS

In Order No. 547, the Commission concluded that the Great Recession and its impact on postal volumes constituted exigent circumstances that authorized the filing of a request for exigent relief. In Order No. 864, the Commission stated that to perfect such an Exigent Request, the Postal Service would need to quantify the net adverse financial impact of the exigent circumstances, and demonstrate that the amount of the proposed rate adjustment does not exceed the net adverse financial impact of the exigent circumstances. When filing its Renewed Request for Exigent Relief, the Postal Service presented the Statements of Thomas Thress and Stephen Nickerson to provide the necessary quantifications and demonstration.

The Statements of both Mr. Thress and Mr. Nickerson were the subject of a large number of Presiding Office Information Requests and many questions during hearings. It is the lost volume analysis of Mr. Thress, however, which garnered the lion’s share of attention in the initial comments of the parties, rather than the contribution loss analysis of Mr. Nickerson. Because those comments often overlap in terms of the subjects they address, but vary widely with regard to the level of detail at which they are presented, it is a substantial challenge to attempt to respond in any coherent fashion. The basic structure of this section of the Postal Service Reply Comments is to respond to the various issues raised on these topics in each of the more comprehensive sets of comments, but within those discussions, address related comments from other parties as appropriate. The result is a structure that is neither purely party-based nor purely subject-based, but something of a blend which allows for more efficient discussion of the matters to be addressed.

In order to respond to certain matters raised in the initial comments and accompanying statements, the Postal Service is filing a Reply Statement from Mr. Thress. As noted in the introduction to these Reply Comments, that Reply Statement of Mr. Thress is attached to these Reply Comments.

A. The Postal Service Has Diligently Followed the Guidance Provided in Order No. 864 to Quantify the Net Adverse Financial Impact of the Exigent Circumstances, and Has Plainly Met the Standards Established in That Order

Before addressing specific comments that have been submitted criticizing the analysis of lost contribution presented in the Statements of Thomas Thress and Stephen Nickerson, it is necessary to identify the standards against which those criticisms should be evaluated. In Order No. 547 (Sept. 30, 2010), denying the Postal Service's original request for exigent relief, the Commission found that the Postal Service had failed to quantify the effects on postal finances of the Great Recession, which were only identified as the relevant exigent circumstance for the first time in that

Order. Following judicial review, remand, and a series of comments from interested parties, the Commission issued Order No. 864 on September 20, 2011, resolving a number of issues on remand. Most relevantly to this discussion, Order No. 864 sought to establish standards to evaluate the quantification it had previously found lacking, and offered specific guidance on how those standards could be met.

The standards discussed in Order No. 864 relate to the evidence necessary to demonstrate the causal nexus required by the statutory "due to" clause. The Postal Service and other parties who had supported the grant of exigent relief were concerned that an unrealistic standard not be adopted. These "administrative feasibility concerns" highlighted the expedited 90-day review period in an exigent rate case proceeding, the difficulties inherent in untangling the interaction of multiple factors, and other difficulties in compiling information that might constrain the Postal Service's ability to determine the effect of a particular exigent circumstance and to accomplish other critical tasks. Order No. 864 responded to these concerns as follows:

> These concerns are misplaced. They are predicated upon the assumption that the causal nexus of "due to" requires a "strict level of precision," "absolute precision," or "perfect proportionality." Id. at 15. However, as the discussion in the preceding Sections IV.C.6.a-d makes clear, the required showings do not require the extreme degree of precision assumed by the Postal Service. The Postal Service is not expected to engage in "a quixotic search for perfect proportionality…." Id. It is simply expected to support its exigent request with credible proof of the type described above.

Order No. 864 at 52. Along similar lines, the Order found that:

> In its calculation, the Postal Service is not required to quantify the net adverse financial impact of the exigent circumstances with absolute precision. The commenters agree that calculating the net adverse financial impact of the exigent circumstances will always involve some degree of imprecision. . . . In summary, the Commission requires the

> Postal Service to quantify the net adverse financial impact of the exigent circumstances, but does not require absolute precision.

Id. at 48-49.

Moreover, Order No. 864 offered both general guidance, and guidance specifically relevant to quantifying the harm from the precise set of exigent circumstances already identified: the volume lost due to the Great Recession.

> Regardless of the nature and amount of proof required, the quantification offered by the Postal Service to support an exigent request must be justified through supportable methods commensurate with the amount of the proposed adjustment. Vague generalizations and unsupported conclusory statements are not sufficient. Historically, the Postal Service has demonstrated an ability to develop and refine methodologies for measuring and projecting costs in a variety of Commission proceedings. Using sophisticated data collection and estimation methodologies, as well as expert opinions and statistical analyses, the Postal Service has been able to address difficult financial and economic estimation problems. Such tools are available in exigent rate case proceedings as they have been in other Commission contexts.
>
> The Postal Service has the resources and ability to justify its quantification through supportable methods commensurate with the amount of the proposed adjustment. It undertakes similar calculations by quantifying the effects of electronic diversion on First-Class Mail volume in periodic reports that it submits to the Commission. Each year, the Postal Service must provide econometric estimates of demand elasticity for all postal products accompanied by the underlying econometric models and input data sets used. 39 CFR 3050.26. The Postal Service uses a volume forecasting methodology that enables it to distinguish and account for the impact of multiple factors that have affected First-Class Mail volumes. <u>The Commission expects the Postal Service to apply similar methodologies to quantify the net adverse financial impact of the exigent circumstances.</u>

Id. at 49-50 (footnote omitted, emphasis added).

The Commission stated a clear expectation in Order No. 864, therefore, that the Postal Service would provide an analysis of mail volume lost due to the Great Recession that was integrated with the sophisticated demand analysis and volume forecasting procedures that the Postal Service has developed over many decades, and upon which both the Postal Service and the Commission have mutually relied during that time span. In presenting such an analysis, however, the Commission made clear an additional expectation: "When quantifying the net adverse financial impact of the exigent circumstances, the Postal Service must factor out the financial impact of non-exigent circumstances, such as the continuing effects of electronic diversion." *Id.* at 48. Similarly, in "demonstrating the requisite causal nexus, the Postal Service is required to exclude non-exigent impacts, such as the on-going electronic diversion of mail volumes." *Id.* at 42. Of course, in the above-quoted passage from page 50, the Order already expressed recognition that understanding and quantifying demand factors such as those causing electronic diversion are already topics to which substantial and continuing attention has been paid in developing and applying the Postal Service's ongoing demand analysis and forecasting models.

Order No. 864 did not stop there, however. Having indicated its expectation for how the relevant *volume* losses would be determined, the Commission further indicated how the lost volumes should be translated into the required quantification of net adverse financial impact:

> The Commission finds that exigent rate adjustments must be causally linked to the *net* adverse financial impact of the exigent circumstances rather than the amount of revenue lost. Given the exigent circumstances found to have occurred in this case, the net adverse financial impact would consist of the lost contribution associated with the volume declines from the 2008-2009 recession.

Id. at 45 (emphasis in original). Taken as a whole, then, Order No. 864 clearly contemplates a straightforward two-step process: (1) identify the amount of mail volume that has been lost due to the Great Recession and (2) quantify the net adverse financial impact of that lost volume. The latter step involves calculating the net contribution to institutional cost that has not been possible because the volume expected to make that contribution is gone from the system. Order No. 864 leaves no doubt that the volume loss decomposition and the subsequent conversion of lost mail pieces to lost contribution dollars should be accomplished in conjunction with the Postal Service's ongoing statistical and financial models, bolstered by expert opinion.

It is not surprising that, when addressing the burden and feasibility of the expectations being articulated, Order No. 864 would express confidence in the Postal Service's ongoing demand analysis and forecasting efforts. For a host of reasons, the Postal Service needs accurate volume forecasts. Consequently, as new volume data become available at the end of each quarter, the Postal Service has a team that is examining those data and assessing how the forecasting models are performing. In recent years, unfortunately, the results that they are assessing reflect volume declines, not the general pattern of volume growth exhibited over the decades preceding and following the Postal Reorganization Act. When volumes are declining, the pressing question becomes, why are they declining? If pieces of mail that were in the system previously are no longer here this year, the Postal Service needs the best possible explanation of why in order to project whether those pieces are likely to be returning next year or not.

Therefore, instead of reliance on vague generalizations or conclusory statements about "official" recession dates, new gadgets, and the like, the Postal Service employs sophisticated estimation procedures, constantly refined to attempt to respond to the ever-changing postal environment, with the sole objective of providing the best possible volume forecasts. The team making those forecasts knows that their forecasts of the future will be compared with actual results as that future unfolds. Having constantly to be looking backward to understand past volume trends, and simultaneously looking forward to anticipate future volume trends, gives experience and perspective and, quite frankly, accountability, that others who start looking at these matters on an *ad hoc* basis may be lacking. By no means does this process always produce perfect projection of future mailer behavior, but the nature of the exercise compels a balanced approach that over time discourages biases in either direction. Having the harm quantification methodology anchored in these ongoing and broader forecasting efforts presumably was important enough to the Commission to merit specific statements of expectation to that effect in Order No. 864.

Although some commenters may have overlooked it, the Postal Service has comprehensively followed the guidance set forth in Order No. 864 to quantify the net adverse financial impact of the exigent circumstances and to demonstrate that the amount of the proposed adjustment does not exceed the net adverse financial impact of the exigent circumstances. To establish the financial conditions that it is currently facing in the near term, the Postal Service presented volume forecasts (in USPS-R2010-4R/9) for FY2013 and FY2014 that rely on the exact same type of sophisticated and extensive demand analysis and volume forecasting methodologies that were previously employed in omnibus rate cases and, as noted in Order No. 864, are now used for periodic reporting. The forecasted volumes are direct inputs into the PCCEM (roll-forward model) presented in USPS-R2010-4R/7. Mr. Thress then used those same demand analysis models, as well as his own expert analysis based on decades of experience devoted to these issues, to decompose observed net volume changes in recent historical years into multiple components, each relating to a factor affecting mail volume for the mail category in question. (Upon request, in response to POIR No. 6, Question 14, Mr. Thress replicated the same decomposition process with respect to the net volume forecasts of future mail volumes for FY2013 and FY2014.) Through this process, Mr. Thress was able to estimate, for each market dominant mail product, the mail volume loss by year (from FY2008 through FY2014) that he attributes to the effects of the Great Recession.

Those losses do not include Mr. Thress's separate estimates of mail volume (by year and by product) that was lost due to the "continuing" and "on-going" effects of pre-existing trends in electronic diversion. That "non-exigent" impact is thus explicitly excluded from his estimate of "exigent" impact, in accordance with the proscription set forth in Order No. 864. Mail changes from these two types of effects, when considered in conjunction with the positive and negative impacts of other factors which fall within neither of these two categories, can be combined to explain year-to-year observed net mail volume changes for each mail product.

Starting with the mail volumes from FY2007, the last fiscal year before the first full year of the Great Recession, Mr. Thress's analysis thus makes it possible to trace how (1) mail volumes first lost due to the Great Recession during each given year of his historical analysis (FY2008 through FY2012) combine with (2) the continued non-recurrence in that year of volume originally lost in a prior year, to yield (3) an annual estimate of total exigent mail volume losses in that year. For example, as shown in Table Two on page 10 of his Further Statement, Mr. Thress estimates that 47.981 billion pieces of Market Dominant mail volume were first lost due to the Great Recession in the years FY2008-FY2011, and those pieces remained lost in FY2012 (that is, the mailers of those previously-lost pieces did not resume mailing them again in FY2012). In addition, 5.565 billion pieces were newly lost in FY2012. Thus, Market Dominant volume was 53.546 billion pieces lower in FY2012 alone than it would have been in the absence of the Great Recession (47.981 + 5.565 = 53.546). The spreadsheets accompanying the Further Statement (USPS-R2010-4R/10) show the results of this process, by year, for each Market Dominant Mail category.

With these exigent volume losses in hand, we then move to the second phase of the process laid out in Order No. 864. To determine the *net* adverse financial impact of these volume losses, the volume losses for each category are multiplied by the applicable unit contribution (to the recovery of institutional costs) for that category as presented in the Commission's Annual Compliance Determination. This procedure is documented in USPS-R2010-4R/11. The resulting lost contribution estimates by product are then summed across products to achieve total Market Dominant lost contribution, and those results are reported on pages 3 and 4 of the Statement of Stephen Nickerson. Mr. Nickerson then takes the final step to compare the net adverse financial impact of the exigent circumstances (defined by the Commission in Order No. 864 as those lost contribution estimates associated with the volume declines from the Great Recession) with the amount of the proposed price adjustments.

In presenting this series of estimations and calculations in this proceeding, therefore, the Postal Service is doing exactly what the Commission indicated in Order No. 864 that the Postal Service needed to do: nothing more, nothing less. The Commission said that it expects the Postal Service to support its exigent requests with credible and supportable quantification methods of the type described. The estimates of lost harm from Mr. Thress and the estimates of lost contribution from Mr. Nickerson are quantifications firmly rooted in the Postal Service's extensive and long-standing volume and cost reporting and forecasting procedures, based on statistical analyses and expert opinions fully explored in scores of questions in multiple Information Requests. In presenting those estimates, the Postal Service has clearly met the standards of Order No. 864. The comments submitted by the parties need to be evaluated in that context.

B. The Harm Estimate of $6.64 Billion is <u>NOT</u> the <u>Cumulative</u> Loss in Contribution Through FY2012 Due to the Great Recession

Page 3 of the Statement of Stephen Nickerson presents the following table (as revised on October 25, 2013):

Table 2
Exigent Revenue and Contribution Losses (in millions), FY 2008 – FY 2012

	Volume	Revenue	Contribution
FY 2008	(11,061)	($3,398)	($1,246)
FY 2008 thru 2009	(34,759)	($9,973)	($3,634)
FY 2008 thru 2010	(42,333)	($12,763)	($4,816)
FY 2008 thru 2011	(47,981)	($14,898)	($5,770)
FY 2008 thru 2012	(53,546)	($16,883)	($6,644)

Apparently, the Commission and other interested parties could have benefited from more clarification of this table. For example, one of the major arguments included in Valpak's initial comments is premised on a complete misinterpretation of this table. Valpak Comments at 48-60.[2] Moreover, even after extensive previous discussion

[2] Valpak has since confessed its error. Errata to Initial Comments of Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc., PRC Docket No. R2013-11 (Dec. 5, 2013).

during hearings, one of the later questions posed also manifested substantial uncertainty regarding whether the contribution losses shown in the last column of the above table each applied to a single year, or were *cumulative* contribution losses over multiple years. Tr. 2/221-222. Therefore, to clarify the record and to reply to Valpak, it is necessary to start from the beginning and explain what this table was intended to convey, and how that information relates to the Postal Service's proposed exigent rate adjustment in this case.

The root of the problem probably lies with the concept of mail volume that is "lost." Looking at the FY2008 row, there is no possible ambiguity, as 11.061 billion pieces of mail are estimated to have been lost due to the Great Recession in FY2008. The problem only appears in subsequent rows. The intent of the second row (FY 2008 thru 2009) was to show the estimate of how much higher mail volume would have been, in FY2009 alone, if the Great Recession had not occurred. The estimate is that, in FY2009 alone, mail volume would have been higher by 34.759 billion pieces. One reason that the row is labeled as it is (FY 2008 thru 2009), rather than merely as FY2009, is in recognition of the fact that, of that 34.759 billion lost pieces, 11.061 billion were pieces that were first lost in FY2008 and remained lost in FY2009, while an additional 23.698 pieces were estimated to have been first lost in FY2009. In FY2009, the net effect of volumes first lost in either FY2008 or FY2009 was that there were 34.759 billion fewer pieces in FY2009 alone due to the Great Recession.

Thus, in reading Nickerson Table 2 (and the closely related Table One in the Thress Statement), it is important to recognize that "lost" volume in any given year can be volume that is lost for the first time in that year, or volume that was first lost in a previous year and continues to be lost in the subsequent year. This issue was discussed in the Postal Service's response to POIR No. 6, Question 16. The rows in Table 2 (after the first row) are labeled as they are to emphasize that the lost volume figure for the year in question includes not only additional mail volume first lost in that year due to the effects of the Great Recession, but also pieces first lost in previous years back to FY2008 that remain lost.

The financial effect of a piece of lost mail in any given year is the same whether that piece was first lost in the year in question, or whether the piece was first lost in a previous year and has simply not returned in the year in question. As shown in the row of Table 2 labeled as FY2008 thru FY2012, then, the volume of mail lost to the Great Recession in FY 2012 alone totaled 53.546 billion pieces, of which 47.981 billion were pieces first lost in previous years (between 2008 and 2011) that did not return to the mail system in FY2012, and an additional 5.565 billion were pieces first lost in 2012. The effect in FY2012 of each of the lost 53.546 billion pieces of mail on revenue and contribution is obtained by multiplying the lost volume (for each product) by the FY2012 unit revenue and unit contribution (for each product). As shown in the last two columns of the table, in FY2012 alone, the estimate of lost revenue is $16.883 billion, and the corresponding estimate of lost contribution is $6.644 billion.

Focusing on contribution, $6.644 billion is the estimate of how much higher contribution would have been in FY2012 alone if there had been no Great Recession. Thus, $6.644 billion can best be thought of as the *annual* amount of lost contribution in FY2012. Annual lost contribution should not be confused with *cumulative* lost contribution. Even though the annual lost contribution in any given year is calculated in part on the basis of volumes first lost in previous years that have carried over, it still reflects only the effect of each piece of lost volume on one year of postal finances.

Looking again at the above table, it might be tempting to attempt to calculate the *cumulative* lost contribution, experienced in the period up to and including any given year, by adding the lost contribution estimate for that row to the sum of the lost contribution shown in all previous rows. For example, if the year in question were FY2012, the total of all five rows of lost contribution in the table is $22.110 billion. Roughly speaking, that is the *cumulative* lost contribution for the period from FY2008 through FY2012. This brings up the other reason that the rows are not labeled merely as one of each of the fiscal years between FY2008 and FY2012. In reality, while the volume losses stated are directly applicable to the last of the fiscal years indicated, the revenue and contribution losses in the table have all been evaluated using FY2012 unit revenues and unit contributions. Hence, looking at the third row (FY2008 thru 2010), the intent of that row is to show that, for pieces first lost between FY2008 and FY2010 due to the Great Recession, that volume totals to 42.333 billion pieces, and the harm to the Postal Service *in Fiscal Year 2012* alone from being deprived of that volume is $12.763 billion less revenue and $4.816 billion less contribution. On the other hand, if one is attempting to evaluate the harm from that amount of volume lost between FY2008 and FY2010 in a different fiscal year, such as FY2010 or FY2011 or FY2014, then one would need to use the unit revenues and unit contributions directly applicable to the desired fiscal year.

In fact, as noted in footnote 2 on page 4 of the Nickerson Statement, USPS-R2010-4R/11 evaluates harm caused by the annual lost volume in each year in terms of both FY2012 and FY2014 unit contributions. So, for example, the lost contribution resulting from the 42.333 billion pieces of mail lost between 2008 and 2010, when evaluated in terms of FY2014 (before-rates) unit contribution, is $5.602 billion, rather than the corresponding estimate of $4.816 billion when evaluated in terms of the effect in FY2012. In other words, because unit contribution levels in FY2014 are expected to be generally higher than they were in FY2012, mail volume that was not there in FY2012 and is still not there in FY2014 causes the Postal Service more harm (in terms of lost contribution) in FY2014 than the same volume loss caused in FY2012.

Thus, to more accurately use the lost volumes shown in the table to calculate a *cumulative* lost contribution, it would be necessary to take the estimates of lost volume in each separate fiscal year and apply to them the relevant unit contributions for that particular fiscal year, and then sum the resulting annual lost contributions across fiscal years. The Postal Service has done those calculations, and rather than the rough estimate of $22.110 billion of *cumulative* lost contribution over the FY2008 through FY2012 period, the more accurate estimate is $21.936 billion. These calculations are shown in the Excel spreadsheet Cumulative.v.Annual.Impact.xls, which is attached electronically to these Reply Comments. Either way, then, using $22 billion as the general estimate of *cumulative* lost contribution between FY2008 and FY2012 due the Great Recession would seem adequate for most purposes. Such an estimate of *cumulative* lost contribution, however, must not be confused with the more relevant estimate of *annual* lost contribution.

C. When Comparing Harm Suffered to Relief Sought, It Is Necessary to Compare Annual Lost Contribution to Annual New Contribution from Proposed Exigent Rates

Contrary views presented on page 18 of the Public Representative Comments notwithstanding, the distinction between *annual* lost contribution and *cumulative* lost contribution becomes rather critical when evaluating the potential effects of proposed exigent rate increases. As explained in the Nickerson Statement, the Postal Service expects, on an *annual* basis (i.e., October implementation), that the exigent rates would generate $1.78 billion of additional contribution in FY2014. To follow the framework presented in Order No. 864 and demonstrate that “the amount of the proposed adjustment does not exceed the net adverse financial impact of the exigent circumstances,” it is thus necessary to compare this *annual* value of the proposed adjustment with a corresponding *annual* estimate of the net adverse financial impact of the Great Recession.

The available information allows several variations of this comparison, all of which lead to the same inescapable conclusion: the proposed price adjustment comes nowhere near exceeding the net adverse financial impact of the exigent circumstances, and in fact falls far short of it. The most simple comparison between annual lost contribution and annual increased contribution is the one implicitly suggested by the above table. The Table 2 estimate of lost contribution, based on 53.546 billion mail pieces that were not there in FY2012 due to the Great Recession because of volume losses over the FY2008-FY2012 period, is $6.644 billon when evaluated in terms of FY2012 unit contributions. Clearly, $1.78 billion does not exceed $6.644 billion.

It nonetheless merits notice, however, that the $1.78 billion increased contribution is not expected until 2014. So, to make a more valid comparison, <u>even assuming that no additional mail volume is lost due to the Great Recession between FY2012 and FY2014</u> (which appears unlikely), one needs to re-evaluate the 53.546 billion pieces of missing volume in terms of the FY2014 unit contributions. To allow this more apples-to-apples comparison to the FY2014 increased exigent contribution, witness Nickerson explicitly presents the superior estimate of the FY2014 net adverse financial impact of $7.669 billion, based on calculations shown in USPS-R2010-4R/11 using FY2014 unit contributions. Nickerson Statement at 4 fn.2. And, once again, even more clearly, $1.78 billion does not exceed $7.67 billion.

The above hypothetical notwithstanding, the Postal Service does not accept the assumption that no further mail volume is being lost due to the Great Recession between FY2012 and FY2014. In response to POIR No. 6, Question 14, Mr. Thress provided his estimate of volume lost due to the Great Recession over the FY2008-FY2014 period as 63.895 billion pieces. Thus, far from finding no further volume loss between FY2012 and FY2014, Mr. Thress estimates that approximately 10 billion additional pieces will be lost during those two years due to the lingering effects of the Great Recession. If one uses the 63.9 billion lost piece estimate through FY 2014, in place of the 53.5 billion lost piece estimate through FY2012, and then applies the FY2014 unit contributions to those pieces, the full FY2014 estimate of lost contribution due to the Great Recession rises to $9.469 billion. See attached Excel spreadsheet Cumulative.v.Annual.Impact.xls. And, once again, and even more clearly, $1.78 billion does not exceed $9.469 billion.

Whichever of the above three estimates of *annual* lost contribution is employed, therefore, it is abundantly obvious that the value of the new rates on an *annual* basis will be far lower than the net adverse financial consequences caused by the exigent circumstances. Moving forward in time, those facts also have implications for *cumulative* loss projections. As just discussed, even <u>after</u> the exigent increases, the annual harm suffered is greater than the value of the proposed rates. Therefore, the *cumulative* harm will continue to grow each year, even without assuming any further volume losses. Therefore, this is not a situation in which it is necessary to anticipate when the *cumulative* value of the new rates over time might exceed the *cumulative* value of the harm suffered. Barring dramatic and entirely unforeseen changes in circumstances (such as the return of all of the lost volume), the *cumulative* gap between harm suffered and relief obtained will actually continue to grow year over year, not diminish.

Moreover, if mail volumes continue their general decline (for whatever reasons), the annual value of the exigent rate increases (in terms of increased contribution) will also likely manifest a general decline. This is because, with continuing volume declines, each successive year will bring fewer pieces by which the increase in unit contribution generated by the exigent rate increases must be multiplied in order to obtain overall net benefit.

Overall, these circumstances support no credible speculation that, at some future point in time, the Postal Service may find itself "overcompensated" by the rate relief it is seeking in this docket. Moreover, because all of the annual estimates of exigent harm presented above (whether they reflect volume losses through FY2014 or just FY2012, or unit contributions from FY2012 or FY2014) are so far in excess of the annual value of the proposed adjustments that, even if those harm estimates were off by a factor of two or even three, the annual harm would still exceed the annual value of the rate adjustment (e.g., $6.64 billion divided by a factor of three is $2.21 billion, which would still be greater than $1.78 billion). Even under such extreme and unrealistic assumptions, therefore, the *cumulative* financial harm from the Great Recession would continue to grow year-over-year, despite some measure of relief to the Postal Service from implementation of the exigent increases.

D. Table V-3 from the Valpak Initial Comments Requires Correction

As noted above, certain comments submitted by Valpak are premised on a misinterpretation of Table 2 from the Nickerson Statement. Specifically, Table V-3 on page 51 of the Valpak Initial Comments needs to be corrected.[3] Using the actual *cumulative* exigent contribution losses by year shown in Cumulative.v.Annual.Impact.xls, that Table should appear as follows.

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

	Cumulative Exigent Contribution Losses	Cumulative Underwater Product Losses
2008	($1,301)	($1,029)
2008-2009	($4,840)	($2,768)
2008-2010	($9,607)	($4,457)
2008-2011	($15,291)	($6,072)
2008-2012	($21,936)	($7,533)

[3] As noted in the preceding footnote, Valpak has since recognized its error and expunged the table in question from its initial comments. The Postal Service nevertheless believes that the revised table in this section may offer helpful clarity to the Commission and other interested parties.

The consequences of these necessary revisions on Valpak's arguments are discussed in section VI.C below.

E. Dr. Lundblad and the Mailer Comments Associated With His Statement Both Fail to Provide Any Valid Basis to Depart from the Estimates of Recession-Related Volume Losses Provided by the Postal Service

A group of mailers (MPA et al.) jointly sponsored the Statement of Dr. Christian Lundblad in this proceeding, filing that Statement on November 26 as an attachment to their Initial Comments.[4] Taken as a whole, neither the Lundblad Statement nor the Lundblad Group Comments establish any legitimate basis to challenge the conclusions reached by the Postal Service's expert, Mr. Thress. Before getting to the substance of Dr. Lundblad's presentation, however, it is necessary to correct a misrepresentation upon which the Lundblad Group participants, as well as others, seek to establish as a foundation for their comments.

1. Neither the Postal Service Nor Mr. Thress Disputes that Electronic Diversion Has Been a Source of Substantial Volume Loss Over the Last Fifteen Years and Is Likely to Remain So Going Forward

The Lundblad Group is not alone is seeking to cast aspersions on Mr. Thress comprehensive "sources of change" volume decomposition analysis by pulling out of context and quoting a series of statements appearing in various Postal Service reports and plans over the years. *See* Lundblad Group Comments at 8-9. The Public Representative does the same thing, cites to some of the same material, and even reproduces one of the slides discussed. PR Comments at 10-14. The apparent purpose of these citations is to create the appearance that Mr. Thress' conclusions

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[4] For ease of reference, the Statement of Dr. Lundblad will be referred to in this section as the Lundblad Statement, and the associated comments as the Lundblad Group Comments.

represent an abrupt departure from the results of previous Postal Service efforts to address the same issue. All of these types of arguments suffer the same shortcomings. Not only are they based on statements that are not necessarily a full representation of the documents in question, but more fundamentally, they are not based on valid apples-to-apples comparisons.[5]

The salient characteristics of Mr. Thress's "apple" are as follows. Working within the larger framework of the Postal Service actual forecasting models and using data through FY2013, Quarter 3, he takes a rigorous and comprehensive look "backwards"

[5] For example, to illustrate the unrepresentativeness of the passages they have selected, on page 8 of the Lundblad Group Comments, there is a quotation from the Risk Factors section (pages 10-15) of the Postal Service's FY2012 Form 10-K. They quote the discussion from page 12 of the 10-K, which focuses specifically on the risk from "electronic diversion." The Risk Factor section begins, however, with the following separate discussion of the risk from "changes in the economy," which the Lundblad Group does not quote:

> The global economy may impact our business and financial condition in ways that we currently cannot predict. The demand for postal services is heavily influenced by the economy. The U.S. national unemployment rate has remained high, decreasing from 9.1% in September 2011 to 7.8% in September 2012. U.S. Gross Domestic Product (GDP) real growth rates have continued their trend of steady, but slow growth. GDP real growth was 2.3% for the year ended September 30, 2012, up from 1.6% for the year ended September 30, 2011. The high unemployment rate, along with continued weakness in housing prices and lackluster economic growth, continue to adversely impact consumer confidence, raising economic risk significantly. These uncertain economic conditions are expected to have a continuing adverse impact on retail sales, investment, consumer spending, consumer confidence, and ultimately the use of the mail. Negative trends in these areas continue to depress the demand for postal services.

United States Postal Service Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended September 30, 2012, at 10. The lack of emphasis on macro-economic factors in the Form 10-K's "electronic diversion" risk discussion is therefore not surprising: the risks from that source are primarily discussed elsewhere.

Where appropriate, the FY2012 Form 10-K discussed the two types of factors together:

> Since peaking at 213 billion pieces in 2006, mail volume and revenues have declined each year. This trend of declining volume and revenues; primarily caused by the recession, the use of electronic media to replace hard-copy transactions and communications, increased competition from alternative delivery services, and an ongoing weak U.S. economy; continued through 2012 and is expected to continue for the foreseeable future.

Id. at 22.

specifically to decompose the actual factors affecting mail volumes, by product, from FY2008 through FY2012. Based on his analysis, he divides the factors into those which he concludes are associated with the Great Recession, and those which are not (including electronic diversion trends which pre-dated the Great Recession).

The "non-apples" cited by the comments come from statements made at different points in time, based on mail volume changes over different periods and usually on "forward"-looking perspectives. Such statements certainly were not provided with the specific intent to comprehensively distinguish recession-related effects from non-recession-related effects over the 2008-2012 period, based on any rigorous statistical or nonstatistical procedures.

Consider, for example, the Lundblad Group's quotation from the Postal Service's 5-Year Business Plan, trumpeted in large font at the front of the Lundblad Group Comments and reproduced from the original slide on page 13 of the Public Representative Comments. Pulling together two statements, the text reads "Electronic Diversion is the Primary Driver of First-Class Mail Volume Decline," and then "The Economy is NOT the Main Cause of Diversion." This text accompanies a graph that should be familiar to anyone who has read Annual Compliance Determinations over the last few years. *See* PR Comments at 13. It shows First-Class Mail volume *since 1973* graphed with Real GDP over the same period. The point being made here is very simple and very clear: First-Class Mail volume essentially tracked Real GDP for decades until the mid to late 1990s, when electronic diversion first took hold, and the two lines have diverged ever since. Stating the same message more prospectively, no change in the economy caused the two lines to diverge initially, and no reasonably foreseeable change in the economy is ever going to make the two lines converge again.

Examined over this lengthy time period, the graph amply supports the "simple story" that the text summarizes. By the same token, however, the graph just as clearly shows that exactly when Real GDP manifests the only real spike (positive or negative) over the time period shown, when the Great Recession hit in 2007, what had been a gradual decline in First-Class Mail volume was suddenly converted into a much steeper and more dramatic plunge. Yet while these years following 2007 constitute the period of paramount interest to the analysis of Mr. Thress, in the context of this slide, they are merely a complicating wrinkle which cannot be encapsulated into the storyline of a one-line slide label. For that reason, there is absolutely nothing about the slide suggesting focus on the time period from 2007 to 2012, and therefore the text cited in the comments cannot fairly be compared with the much narrower and more specific conclusion drawn by Mr. Thress. By the same token, however, the fundamental message being conveyed – that substantial electronic diversion has been around for a while and is here is to stay – is in no way inconsistent with the results of Mr. Thress' analysis.

Even before the filing of initial comments, the Postal Service responded to a question (POIR No. 5, Question 5) explaining why these and other previous statements from various other postal sources provide no valid basis to question Mr. Thress's more recent analysis and conclusions. Not only did neither the Lundblad Group nor Public Representative comments bother to mention that POIR response, but, based on a remark offered on the top of page 14 of his comments, the Public Representative seems to be unaware of its existence. As explained in detail in that response, differences in timing, perspective, focus, and purpose are the primary reasons why certain aspects of those materials, when viewed out of context, do not appear to align perfectly with the results of the Thress analysis. Quite frankly, however, much of the material cited in the Lundblad Group and Public Representative Comments, both on the pages cited above and on subsequent pages, are nothing more than affirmations that electronic diversion is real, has been reducing mail volume for many years, and will continue to grow. To imply that such statements are either inconsistent with the Thress Statement, or directly comparable to a focused effort to parse out the effects of the Great Recession year by year and product by product, would be misleading at best.

For purposes of true comparison, however, there is essentially only one other "apple" the Postal Service has produced. That would be the analysis, also performed by Mr. Thress, presented in response to a GCA interrogatory in Docket No. N2010-1, which sought a similar decomposition of mail volume changes broken out by factor. What perhaps makes that analysis more noteworthy is that it was conducted *before* the first exigent case was even filed, and well before Order No. 547 had decreed that the lost institutional cost contribution from volume declines due to the Great Recession had greater significance than that from concurrent volume declines due to ongoing electronic diversion. Therefore, any tacit insinuation that Mr. Thress has intentionally slanted his analysis in this proceeding would not apply to his work as first presented in Docket No. N2010-1.

For purposes of comparison, the most germane figure from that earlier decomposition effort (conveniently displayed as the bottom-line result in Table 2 on page 5 of the original Thress Statement of November 21, 2011, presented in Docket No. R2010-4R, but explicitly noted as a reproduction of the Docket N2010-1 analysis) is the total First-Class Mail and Standard Mail lost due the Great Recession in the 2008-2009 period of <u>33.508 billion</u> pieces. Looking at Table 1 on page 4 of Mr. Thress' Further Statement in this docket, and adding the First-Class Mail and Standard Mail rows in the 2008-2009 column, yields a corresponding total of <u>33.966 billion</u> pieces. Clearly, any suggestion that the current results represent a major shift in direction finds no support in the one true apples-to-apples comparison that can be made.

This is not to say that, between the Docket N2010-1 work and the current analysis, there are no material differences, in terms of either the models estimated or the results presented. The earlier effort was based on data only through the end of FY2009. Nearly four more years of data, particularly with respect to a recession that continues to display more tenacity than almost everyone expected, cannot help but offer improved insight into potential changes in the underlying relationships. Yet if there were any questions regarding the thrust of the Docket No. N2010-1 analysis, one need look no further than the GCA Initial Brief (filed October 15, 2010) in that docket. When it suited GCA's purpose in opposing the Postal Service's five-day street delivery proposal, GCA repeatedly and enthusiastically cited Mr. Thress's work as establishing that the sharply lower volumes in FY2009 were "largely" the result of the Great Recession. GCA Initial Brief, Docket No. N2010-1, at 3, 7-8, 10, and 11. Unlike Mr. Thress, GCA's views on the role of the Great Recession appear to depend on what suits GCA in a given case. *See* Reply Comments of the United States Postal Service Regarding Court Remand, PRC Docket No. R2010-4R (Aug. 1, 2011), at 19-20. As for the Lundblad

Group and the Public Representative, any suggestion by them that Mr. Thress's results conflict with some pre-existing consensus about the source of volume changes in 2008, 2009, and the years following is entirely illusory.

2. The Comments of the Lundblad Group Materially Distort Certain Critical Facts Regarding the Thress Analysis

The Lundblad Group Comments start with the declaration that the "central question in this case is the extent to which the Postal Service's losses are due to the 2007-2009 recession rather than Internet diversion and other non-recession causes." Lundblad Group Comments at 2. The Postal Service agrees that the focus of inquiry identified here by the Comments is indeed the pivotal one in this proceeding, although the Postal Service might dispute the particular choice of phrasing. Taken more or less at face value, the question is to what extent the Postal Service identifies volume losses as due to the Great Recession, and to what extent it effectively identifies volume losses as due to electronic diversion. Viewed from this literal perspective, one would imagine that the Lundblad Group Comments would at least get the basic facts straight on this "central question." It is most unfortunate, therefore, that the Comments immediately mischaracterize the answer that the Postal Service has provided to this critical inquiry. The Lundblad Group Comments allege that the "Postal Service claims that essentially all of its decline in mail volume from Fiscal Year 2007 to 2012 resulted from the former, and none from the latter." *Id.* at 2. While the Comments then attack such a claim as "implausible" and "unsupportable," *id.*, that claim is, in fact, not the one made by the Postal Service.

Table Two from the Statement of Mr. Thress provides the numbers. In the column labeled "Diversion," Mr. Thress effectively estimated that, in FY2012, the Postal

Service was losing, at a minimum, over 12 billion more pieces of Market Dominant mail per year to electronic diversion than it had been in FY 2007. These pieces were, of course, on top of the volume lost to such diversion up to and including FY2007. By any relevant standard, 12 billion is neither "none," nor "essentially . . . none." To be sure, that figure is noticeably smaller than the corresponding figure that Mr. Thress estimated in FY2012 for Market Dominant mail pieces lost since FY2007 due to the Great Recession, which totaled over 53 billion pieces, but it is still far from "none."

The disparity between the recession-related estimate and the diversion estimate, moreover, is much less pronounced when the comparison is focused on First-Class Mail. For that class, Mr. Thress effectively estimates that the FY2007-FY2012 loss to electronic diversion was no less than 11.3 billion pieces, while the corresponding figure for losses due to the Great Recession was 22.6 billion pieces. First-Class Mail may not be the powerhouse that it once was, but it still is the most important class of mail for generating institutional cost recovery by a wide margin. In FY2012, Mr. Thress estimates that the First-Class Mail volume loss (over the 2007-2012 period) effectively identified by him as attributable to electronic diversion was almost exactly one-half the corresponding loss attributed to the Great Recession. The Lundblad Group Comments are in error – and in fact mischaracterize the Postal Service's conclusion – when they allege that the analysis failed to recognize any material amount of additional electronic diversion over the 2007-2012 period.

Similarly, the Lundblad Group Comments take liberties when they assert that "Mr. Thress' analysis purportedly shows that essentially the *entire* net decline in volume – 25.6 percent – between Fiscal Years 2007 and 2012 was caused by the 2007-2009 recession." *Id.* (emphasis in original). But how can it be said that the Great Recession was alleged by Mr. Thress have caused the entire net decline in volume, when, as explained above, Mr. Thress effectively estimated that over 12 billion pieces of mail were lost not to the Great Recession, but rather to electronic diversion? The answer is in the very subtle little word tucked between "entire" and "decline" – "net." Unless the reader fully appreciates the significance of the distinction between "decline" and "net decline," the natural inclination is to suppose that Mr. Thress must be asserting that no other factors besides the Great Recession were causing volume to decline over the five-year period.

In fact, quick examination of Mr. Thress's Table Two would show that not to be the case: the two other columns that were causing volume declines over the period (in addition to the column encompassing the Great Recession effects) are the Diversion column and the Nominal Price column. Taken together, the three columns (Diversion, Price, and Recession) cause the *gross* volume decline (the sum of all negative factors), while the *net* volume decline is the sum of all positive and negative factors combined. The Lundblad Group Comments can make their claim about the *net* volume decline not because Mr. Thress estimates that no other factors besides the Great Recession were reducing volume, but rather because of the sheer coincidence that the sum of all of the positive factors just happens to almost exactly offset the negative effects of Diversion and Price. Contrary to the impression that one might get by reading just the first full text page of the Lundblad Group comments, therefore, Mr. Thress actually estimated that by FY2012, in addition to all the billions of pieces of mail that were diverted to electronic media in FY2007 and before, an additional 12 billion pieces of mail per year were being diverted, independent of the effects of the Great Recession.

The qualifying phrase appearing at the end of the previous sentence ("independent of the effects of the Great Recession") is important. Its significance goes back to what was flagged earlier as the "phrasing" of the "central question" as posed on page 2 of the Lundblad Group Comments. The Lundblad Group explicitly bifurcates the possible factors causing volume changes into two groups: the Great Recession on the one hand, and "Internet diversion and other non-recession causes" on the other. With this subtle sleight of hand, the unstated premise is advanced that changes in internet diversion levels could never themselves have been caused by recession-related events and pressures. By definition, as the question is intentionally structured, Internet diversion is always a "non-recession cause."

While that may be how the Lundblad Group views electronic diversion, that is not how Mr. Thress does. And since it is the conclusions of Mr. Thress that the Comments are purporting to portray, it would seem more appropriate for them either simply to present his views unvarnished, or to present his views and express disagreement. What is not appropriate is to ascribe to him "claims" that he never made. Mr. Thress does not divide the world between recession-related effects and necessarily separate diversion effects in the manner presupposed by the "central question." Instead, simplifying a bit for purpose of exposition, Mr. Thress has one trend which he essentially treats as reflecting the rate of diversion before the Great Recession (and which generated the 12 billion piece estimate for FY2012 mentioned above), and a different trend which starts at the time of the Great Recession and is picking up mail changes over the years since that are otherwise unexplained by his model. As Mr. Thress explains in response to POIR No. 3, Questions 1 and 2, as well as at page 8 of his Reply Statement, that second trend would not only include the effects of acceleration caused by the Great Recession of the pre-existing rate of diversion, but it would include the effects of many other shifts in consumer and business behavior triggered by the Great Recession as well.

Thus, although some of the mail pieces estimated to be lost through the operation of the factors underlying this trend term will include pieces lost to additional diversion, because the “common denominator” of those factors is seen to be the Great Recession, Mr. Thress treats them all as recession-related. In other words, some undetermined part of the volume loss reflected in the second trend term is believed to be mail lost to *accelerated* electronic diversion in the 2007-2012 time period. Mr. Thress’s explanation of why diversion would accelerate due to the Great Recession is presented most fully in response to POIR No. 3, Question 1 and POIR No. 9, Question 9.

Therefore, when the Lundblad Group Comments deny that Mr. Thress has attributed any (or any material amount) of the volume lost between 2007-2012 to electronic diversion, that assertion in wrong in two ways. First, as described above, there is the minimum of 12 billion pieces that he treats as attributable to electronic diversion, by virtue of the continuation of diversion trends as they existed at the outset of the Great Recession. Second, there is some additional, albeit undetermined, number of pieces embedded in his recession-related trend term that reflects losses associated with the acceleration of diversion in response to the Great Recession. Just because the

Lundblad Group is of the view that the categories of recession-related mail loss and diversion mail loss are mutually exclusive does not mean they are free to describe Mr. Thress' results as if his conclusions are premised on that view as well. It is much easier to attack an opponent's results as "implausible" if you are not confined to portraying those results accurately. Contrary to what the Lundblad Group Comments suggest, Mr. Thress fully recognized that there were material increases in the amount of electronic diversion between 2007 and 2012. That recognition, however, is perfectly consistent with his finding that the primary driver of mail declines between the years of 2008 and 2012, most particularly over the early years of that period, was the dramatic shock to the economy known as the Great Recession.

A host of similar deficiencies undermine the Lundblad Group Comments' criticisms of Mr. Thress. Looking primarily at "standard" macroeconomic variable such as gross GDP, the Comments (e.g. at 16-17, 26-27) maintain that the recession ended and the recovery began in mid-2009. As explained once again by Mr. Thress in his Reply Statement at 13-14, looking at the macro-economic variables most relevant to explaining changes in postal volumes, real private employment per adult and real gross private domestic investment per adult, the effective "bottom" did not come until FY2011. As likewise discussed at length in the Reply Statement of Mr. Thress, one of the fundamental errors made by Dr. Lundblad is that he mistakenly insists on expecting that the Great Recession should have behaved like a typical recession. The Lundblad Group Comments (e.g., at 17) manifest the exact same error. Expecting the same "pattern of recovery" based on a purported "recovery in GDP" (Comments at 18) conflicts directly with the actual "output gap" in GDP (first discussed and illustrated by

Mr. Thress in response to POIR No. 1, Question 6), which the Lundblad Group Comments (pages 29, 43) would thus prefer simply to ignore. Failing to recognize the unique nature of the Great Recession completely undermines the criticisms (e.g., page 27 of the Comments) of Mr. Thress's use of trend terms and variables.[6]

Returning again to the topic of electronic diversion, the Lundblad Group Comments (pages 30-35) overplay their hand with their criticism of Mr. Thress's observation that "the growth of Internet [mail] substitution will flatten out" in accordance with the conventional S-curve exhibited by the rate of diffusion of innovations. Their response, in a nutshell, is that "technological innovation and its adoption in society appear to be accelerating at an exponential rate." They essentially point to the mere number of new gadgets and their new features to conclude (page 33) that "[i]n terms of the S-curve, electronic substitution is very much in the rapid take-off phase." Consider, however, that at each discrete point over the next five years, the next ten years, and the next twenty years, in accord with their view (page 31) that "the cornucopia of new products and services that daily expand the power of the Internet and the means of interacting with it" will not cease its exponential expansion, we can be confident (without knowing exactly what they might be) that someone will be able to compile a list of new gadgets and features just as impressive as the current litany recited by the Lundblad Group Comments at 33. So, if their reasoning had any validity, based on such an updated list, someone will also have the ability at every point over the next five years,

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[6] Mr.Thress specifically rejects in his Reply Statement the claim (page 27 of the Comments) that it can be inferred that he uses such trend variables because he alternatively tried cyclical explanatory variables and found that they did not work. His Reply Statement also amply refutes the criticisms regarding Standard Mail advertising.

the next ten years, and the next twenty years, to *still* claim that "[i]n terms of the S-curve, electronic substitution is very much in the rapid take-off phase."

In reality, however, there is only such much more mail out there to be diverted to electronic media. As shown by their own graph (page 40), over half of bill payments are already gone. It seems mathematically impossible that the rate of diversion *of mail* to electronic media will still be in "the rapid take-off phase" twenty years from now, and it would be highly unreasonable for anyone to expect it might be so just because internet-related developments will undoubtedly being continuing over that period. The obvious flaw in their argument is that they are hopelessly confusing the *general* pace of internet-related innovations, which indeed will extend and expand into the foreseeable future, with the *specific* rate of the diversion of mail to electronic media, which cannot continue unabated over such a time horizon. In other words, they really have not presented any relevant basis to challenge Mr. Thress's entirely valid observation that "the growth of Internet [mail] substitution will flatten out."

One point on which the Postal Service and the Lundblat Group Comments (pages 16-17) agree is that the <u>time path</u> of actual volume changes must agree with any proffered explanation of such changes for the explanation to be plausible. As Mr. Thress establishes in his Reply Comments, it is the explanation proffered by Dr. Lundblad and the group supporting him that is manifestly inconsistent with the time path of actual volume changes, not the explanation presented by Mr. Thress. Stated most succinctly, the shock of the Great Recession coincides well with the dramatic mail declines in 2008 and 2009, while there is no plausible equivalent "shock" explanation applicable to the otherwise reasonably smooth shift from mail to electronic media. Dr. Lundblad and his supporters cannot escape this fatal flaw in his assumptions.

3. Mr. Thress Correctly Limits His Estimation of Recession-Related Volume Losses From Macro-Economic Factors to Consideration of Periods in Which Those Factors Were Reducing Mail Volume

The Postal Service asked Thomas Thress, on behalf of the consulting firm that has taken the lead on volume forecasting for the Postal Service for over three decades, to provide his best estimate of the volume lost by the Postal Service since FY2007 because of the Great Recession. Of course, mail levels in any given period reflect the net effective of all relevant factors – including those that cause positive changes and those that cause negative changes – on mail volumes observed in the previous "base" period. By definition, however, volume losses, such as volume losses caused by the Great Recession, represent *negative* changes in volume relative to the prior period.

Therefore, when considering the effects of his macro-economic variables, Mr. Thress included in his estimate of recession-related lost volume only the negative effects of those variables. Once the effects of such a variable turned positive, Mr. Thress excluded such subsequent positive values from his calculation of lost volume. Mr. Thress explained his procedure in this respect in response to three different POIR questions: POIR No. 1, Question 6; POIR No. 3, Question 6; and POIR No. 6, Question 4. Nonetheless, Dr. Lundblad and the Lundblad Group (page 44) challenge this approach. Their challenges are without merit, and their suggested alternative would incorrectly reduce the estimate of the deleterious effects of the Great Recession on mail volume.

As stated in the response to POIR No. 3, Question 6, the macro-economic impacts presented in his Further Statement "do not measure the impact of the Great Recession vis-à-vis typical macro-economic conditions, but instead, compare the impact of the Great Recession to a baseline that assumes zero macro-economic growth." There is nothing "fundamentally incorrect" about this approach which leads to the alleged *overstatement* of the loss, and in fact, it is Dr. Lundblad's opposite approach which necessarily would lead to a *understatement* of the loss of mail volume due to the Great Recession.

F. The Public Representative Apparently Fails to Grasp the Concept of Estimating Volume Losses Due to the Great Recession

The criticism of Mr. Thress's analysis voiced in pages 24-35 of the Public Representative's comments are rooted in some fundamental misapprehensions regarding the task at hand. For example, the Public Representative apparently takes the view that once the rate of volume decline for a particular product or class of mail is no longer increasing (or the rate of volume growth is no longer falling) on account of factors caused by the Great Recession, the "exigent volume losses" have ended. PR Comments at 24-25.

In fact, however, because the "new normal" includes additional volume declines each year (relative to what volume would have been in the absence of the Great Recession), the exigent volume losses do not end, but continue to accumulate. Moreover, just because volume decline rates may have "bottomed out" in a given year for one specific mail product or mail class, that cannot be equated with agreement that the same is true for all mail products and mail classes. Specifically, certain negative trends for certain types of mail, triggered by the Great Recession, continue to cause additional declines each year. Thus, the Public Representative reads too much into Mr. Thress's agreement that, compared with the massive volume losses in 2008 and 2009, Standard Mail may to some extent have neared the bottom in 2010. *See* PR Comments at 24.

As Mr. Thress emphasized on pages 5-7 of his Further Statement, the timing of the effects of the Great Recession on mail volumes do not coincide exactly with the effects on the broader economy (specifically GDP) by which turning points in the overall economy are usually evaluated. To fully account for the impact of the Great Recession on *postal volume*, which is the objective established by the Commission, *see* Order No. 824 at 29, it is necessary to extend the analysis to include whatever time periods in which that *impact* continues for specific categories of mail. Thus, the erroneous assertion by the Public Representative that "the exigent period of the most recent recession is over-stated" by Mr. Thress.

The Public Representative's comments regarding the Intervention Analysis employed by Mr.Thress confuse two distinct phases in the evaluation of an exigent rate request: the "due to" phase and the "necessary" phase. *See* PR Comments at 27-29. Mr. Thress was requested to provide an estimate by product by year of what mail volume would have been if the Great Recession had not occurred – in other words, the volume lost "due to" the Great Recession – which he has done. Although, as amply manifested throughout this proceeding, arriving at such estimates is no easy task, the concept is simple. Either a piece of mail is there, or it is not there.

To the Public Representative, however, not all pieces of lost mail are created equal: "In contrast, volume losses due to 'trend' and 'step' parameters, include sustained, operational, changes being made by the Postal Service, such as plant closings and reductions in hours. Because these changes are planned, they are no longer unexpected, and should not be considered losses due to exigent circumstances." *Id.* at 28. Somehow, the Public Representative finds it appropriate to inject "operational changes being made by the Postal Service" (regarding how aggregate mail volumes are processed *afte*r being presented by mailers to the Postal Service) into an analysis of what factors are driving mailers to present (or not present) individual pieces of mail in the first place. In fact, what the Postal Service does or does not do in order to process mail volume that is or is not there properly plays *no* role in the initial effort to quantify the volumes that are being lost. Mr. Thress should not be faulted for not taking into account factors which are entirely unrelated to the analysis he was asked to conduct.

The confusion that the Public Representative's proposal would inject into an analysis of the demand for postal services is compounded by the Public Representative's own apparently inconsistent attempts to explain its views:

> In Table IV-2, the Public Representative removes all values related to the trend, step, and delta in Mr. Thress's intervention analysis for each product between 2008 and 2014. These results capture the volumes lost to circumstances to which to Postal Service did not adjust, and constrains volume losses to exigent circumstances.

Id. at 28. In the statement quoted in the previous paragraph, the Public Representative asserts that volumes should be excluded because the Postal Service made planned operational adjustments, but in the quote here, we are told that volumes should be excluded because the Postal Service "did not adjust." The Public Representative has failed to articulate a coherent basis to appropriately distinguish, within Mr. Thress's demand analysis models, between intervention variables that appear as initial pulses, trends, or step components. All three are appropriately used to identify mail volume lost due to the Great Recession, exactly in the manner in which Mr. Thress has done so.

The Postal Service, however, is not oblivious to the larger point that the Public Representative appears to be attempting to make at this point in his discussion of the Thress analysis. While irrelevant to the question of the appropriate methodology for estimating how much mail volume has been lost due to the Great Recession, the Public Representative's real concern may relate to how much of an exigent rate increase is "necessary" to compensate the Postal Service for the harm caused by that lost volume. Indeed, the Public Representative addresses that very issue more directly in the previous section (III. Exigency) of his comments. As discussed further in section III below, however, the views expressed by the Public Representative in that context are as unfounded as his comments on the Thress Analysis.

More directly with respect to the Thress analysis, the Public Representative claims in a discussion of the Hodrick-Prescott filter that volume lost to cyclical effects should not have been counted by Mr. Thress as volume lost due to the Great Recession for purposes of the exigent case. *Id.* at 25. His reasoning is the same as that presented above in the context of Intervention variables: such volume losses "represent economic events to which the Postal Service could have responded." As noted above, this approach improperly confuses the appropriate estimation of lost volume that Mr. Thress was requested to conduct, with the separate question of what relief from the harm caused by such lost volume might be appropriate. But putting that to the side momentarily, the reasoning proffered by Public Representative in this instance seems to be totally backwards. Cyclical volume losses are ostensibly *temporary* volume losses, and are exactly the type of volume losses to which, under ordinary circumstances, it would be counter-productive to respond by making permanent changes to the networks. The logic of the Public Representative's criticism of Mr. Thress in this regard makes no sense.

Next, the Public Representative faults Mr. Thress for "inconsistent choice of macro-economic variables across products," going so far as to claim that variables "should be consistently measured so that their effect on volume is consistent." *Id.* at 25-27. In reality, of course, the effect of the macro-economy is <u>not</u> consistent across products. Throughout this proceeding, Mr. Thress has offered copious explanation for his choice of variables for each of his equations. If the Public Representative did not find Mr. Thress's explanations "convincing," *id.* at 26, the Public Representative might have proffered his own equations estimated with different variables. Ultimately, the Public Representative offers no useful guidance to the Commission on this matter, and his criticisms should be disregarded.

Finally, the Public Representative insists that "a proper analysis of diversion requires explicit measurement of Internet diversion" and faults Mr. Thress for not including any. *Id.* at 31-34. Once again, one wonders why, if the Public Representative thought that the models could have been improved in this regard, he did not offer models with such improvements. Moreover, even the mere comments that he offers in lieu of alternative models provide no credible support for his views. He provides no compelling link between the raw increase in wireless data traffic that he cites and the actual amount of *mail* that such traffic might divert. He provides no discussion of why "payment methods using smartphones as an alternative to point of sale charges paid by credit card," *id.* at 34, are any more of a threat to the mail than the long-standing and widely-available alternative of using a debit card. Such a belief is hardly intuitive: after all, a credit or debit card withdraws funds from, in all likelihood, the same bank account that the smartphone application would debit, and it is not apparent how a smartphone in one's pocket is any more convenient than a credit or debit card in the same pocket.

The Public Representative's citation of Mr. Thress's response to POIR No. 6, Question 4.b, in support of the claim that Mr. Thress "admits that he did not attempt to devise any other measure of Internet diversion" besides the number of households with broadband Internet access, *id.* at 32, is little short of misleading, and it certainly does not appropriately credit the massive amount of explanation Mr. Thress has provided on this issue. Extensive discussions were submitted in response to POIR No. 3, Question 1; POIR No. 4, Question 2; POIR No. 6, Question 25; and POIR No. 9, Question 7. The Public Representative suggests that "measurement of mobile technology and the rise of Internet-based payment methods are two variables that should have been included in Mr. Thress's analysis." PR Comments at 31. After detailed discussion of the challenges posed by attempting to model the effects of electronic diversion on mail volume, Mr. Thress concluded in response to POIR No. 9, Question 7:

> In general, it is my belief that the failure of the Internet variables which I have used in the past to continue to explain ongoing Internet diversion is not because of a failure specific to these particular Internet variables, but because of a more general failure of the rate of mail diversion to the Internet and other electronic alternatives to be amenable to being modeled by a single "Internet" variable. . . . The problem with the use of the Internet variables used in previous years was not a failure to find exactly the right variable, it was that "exactly the right variable" does not, and ultimately, cannot exist.

Neither of the two candidate variables mentioned by the Public Representative, either alone or in combination with the other, offers any hope of surmounting the obstacles already identified by Mr. Thress. His alternative use of Intervention Analysis provides the appropriate resolution to this dilemma. Once again, the criticisms of the Public Representative of his approach are without merit.

Based on his pastiche of eclectic criticisms of Mr. Thress, many of which have no bearing on the actual role the Thress analysis was intended to fulfill in this proceeding, the Public Representative has submitted an alternative set of volume loss estimates. PR Comments at 29. As noted above, and will be discussed further below, the reasoning behind his proposed adjustments is fatally flawed. Moreover, as Mr. Thress indicates in his separate Reply Statement at pages A-11 – A-12, the Public Representative has also failed to execute his intended set of adjustments properly. His misunderstanding of the mechanics of the spreadsheet have caused him to remove lost volumes beyond those he purports to have intended to remove. For that reason alone, the Commission cannot rely on his proposed adjustments.

Moreover, as the Public Representative recognizes in footnote 23 on page 29, the full ramifications of his *ad hoc* approach to the task at hand are fundamentally unclear. Mr. Thress has presented a fully integrated set of analyses, in which the volume estimates behind the Postal Service's financial projections for FY2013 and FY2014 have been decomposed into components identified as recession-related or not. This creates a necessary consistency between the Postal Service's estimate of exigent harm, and its estimate of exigent remedy generated by the new rates. The Public Representative's decomposition is not integrated with anything, and it is therefore unclear how one is expected to reconcile his proposals with "test year" financials. Certainly all of the volume forecasts would no longer be aligned with the volume loss estimations. The Commission made very clear its expectation that the quantification of the estimated harm should be compatible with the volume forecasting methodology. Order No. 864 at 50. The Public Representative's tentative attempts to adjust Mr. Thress's results, while flawed in and of themselves, would fail to provide a usable product even if, contrary to fact, they were not inherently flawed.

G. The Public Representative's Attempts to Ignore Actual Volume Losses, Because of His Own Theoretical Expectations With Respect to the Postal Service' Ability to Respond to Those Volume Losses, Provide No Valid Basis to Reject or Alter the Exigent Request

The Public Representative takes umbrage that "[t]he Postal Service Request does not present total revenue and contribution losses 'due to' the recession. This might be because the Postal Service would like the Commission to believe the effects of the recession are continuing, and may be felt for 20 or more years." PR Comments at 15. In reality, of course, it is not simply that "the Postal Service would *like* the Commission to believe that the effects of the recession are continuing," but rather that virtually any observer of the economy, serious or casual, would acknowledge that the effects of the Great Recession are continuing. That is true not only for the economy in general, but, as Mr. Thress demonstrates, even more so for the Postal Service specifically, given the sectors of the economy upon which it is most dependent. The Public Representative's preferred views on the mechanics of an exigent postal rate adjustment do not and cannot miraculously transform a continuing global saga into a neat and tidy historical narrative set entirely in the past. Take, for example, the Public Representative's claim that "[w]hat is missing is a Postal Service statement such as an additional $1.78 billion in contribution is 'necessary' for the Postal Service to continue providing effective and adequate postal services *until the Postal Service has recovered from the effects of the recession*." *Id.* (emphasis in original). The claim apparently presumes, with no basis beyond sheer assertion, that the Postal Service in fact will "*recover*" from the effects of the Great Recession. Those effects, stated most succinctly, are lost volume, and while not entirely impossible, the prospects of the Postal Service ever recovering that lost volume are remote at best.

Therefore, when claiming that, if the purpose of the exigent request is to recover from the recession, "the request should be based on the total effects of the recession," *id.* at 18, the Public Representative is merely postulating his own standard. That standard not only lacks any basis in the law or the Commission's rules, but it would also be impossible to meet under the current circumstances. Rather than unnecessarily attempting to seek to quantify the "total effects" of the Great Recession, the Postal Service has reasonably and practically expressed those effects in terms of estimated *annual* effects in a given year. Such an *annual* measure of net adverse financial impact can be easily evaluated against the *annual* anticipated remedy provided by the exigent rate adjustment, to ensure that the latter does not exceed the former. *See* Order No. 864 at 46.

To the extent that the Public Representative also expresses concern regarding how the appropriate year for the *annual* comparison should be selected, PR Comments at 18, the relevant criteria are not all that difficult to identify. The value of the exigent rate adjustment ($1.78 billion in additional contribution) is calculated by Mr. Nickerson explicitly using FY2014 volumes and unit contributions, and therefore implicitly FY2014 revenues, and attributable costs. At one level, therefore, the most valid estimate of harm for comparison with the amount of remedy provided by the new rates would likewise be an estimate of lost volume in FY2014, evaluated using FY2014 unit contributions. Since FY2014 volumes are necessarily forecasts, however, there might be a preference for using the most recent year of historical volumes available when the case was constructed. That year is FY2012, and using the FY2012 unit contributions, the estimated harm is $6.644 billion. This is as close to FY2014 as one could get at the time the case was filed with totally historical data.

Moreover, as Mr. Nickerson has discussed, Nickerson Statement at 4 fn.2, the FY2012 estimate of lost volume (i.e., volume that was absent in FY2012 on account of the Great Recession) can be evaluated using either FY2012 or FY2014 unit contributions. Since FY2014 unit contributions are the same ones used by Mr. Nickerson to evaluate the value of the new contribution from the exigent rate adjustments, it would be reasonable to consider the estimate of harm using FY2014 unit contributions to provide the more valid basis for comparison. As Mr. Nickerson's footnote indicates, that amount is $7.669 billion, which represents the net financial adverse effects in FY2014 alone of volume lost through FY2012 due to the Great Recession, *further assuming that no additional volume was lost between FY2012 and FY2014 due to the Great Recession.* Moreover, the spreadsheet in USPS-R2010-4R/11, from which Mr. Nickerson obtains the lost contribution estimate of $7.669 billion using FY2012 volumes and FY2014 unit contributions, shows the same calculation using corresponding lost volumes for each previous year with FY2014 unit contributions. It shows the net adverse financial impact in FY2014 alone of recession-related volume lost through FY2008 as $1.460 billion, through FY2009 as $4.257 billion, through FY2010 as $5.602 billion, and through FY2011 as $6.680 billion, all calculated using FY2014 unit contributions. For all years past FY2008, each of these FY2014 evaluations of exigent harm is well in excess of the FY2014 evaluation of the value of the new exigent rates.

Admittedly, none of this addresses the Public Representative's claims about the potential effect of the Postal Service's ability to "right-size" the network to mitigate the harm from lost volume due to the Great Recession.

> Almost six years after the start of the recession, the Public Representative would assume that postal management has reacted, and is somewhere on the path to adjusting to the new normal. . . . It is not equitable to compensate the Postal Service for FY 2008 network capacity, when this network capacity is no longer required to meet present or future mail demands.

PR Initial Comments at 17-18. Similarly, the Public Representative asserts as fact that "the network capacity will be reduced over time and the Postal Service need not be made whole to pay for network capacity that no longer exists," and that "the problem with the Postal Service's current estimate of volume loss" is that the Postal Service "would like to continuously be reimbursed to support the size of its network at the beginning of the recession, even though its network currently is much smaller." *Id.* at 22.[7] The Postal Service acknowledges that, since the framework of the present exigent

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[7] Once again, the Public Representative is confusing two entirely separate issues by claiming that the presence or absence of subsequent responsive network adjustments somehow creates a "problem" with

case is to compensate the Postal Service for lost contribution to the recovery of institutional costs associated with the volume declines from the Great Recession, it is theoretically conceivable that such compensation may not be entirely necessary if the Postal Service were already actually able to shrink institutional costs in response to the volume decline by shrinking the size and scale of its networks.

In the real world, however, the Postal Service's networks are much more a function of its universal service obligations and service standards than simple mail volume. Broadly speaking, the Postal Service must deliver mail to every address, and the size of the delivery network certainly keeps growing every year despite the fact that mail volumes are declining. Service standards, rather than mail volume, are in many respects the more critical drivers of the scope of the required facility network. And, virtually by definition, the same is true of institutional costs. If specific cost components varied automatically in response to changes in mail volume, they would not be institutional costs, but rather volume-variable costs. One cannot blithely assume, as the Public Representative has in the above statements (without any reference to reported postal costs), that network adjustments have inevitably followed volume declines in the past, or that network adjustments will inevitably follow volume declines in the future.[8]

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the Postal Service's methodology for estimating lost volume. Lost volume is lost with or without network adjustments, and the potential for such subsequent operational adjustments has no role within appropriate *volume* estimation and decomposition procedures.

[8] Note that the Postal Service in this context is referring only to the relationship between institutional costs and volume changes. In the remand phase of Docket No. R2010-4, the Postal Service had occasion to point out that, in FY2008 and FY2009, volumes were falling so fast that the Postal Service was unable to adjust even its volume-variable cost components in proportion to the volume declines. *See* Initial Comments of the Postal Service Regarding Remand, PRC Docket No. R2010-4R (July 25, 2011), at 47-50. Fortunately, in the intervening years, the Postal Service has been able to rectify that situation, and there is no apparent dispute that, with respect to volume-variable costs, the Postal Service has been able to adjust to the new lower overall levels of mail volume. Therefore, a multiplication of the lost number of pieces of mail by the relevant unit contribution per piece now provides a more appropriate measure of the

To be sure, postal management has “reacted” and attempted to adjust to the “new normal,” in the form of the significant cost reductions that it has achieved, and will continue to achieve as part of its Five-Year Plan, as discussed further in sections III and V below. That Plan includes initiatives relating to the Postal Service’s networks that can only be achieved through legislation and that have so far been thwarted. Curiously, though, the Public Representative’s counterparts have opposed one of the Postal Service’s primary such efforts. In Docket No. N2010-1, the Postal Service proposed to reduce the institutional costs associated with delivery by reducing street delivery to five days per week. The Public Representatives in that case urged the Commission to recommend against that effort. Public Representative’s Brief, Docket No. N2010-1 (Oct. 15, 2010), at 3, 20. They did so, in part, on the theory that mere temporary volume losses from the Great Recession would not allow the Postal Service to recoup all of the cost savings that it had estimated:

> A question was raised on the record as to whether mail volume actually will remain at or below FY 2009 levels for the Postal Service, given that predictions made by the foremost forecasting experts in the 1970s and 1980s about where mail volume would be 10 years later were not highly accurate. Tr. II/471. In addition, FY 2009 represents a severe recessionary period, so volumes may have been suppressed for that reason, as well as because of internet diversion. As the major cost savings presented in the Plan assume that mail volume, and therefore routes, do not increase above 2009 levels, if volume demand were to increase above 2009 levels for several years, cost savings could be reduced.

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net adverse financial effects than it might have, for the reasons discussed in the Postal Service’s remand comments, when applied in the 2008-2009 period. As the Postal Service has been able to reduce volume-variable costs year by year in response to volume changes, those reductions are reflected in the year-by-year changes in the ACD unit contribution figures used to quantify the harm from the volume losses.

Id. at 18 (emphasis added). Given his colleagues' opposition to the Postal Service's earlier effort to reduce network costs in response to the Great Recession, it is astonishing that the Public Representative now attempts to blame postal management for the circumstance that the facts do not bear out his unsupported assertion that "its network currently is much smaller" than it was at the beginning of the recession.[9] PR Comments at 22 fn.15.

All parties agree that volumes have been declining over recent years. As the Public Representative's Brief in Docket No. N2010-1 indicates, exactly when it becomes clear that those volumes are truly unlikely to come back is not a simple matter to resolve. But, more critically, the size of the postal operations network (and, in some more relevant respects, the size of the pool of all institutional costs that needs to be recovered) is a function of many other factors besides volume. To assume that overall volume declines automatically translate into network reductions and institutional cost reductions, as the Public Representative does, is fundamentally unreasonable. But it is even more patently unrealistic to expect, as the Public Representative implicitly does in his criticisms of Mr. Thress, that it is actually possible to segregate, year by year as they occur, volume losses into categories of those pieces that will automatically convert to network reductions, and those pieces that will not. The analysis used by Mr. Thress and Mr. Nickerson to quantify the net adverse financial impact of the Great Recession

[9] The Public Representative derides the Postal Service's view that exigent funding will be necessary until Congress makes fundamental change in business model, yet nonetheless on the very same pages makes a direct connection between the continued need for exigent funding and the Postal Service's ability to adjust to the "new normal." *See* PR Comments at 14-15. The comments in this respect seem utterly oblivious to the fact that the Postal Service cannot adequately adjust to the "new normal" unless and until Congress grants it the full authority to exercise the flexibility commensurate with the necessary new business model.

on institutional cost recovery comports entirely with the steps identified in Order No. 864, and the Public Representative's criticisms of the Thress methodology provide no valid basis to depart from those procedures.

H. GCA's Criticism of the Postal Service's Quantification of Exigent Harm, and Other Aspects of Its Demand Analysis, Are Without Merit

GCA's challenges to the Thress quantification of exigent harm, GCA Comments at 2-20, fail in every respect. GCA's simplistic view that the effects of the Great Recession on the Postal Service ended in 2009 is factually wrong, and it manifests a fundamental misunderstanding of demand analysis and forecasting in the postal context. In insisting that the Postal Service has not adequately distinguished volume losses due to the Great Recession from volume losses due to ongoing diversion, GCA has not only distorted the record, but in essence has additionally imposed on the Postal Service the "quixotic search for perfect proportionality" that Order No. 864 expressly disavowed would be required. Lastly, the "special problem" in Single Piece First-Class Mail alleged by GCA is merely the illusory result of flawed analysis. GCA's further allegations about demand elasticities, while not pertinent to the exigent harm quantification, are nonetheless as devoid of validity as the rest of its arguments.

1. The Harm Inflicted by the Effects of the Great Recession Is Not Confined Merely to the Years Within the NBER Start and End Points

GCA claims that any volume losses which occurred after the end of the recession "as pinpointed by" the National Bureau of Economic Research (NBER) cannot be counted towards exigent harm. *Id.* at 2-8, 19. GCA cites an observation made by the Commission in Order No. 547 that including any such losses "would appear to be problematic," although, to its credit, GCA does not attempt to claim that this remark disposes of the issue. As already explained by the Postal Service in its Request, however, the potential concern posed in Order No. 547 was noted only days after NBER issued its determination, was presented without any opportunity for parties to react, and was therefore appropriately made in only the most tentative of terms.

Moreover, that hesitancy to say more was prudent and fully warranted. Even at the most superficial level, purporting to exclude all losses strictly on the basis of the NBER "end date" does not withstand scrutiny. The end of a recession is the start of the recovery period, not the end of the recovery period. When a worker does not get paid because he was sick and missed a full five-day work week, no one could reasonably say that if his fever quit climbing and started to drop on the third day, the pay he missed on the two days after that was not "due to" his illness. Therefore, identifying the *relevant* date when things stopped getting worse on a macro-economic level is far from identifying the date when the harm stopped.[10]

Of course, as Mr. Thress explained in his Further Statement, the macro-economy does not move in unison, and the "end date" determined by the NBER on the basis of GDP is not the *relevant* "end date" in any sense for purposes of this exercise. This is because macro-economic factors other than GDP have been empirically shown to be more accurate than GDP for explaining changes in mail volume for specific categories of mail. For the two macro-economic variables most closely related to mail volume, as Mr. Thress summarizes on pages 13-14 of his Reply Statement, the turning points came

[10] As already noted, Request at 11 fn.19, based on a sample of one – that one being a judge on the D.C. Circuit panel that ruled on the previous exigent case – the notion that harm ended on the "official" end date of the Great Recession is not credible.

much later: 2011PQ1 for Private Employment Per Adult (First-Class Mail), and 2011PQ3 for Real Gross Private Investment per Adult (Standard Mail).

GCA utterly ignores the portion of Mr. Thress' presentation in which he explains why GDP is not the variable to examine for any realistic identification of the "end point" of worsening effects of the macro-economy directly on postal volumes. GCA instead trumpets only the end of the recession as "pinpointed by the NBER." Because, for purposes of assessing adverse effects on postal volumes, the NBER is "pinpointing" the wrong date, GCA's position that only 2008 and 2009 can be counted as "recession years," GCA Comments at 5, must be rejected at even this most basic threshold level. In terms of direct effects on postal volumes, the macro-economy was actually continuing to worsen through FY2010 and into FY2011.

Beyond this most basic confusion of the facts, however, GCA compounds its error by either misunderstanding or distorting the logic of demand analysis and forecasting. The logical flaw is evident when GCA postulates that mail volumes in one time period are not a function of macro-economic factors in previous periods. *Id.* at 3-4. <u>To be very clear, the ramification of this fundamental conceptual error extend well beyond *any* consideration of trends, or what may be viewed as other more complicated aspects of forecasting.</u> To illustrate this, the following hypothetical strips everything down to the least complicated level possible. Assume that there is only one macro-economic index, and that mail volume moves in direct proportion to that index. Consider the following pattern of events, consistent with those assumptions.

	2006	2007	2008	2009	2010	2011	2012
Macro-Index	195	200	175	150	125	126	127
Mail Volume	195	200	175	150	125	126	127

The story behind these hypothetical numbers is simple: the economy went into recession in 2008, the recession continued through 2009 and 2010 as the macro index continued to fall, the "end point" of the recession came at the end of 2010 with the appearance of positive (if minimal) growth in 2011 and 2012, and mail volumes followed the macro-index. Under GCA's view (as implicit in the table on page 5 of its comments), volume losses only count in "recession years," in this instance, 2008-2010, so the appropriate interpretation of this hypothetical according to GCA (in terms of mail volume lost due to the recession in each given year alone) would appear to be follows:

	2008	2009	2010	2011	2012
GCA Recession Volume Loss	25	50	75	0	0

Viewed correctly, of course, under this hypothetical, the volume losses due to the recession manifestly continue on to what GCA would call the "post-recession" years of 2011 and 2012:

True Recession Volume Losses	25	50	75	74/75	73/75

For purposes of this discussion, there is no need to resolve the question of whether the appropriate harm calculations for 2011 and 2012 are 73 or 74 or 75 or something similar (although that issue is addressed elsewhere in these Reply Comments). Instead, what is important to see here is what GCA steadfastly refuses to acknowledge: mail volume in 2011 and 2012 is substantially below what it would have been in the absence of the recession, and therefore any competent evaluation of mail volume lost "due to" the effects of the recession cannot simply ignore the *effects* of the recession in post-recession years, in contrast to the recognition of effects during recession years. The effect in those post-recession years is emphatically not zero.

GCA asserts that it is "incoherent" to say that mail volumes in one quarter are caused by macro-economic factors prevailing many quarters earlier. *Id.* at 3. In fact, GCA has this exactly backwards. It is "incoherent" to say that mail volumes in one quarter are unaffected by the net effect of macro-economic factors over all previous quarters. As is evident from the sources of changes tables presented by Mr. Thress, volume forecasting is conducted by moving from a base period to a forecast period. This is not done just as a convenience for the forecasters, but rather because this is how mail volumes behave. GCA's failure to grasp this reality invalidates its entire argument regarding the period over which mail volumes can be lost and have been lost due to the macro-economic effects of the Great Recession. *Id.* at 2-8.

Moreover, GCA's befuddlement regarding the continuing effects on mail volumes over time of changes in mail-driving factors which occur in earlier periods not only taints any discussion of direct macro-economic effects, but precludes appropriate understanding of mail *trends* as well. As Mr. Thress explained in detail in response to POIR No. 1, Question 9, the shock of the Great Recession appears to have changed consumers' attitudes on topics as fundamental as their willingness to take on debt. As he observed, changes of this nature have a significant effect on underlying mail volume trends and are likely to continue to affect the Postal Service adversely even as the cyclical effects of the Great Recession fade. That concept is aptly summarized in his quotation in response to POIR No. 9, question 12, of the comments of 2010 Nobel Laureate and labor economist Dale Mortenson in a 2011 panel discussion on the Great Recession: "If you look at the data, what happened was unemployment doubled in a year, and it didn't do that for structural reasons. It obviously did that because all of a sudden expectations changed. And expectations, as far as I can see, haven't changed back." GCA's strained notion that the effects of changes in mail-causing factors are somehow metaphysically constrained to the quarter in which they occur has no basis in facts or in logic.

2. The GCA Discussion of Electronic Diversion Offers No Valid Criticism of Mr. Thress

The portion of GCA's comments addressing electronic diversion, *id.* at 8-14, is disconcerting in a number of ways. The Postal Service agrees with GCA that one of the more challenging aspects of the Commission's prescription in Order No. 864 is to attempt to segregate the effects of ongoing electronic diversion from the effects of the Great Recession. GCA's problems start when it first alleges that Mr. Thress has attempted to achieve this objective by "purely statistical (econometric) means." *Id.* at 10. GCA is apparently of the opinion, though, that the necessary questions "cannot be answered by a purely econometric approach." *Id.* at 9. Rather, according to GCA, an "historical inquiry" is needed because these "are not questions that can be answered by statistical techniques in an econometric analysis of volume behavior." *Id.* at 11. Yet then, rather inconsistently, GCA turns around, injects into the discussion a variety of data about various electronic devices and technologies, and claims that developments of this type "should have been studied, quantified as exactly as possible, and reflected in any econometric estimation of the impact of the recession." *Id.* at 13-15. GCA thus appears to be hopelessly conflicted as to whether Mr. Thress used too much econometrics, or not enough econometrics.

In claiming, however, that Mr. Thress improperly attempts to address electronic diversion solely with statistical and econometric analysis, and in further alleging that the Postal Service's written presentation includes no "historical inquiry" regarding electronic diversion as "the net result of a multitude of human decisions," *id.* at 10-11, GCA is simply ignoring the record developed in this and many other cases. That Mr. Thress and his colleagues have over the years devoted considerable time and effort to conducting the "historical inquiry" which GCA believes to be so critical is patently obvious from the testimonies submitted by Mr. Thress and Peter Bernstein in the last several omnibus rate case dockets. Indeed, if one wanted to quibble at all with how to characterize that effort, it might be to suggest that "historical" inquiry is not a perfectly apropos term, because extensive research and analysis have been conducted as these developments unfolded, rather than waiting to consider them solely on a *post hoc* "historical" basis.

In this case, the depth and scope of the attention that Mr. Thress and the entire postal demand analysis team have devoted to the topic of electronic diversion is reflected most fully in Mr. Thress' responses to POIR No. 3, Questions 1- 2; POIR No. 4, Questions 2 and 4; POIR No. 6, Questions 12, 13, and 25; and POIR No. 9, Questions 7, 9 and 11. Yet if there is even one citation to a POIR response in this portion of GCA's comments (indeed, in the entire 28 pages of those comments), it is extremely well hidden. GCA may be enamored with proposing Information Request questions, but has no discernible inclination to bother to acknowledge the answers. The ability to ignore written responses, however, does not justify the affirmative allegation that they have not been presented.

In the POIR responses that GCA chooses to ignore, Mr. Thress does far more than merely demonstrate "that an increase in diversion happened more or less coincidentally in time with the onset of the recession." GCA Comments at 10. Mr. Thress identified the shifts in factors such as the number of credit card accounts and the number of consumer loans, and the disproportionate impact of the Great Recession on those who were more likely to pay their bills by mail. *See, e.g.*, Responses to POIR 6, Questions 4 and 25. But equally importantly, he reviewed the sequence of technological and behavioral shifts which have enabled the diversion of mail to electronic media, and he carefully examined the timing of the volume declines to be explained as he searched for any plausible alternative explanation. *Id.* As portrayed in compelling fashion in Mr. Thress's Reply Statement, the details of the timing aspect render that explanation too unlikely for it to survive as a viable alternative hypothesis. In other words, despite GCA's expectations to the contrary, *see* GCA Comments at 14, the "statistical procedures" employed by Mr. Thress, in the form of the graphs displayed in his Reply Statement, strongly refute the possibility that the "wide availability of new electronic devices and services" caused the volume declines that Mr. Thress has instead attributed to the Great Recession.

GCA's immediate reaction to this might be that Mr. Thress, in fact, has not *proven* that the Great Recession caused those volume declines. Admittedly, like in many criminal trials, the evidence available is largely circumstantial. There is no smoking gun, no surveillance camera videotape, and no signed confession. There are no DNA samples to be tested. Nonetheless, all that is required here is appropriate application of Occam's Razor, a construct of logic that, stated in common parlance, suggests that simpler explanations are, all things being equal, generally better than more complex ones. Diversion of mail to electronic media was proceeding at a relatively smooth pace in the years leading up to the Great Recession. When that extraordinary event hit, mail volumes plummeted. The Great Recession was an undeniable "shock" to the nation's economy. Coincident with the arrival of the Great Recession and the volume plunge, there was no comparable technological "shock" that could have plausibly caused previously smooth rates of technological diversion to multiply at anywhere near the magnitude necessary to cause the observed volume declines. The far simpler explanation, and the far better one, is that those volume declines are, as Mr. Thress properly concluded, attributable to the Great Recession.

GCA characterizes the standard to be met as one that must be strict because the exigent provision is a *narrow* exception to the price cap regime, and on that basis urges the Commission to reject Mr. Thress' conclusion regarding the relative roles of the Great Recession versus ongoing electronic diversion. *Id.* at 9. In this sense, however, GCA is merely attempting to roll back the portions of Order No. 864 in which, as summarized earlier in these Reply Comments, the Commission recognized that there would always be some degree of imprecision in the quantification of harm, particularly with regard to the difficulties inherent in untangling the interaction of multiple factors. Order No. 864 at 48, 52. The Commission assured the Postal Service that it would simply be expected to support its exigent request with credible proof based on a combination of econometric models and expert opinion. *Id.* Mr. Thress, one of only an extremely small group of people whose entire careers (both before the Great Recession hit and thereafter) are devoted to understanding and forecasting changes in the mail volume flowing through our nation's postal system, has amply provided credible proof based on both.

GCA implicitly acknowledges that, if the recession-related volume losses estimated by Mr. Thress are accepted, the amount of relief afforded by the exigent rates sought by the Postal Service is only "a relatively small portion" of the exigent harm. GCA Comments at 20. These circumstances bring into play another portion of Order No. 864. As part of the discussion of how difficult it might be to meet the standards contemplated by the Order, the Commission made the following observation:

> Supportable methods justifying the quantification must be commensurate with the amount of the proposed adjustment. A larger amount requires more rigorous estimation techniques and a more persuasive showing that the sums sought are the result of the exigent circumstances.

Order No. 864 at 50. Although perhaps not stated explicitly, a logical corollary to this evaluation guideline would seem to be that, the closer the Postal Service comes to meeting or exceeding the quantified harm with its proposed rate adjustment, the more persuasive the showing of exigent harm that must be made. Needless to say, the Postal Service is firmly of the view that its showing of harm is entirely persuasive. But with GCA and others seeking to emphasize the *narrow* nature of the relief available under the exigent safety valve as grounds for the Commission to *raise* the level of proof required, it should be emphasized that this view is out of step with the principles that the Commission has already articulated.

Moreover, Mr. Thress does not need to be entirely correct in his attribution to the Great Recession of the mail volume losses picked up by his trend terms in order for an substantial positive margin to be maintained between quantified harm and the expected value of the proposed rates. Instead, he would have to be *almost entirely incorrect* in order for the proposed exigent relief to even begin to come close to exceeding the true exigent harm. Even GCA does not go so far as to make that claim. GCA Comments at 19-20. As the Commission properly recognized in Order No. 547, the Postal Service suffered a huge financial blow when the Great Recession hit. Even after making reasonable allowances for ongoing electronic diversion that would have continued regardless, the Postal Service is still seeking relief for only a "relatively small portion" of the exigent harm.

3. Just Because GCA and Its Analyst Do Not See Any Changes in the Trends for Single Piece First-Class Mail At the Time of the Great Recession Does Not Mean Such Changes Are Not There

GCA points to what it calls a "special problem" for Single Piece First-Class Mail. *Id.* at 15-19. In the view of GCA, that problem arises because Mr. Thress identifies a break in the trend for First-Class Mail, coincident with the onset of the Great Recession, and yet GCA cannot discern any such trend. As Mr. Thress explains on pages A-16 – A-20 of his Reply Statement, Dr. Clifton does not see the break because he is not employing the appropriate procedures to look for it. Single Piece First-Class Mail trends did indeed change significantly at the time of the Great Recession. As there is thus no "special problem" with this category of mail, this section of GCA's Initial Comments therefore becomes irrelevant.

4. GCA Provides No Reliable Basis to Question the Postal Service's Price Elasticity Estimates

GCA includes a section that argues that the proposed exigent rate adjustments are not "reasonable" under the statute. GCA Comments at 20-25. GCA reaches this conclusion based on an assertion that postal price elasticities are significantly higher than have been estimated. GCA submits that the "Commission should not rely on [those elasticities] to support the conclusion that the proposed increases will produce revenue estimates anywhere near those the Service claims for them, and in some cases might actually lose revenue." *Id.* at 24. Needless to say, this appears to be a rather strange position for an opponent of the proposed rate adjustments to be advocating. If the Postal Service is going to obtain the contribution target that it has set (which, after all, is only a portion of the estimated harm), higher elasticities would mean that higher rate increases would be needed to yield the same amount of net contribution. In other words, the proposed rates could only be considered "unreasonable" relative to the higher rates which would achieve the contribution target, and which would, by that measure (the "desired goal" measure, as GCA dubs it), be more "reasonable." That is the natural implication of the factual assertions that GCA is advancing.

Not surprisingly, GCA is not going down that road. Instead, GCA argues that a price increase which reduces revenue or brings in significantly less revenue than anticipated is unreasonable. *Id.* at 23. Why GCA is focusing on revenue, rather than contribution, is not entirely clear (although one can make a pretty good guess). In any event, GCA apparently maintains the view that negative revenue or significantly less revenue than anticipated will occur in this docket if the proposal is approved. *Id.* The consequences of this conclusion, however, are rather stark and, once again not surprisingly, GCA does not spell them out. If the elasticities are as GCA hypothesizes, then not only are rate increases as proposed in this case unreasonable, but any increase in real prices (i.e., above the rate of inflation) would likewise be unreasonable. GCA has thus presented no basis to declare the instant exigent rate request unreasonable that would likewise not render any other exigent rate request unreasonable. In other words, GCA is seeking nothing less than to write the exigent safety valve out of the statute, at least unless and until elasticities return (in GCA's view) to more traditional levels .

On any number of levels, these views are unsustainable. Increased contribution is the "desired goal," not increased revenue. More to the point, however, the factual predicate for the GCA assertions does not withstand scrutiny. There is no sound basis presented by Dr. Clifton to call the current elasticity estimates into question. *See* Thress Reply Statement at 41-58. The most obvious flaw in Dr. Clifton's comparison of the Postal Service's elasticity estimates to those suggested by other researchers is the failure to account for the offsetting effects of cross-price elasticities from other postal products. Therefore, the premise for this entire line of argument in the GCA Comments is counter-factual, and the hypothesized concern provides no legitimate impediment to implementation of the proposed exigent rates.

I. The Criticism of the Thress Analysis Offered by Valpak are Long on Rhetoric and Short on Substance

Valpak devotes 22 pages of its Initial Comments to criticism of Mr. Thress's analysis estimating mail volumes (by product) that have been lost due to the Great Recession. Valpak Comments at 26-48. Most of this is focused exclusively on the estimates for Standard Mail. *Id.* at 26-42. Valpak expresses great consternation that Mr. Thress' estimates of the negative impacts on Standard Mail exceed the net effects of all factors (positive and negative) over the relevant time period. Thus, for example, with respect to Standard Mail Letters, Valpak declares that "[n]ever explained is how witness Thress could decompose an actual decline of 8 billion pieces into a 'virtual' decline of 21 billion pieces." *Id.* at 37.

In fact, Mr. Thress has provided a great deal of explanation regarding Standard Mail specifically, most of which came in response to POIR questions suggested by Valpak. *See, e.g.*, Responses to POIR 1, Questions 1, 7, and 8; POIR No. 3, Question 2; POIR No. 7, Questions 10 and 11. As if committed not to let inconvenient facts get in the way of a prepared script, Valpak never mentions any of these responses, except to cite one response on the subject of mail classification terminology. In terms of the substance of Valpak's comments regarding why the observed estimates are indeed reasonable, Mr. Thress already provided the requested explanations in the POIR responses cited above, and he reiterates those explanations in his attached Reply Statement.

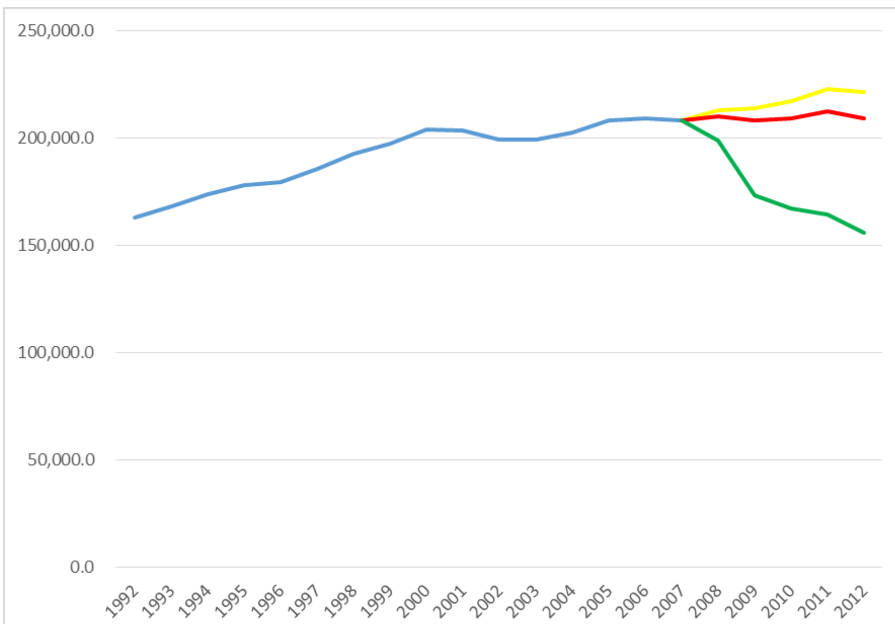
One claim made by Valpak regarding Standard Mail merits additional comment, however. In providing its bullet point notation of three specific results it purports to find particularly suspect, Valpak alleges that Mr. Thress concludes "that catalogs in the Flats product are <u>profoundly affected</u> by the 2008-2009 recession, while catalogs in the Carrier Route product are <u>completely unaffected</u>." Valpak Comments at 42 (emphasis in original). It is incorrect to claim that Mr. Thress concluded that Carrier Route mail was completely unaffected by the Great Recession. Indeed, that claim in this portion of the Valpak Comments is contradicted by Valpak's own discussion of the matter on page 39 and in the tables appearing on page 40.

Leaving specific discussion of Standard Mail behind, Valpak shifts the rhetoric into overdrive when it claims that the assumed scenario from which volume losses are estimated is "supremely optimistic." *Id.* at 42-48. Valpak starts by declaring the volume forecasting baseline extrapolated from the pre-Recession era as reflecting "the Great Party." The comments then resurrect an earlier hypothetical regarding a potential requirement that the Postal Service be obligated to return "excess profits" it earned over that period. *Id.* at 43. The implicit suggestion here is that the Postal Service must have done something improper during those years by accepting the mail tendered by its customers, as if it had some ability instead simply to refuse to deliver mail. Moreover, these events occurred while the Postal Service was under the break-even constraint of the pre-PAEA regime, with no opportunity for any retained earnings, much less "excess profits."

If, as Valpak asserts, it was so obvious that the "party" was unsustainable, why would Congress have nonetheless chosen that time to impose a price cap regime on the Postal Service, with no routine mechanism for adjusting to severe economic "corrections"? The simplest, most logical (and correct) answer is that Congress built in a safety valve to address circumstances causing volume declines so substantial that the Postal Service could not adjust to them in the ordinary course of business. In emphasizing the unsustainability of the economic environment in place when the PAEA was enacted, Valpak simply buttresses the view that Congress intentionally made provision for that unsustainability when it included the exigent request provision to address exceptional or extraordinary circumstances of the type which unfolded in 2008 and beyond.

Nonetheless, as Mr. Thress explains in his Reply Statement, his baseline scenario was neither “supremely optimistic” nor “rosy.” That fact comes through most vividly in the graphs Mr. Thress included in his response to POIR No. 6, Question 1. Surprisingly, Valpak itself cites the very same graphs to support its erroneous view that Mr. Thress’s baseline for comparison (the red middle line in the graph below) is so unrealistic that it would require “the arrival of economic nirvana.” Valpak Comments at 46-47.

Total Market Dominant Mail



Note: Volume here excludes First-Class Parcels, Parcel Post, Lightweight Parcel Select, and Free Mail.

Mr. Thress explains in greater detail in his Reply Statement why Valpak’s hyperbolic characterization of his baseline is itself baseless. However, the most salient point is one that he already made in the same POIR response, in the section directly below the graph:

> Market-Dominant Mail volume grew at an average annual rate of 0.9 percent from FY 2002 through FY 2007. In the absence of the Great

> Recession, Market-Dominant Mail volume would have been expected to grow at an average annual rate of 0.1 percent from FY 2007 through FY 2012. This still would have been the lowest growth rate for mail volume over any five-year period since at least 1947.

Emphasis added. Despite all of its bluster, Valpak neglects to offer any specific alternative to the implicit Thress baseline. That deficiency in its submission is of no great importance, however, as Valpak fails completely in its attempt to paint the Thress baseline estimates of what volumes would have been in the absence of the Great Recession as something other than what they are: inherently reasonable.

J. Other Comments Fail to Acknowledge the Breadth of the Postal Service's Quantification Analysis

In assessing the Postal Service's initial request for exigent relief, the Commission reached the following conclusions:

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

Order No. 547 at 50. Accordingly, in order to quantify the harm caused by the exigent circumstances identified by the Commission in Order No. 547 – the "recent recession and its impact on postal volumes" – the renewed exigent request filed by the Postal Service in this proceeding employs the same procedures long used by the Postal Service to forecast mail volumes. Having quantified such harm, the Postal Service is now merely seeking to recover only a modest portion of that amount through price adjustments above the CPI cap.

Nevertheless, at least one other commenter asserts that virtually all of the losses claimed by the Postal Service result from the effects of electronic diversion. Senator Collins Comments at 1-2. Reading those comments in isolation, one might presume that the Postal Service has somehow failed to locate the dramatic and unprecedented *recession-related* losses noted by the Commission in the above-quoted passage from Order No. 547, and that the Postal Service was instead pointing only to “foreseeable” and “predictable” declines in mail volume due to electronic diversion. Such a presumption would be incorrect. In fact, the Postal Service has carefully identified the “foreseeable” and “predictable” portion of volume losses due to electronic diversion, and explicitly <u>excluded</u> those continuing losses from its entirely separate estimate of recession-related volume losses. Of course, the Postal Service’s estimates affirmatively do encompass the broader effects of the recession on consumers and businesses described in Order No. 547, effects that the commenter, in her haste to discount any connection between the recession and electronic diversion, completely fails to acknowledge.

For each mail category, the Postal Service has presented a comprehensive and detailed analysis to decompose the various factors which have affected mail volumes, from the periods prior to the Great Recession and continuing up to the present. In contrast, the commenter offers nothing to support her supposition that the Postal Service’s dramatic (to say nothing of ”significant and substantial”) losses in volume, revenue, and contribution, which emerged simultaneously with the financial collapse now known as the Great Recession, were actually "a result of electronic diversion and similar long-term trends." *Id.* at 2. The further implication of this position, that "the Postal Service [could] reasonably be expected to adjust to [these losses] in the normal course of business," *id.* at 1, ignores the strictures of the price cap regime established by the PAEA, for which the exigent provision was specifically included to provide a necessary safety valve.

K. Mr. Buc's Analysis Is Too Limited in Size and Scope To Be Useful in This Proceeding

On behalf of a consortium of mailers, Lawrence Buc submits a Statement presenting results of surveys he conducted for two purposes. First, he addresses the question of price elasticity. Second, he addresses the question of the relationship between the Great Recession and electronic diversion. None of his results are particularly informative.

With respect to own price elasticity estimates, Mr. Buc concludes based on his research that own-price elasticities estimated by the Postal Service for First-Class Mail and Standard mail are too low. In other words, he is suggesting that those classes are more price sensitive than the Postal Service's long-standing econometric analyses have shown. According to the Buc Group Coments at 6, the Postal Service's elasticities provide no reliable basis for forecasting the effects of a [nominal] price increase of approximately 6 percent. In Section II of his Reply Statement, Mr. Thress explains why Mr. Buc's work does not validly support that conclusion. Moreover, while the Postal Service's confidence in its demand analysis is unshaken by Mr. Buc's presentation, what is curiously missing from both his Statement and the Comments to which it is attached is any explanation of what the consequences would be for this case even if he were correct. If the Postal Service obtains, on net terms, less revenue and contribution that its forecasts have projected, it would achieve less of the contribution recovery target that it hoped to achieve in this case. That does not, however, have any material bearing on whether the Postal Service has shown that it is entitled to recovery for the amount of harm for which the Postal Service is seeking relief. It is for the Governors to determine if the overall interests of the Postal Service are advanced by a request for exigent relief of this magnitude, and that determination has been made. Clearly, neither the Buc Group Comments nor Mr. Buc are suggesting the Commission should approve higher rate increases in order to make up from any target contribution lost to higher than anticipated volume responses.

The results of Mr. Buc's research regarding the relationship between the Great Recession and electronic diversion are apparently based on feedback from only 11 First-Class Mailers. This is far too small a sample to reach any valid general conclusions. That the transition process from hardcopy to electronic media for these individual business mailers was unaffected by the Great Recession merely suggests that they fell within the particular set of mailers who were continuing to shift away from hard copy media at pre-Recession rates. As shown in Mr. Thress's Table 2, for First-Class Mail as a whole, such mailers were expect to divert an additional 12 billion pieces of mail in 2012, relative to what had been diverted in 2007. None of this proves anything about the potential existence of other mailers whose corresponding shifts were affected by the Great Recession. Perhaps more importantly, there is nothing within these results that is inconsistent with the view that the shift from hard copy to electronic media is an ongoing but gradual process, influenced by factors as diverse as a company's focus on controlling costs and higher customer comfort levels. As such, that process is appropriately modeled through trend factors, as Mr. Thress has done. Mr. Buc's survey, of course, offers no insight as to how *consumers* might react to these issues.

III. THE STATUTE AND THE COMMISSION'S RULES REQUIRE THAT THE POSTAL SERVICE AND THE COMMISSION GIVE CONSIDERATION TO THE POSTAL SERVICE'S ABILITY TO MAINTAIN SUFFICIENT LIQUIDITY TO ENSURE THE CONTINUATION OF POSTAL SERVICES ADAPTED TO THE NEEDS OF THE UNITED STATES

The Public Representative, Valpak, and Valassis argue that the Postal Service's discussion of its liquidity position indicates that its Request is improper under the statute. However, these arguments do not provide any basis to reject the Postal Service's Request, because they fail to take into proper account the language of the statute (and the Commission Rule implementing that language) to which the Postal Service's liquidity discussion is directed: the requirement that for an exigent increase to be approved, it must be "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."

This "necessary" clause sets forth a standard that is independent of the "due to" provision found earlier in the exigency provision. Indeed, the structure of the exigency provision clearly shows that the "necessary" determination is something that the Commission considers once it has determined whether an increase is "due to" an exigent circumstance: that is, an increase that is "due to" an exigent event can only be approved "provided that" it also meets the "necessary" standard. Furthermore, the focus of the “necessary” inquiry is not on the “extraordinary or exceptional circumstances” that give rise to an exigency request, but on whether the requested price increase related to those circumstances is necessary to ensure that the Postal Service can continue providing “postal services of the kind and quality adapted to the needs of the United States.”[11]

The Commission’s rules reflect this distinction between the “due to” clause and the “necessary” clause. The “necessary” language of the exigency statute is repeated verbatim in a different provision in the Commission’s rules from the provision that implements the “due to” clause. 39 C.F.R. §§ 3010.61(a)(3), (4). *See also* Order No. 864 at 8 (noting that the “due to” test is implemented by Commission Rule 3010.61(a)(3)). The Commission has also recognized, consistent with the statute and its Rules, that the “necessary” provision is a separate test from the “due to” provision. *See, e.g.*, Order No. 864 at 51 (noting that even if the Postal Service can satisfy the “due to” requirement, an exigent request may still be denied if it is not “necessary”).”); Order No. 547 at 20 (noting that the “necessary” inquiry occurs after the Commission finds the “due to” requirement to be met). Furthermore, the Commission has recognized that the “due to” clause has a narrower focus than the “reasonable and equitable and necessary” clauses of the exigency provision. 864 at 36-37.

The plain language of the “necessary” clause makes considerations of the Postal Service’s overall liquidity situation relevant to an exigent request, once it is determined that the requested increase meets the “due to” requirement. It is only through the

[11] The purpose of this language is self-evident: even if the Postal Service has suffered financial harm as a result of exigent circumstances, there is no reason to pierce the price cap if doing so is not “necessary” to maintain and continue the development of universal postal services based on the needs of the American people.

maintenance of adequate liquidity that the Postal Service can continue paying those expenses that are necessary to "maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." Indeed, the Commission has recognized that postal operations depend fundamentally on adequate liquidity. *See* FY2011 Annual Compliance Determination at 22 ("Liquidity, or the availability of cash through operating revenues and debt, is the most important requirement for any business organization. Without the ability to generate sufficient cash from business operations, or to access sufficient debt capacity to invest in the business, an organization cannot continue to operate."). Adequate liquidity is not only necessary for the Postal Service to "maintain" its provision of postal services at the level "adapted to the needs of the United States," but also to make the capital investments that are essential for the Postal Service to "continue the development of" such postal services.[12] It is also necessary for the Postal Service to plan for and guard against contingencies, as any prudent, business-like organization should do. In sum, the "necessary" clause means that a consideration of an Exigent Request does not take place in a vacuum in which all consideration of the Postal Service's overall financial condition is ignored.

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[12] In discussing the meaning of the "due to" clause, the Commission said that "section 3622(d)(1)(E) establishes standards that do not directly relate to the Postal Service's fiscal soundness." Order No. 864 at 37. However, this statement was made in the context of discussing the meaning of the "due to" clause, which indicates that the Commission did not intend a definitive interpretation of the "necessary" provision. In any event, the statement cannot be squared with the plain language of that provision. In particular, the Commission did not and cannot explain how the phrase "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" can somehow be applied without considering the Postal Service's fiscal situation.

A. Valassis, the Public Representative, and Valpak Fail to Account for the Differing Elements of the Exigency Clause, as Reflected in the Commission's Rules

After wading through the misstatements of the Postal Service's position, Valassis's argument boils down to a view that the Postal Service cannot refer to its overall financial situation in justifying an exigent request. Valassis bases this position on its view that various statements made by the Commission in Order No. 547 means that any consideration of the Postal Service's financial condition is impermissible, because it would constitute the Postal Service using an exigent increase as a means of addressing "other problems which did not stem from the exigency." Valassis Comments at 17. *See also id.* at 28 (stating that the Postal Service seeks to use the exigency provision as a "general escape clause from the price cap").[13]

However, Valassis completely fails to recognize that the Postal Service's discussion of its liquidity position is in compliance with Commission Rule 3010.61(a)(4), which requires the Postal Service to provide "a full discussion" of why this increase is "necessary." Nothing in Order No. 547 sought to apply Rule 3010.64(a)(4) or the statutory language that it repeats verbatim. The Commission made this very clear in Order No. 547, in which it said that its threshold determination that the Postal Service had not satisfied the "due to" requirement meant that it did not need to consider whether the increase was "necessary." Order No. 547 at 27. The Commission also repeatedly emphasized following the remand that its decision in Order No. 547 was based solely on the "due to" clause, as effectuated by Rule 3010.64(a)(3). *See* Order No. 864 at 8

[13] The Public Representative and Valpak also take this position. For instance, the Public Representative states that the Postal Service's request should be denied because the Postal Service's discussion of liquidity "clearly indicates the need for an exigent price increase is 'due to' a perceived cost of service liquidity problem." PR Comments at 10. *See also* Valpak Comments at 18-20.

("The Commission denied the Exigent Request because the Postal Service did not demonstrate that its proposed adjustments were 'due to' the exigent circumstances. The Commission found that the Postal Service failed to show, as required by the Commission's rules, how the proposed adjustments 'relate to the extraordinary or exceptional circumstances that purportedly give rise to them.") (citations omitted). Thus, it was the failure by the Postal Service to "relate the proposed rate relief to the identified exigent circumstance" in compliance with Rule 3010.61(a)(3), that led to the Commission's view in Order No. 547 that the Postal Service was seeking to use the exigency provision as an attempt to resolve "long-term structural problems."

The Commission therefore did not purport to interpret the meaning of the "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" language of the exigency provision, or the Commission Rule that effectuates that language. *See id.* (noting that because the Commission had found that the Postal Service had not satisfied the "due to" requirement, "it was unnecessary for the Commission to decide whether the adjustments" satisfied the "necessary" test). *See also id.* at 30.[14] Indeed, the Commission did not even discuss Rule 3010.61(a)(4) in Order No. 547. Even if "reasonable and equitable and necessary" may also inform the meaning of Rule 3010.61(a)(3) to some extent, that does not in any way limit the plain language of this aspect of the statute or of Commission Rule 3010.64(a)(4).

[14] Remarkably, despite these clear statements by the Commission, Valassis attempts to argue that Order No. 547 also amounted to a finding by the Commission that the Postal Service had failed to adhere to the "necessary" prong. Valassis Comments at 9.

For all its arguments about the “necessary” prong, Valassis fails to even acknowledge the existence of Rule 3010.61(a)(4), much less explain how the Postal Service could satisfy the plain language of that Rule without discussing its overall liquidity situation. In fact, Valassis’s only discussion of the principle embodied in that Rule constitutes a brief discourse on how “the needs of the United States” in fact means a “healthy, thriving postal industry,” and that the health of the postal industry depends most critically on not increasing prices above the price cap. Valassis Comments at 34. Of course, if this were in fact the – which it clearly is not, since it refers broadly to postal services “adapted to the needs of the United States” – then language’s import the exigency clause would be meaningless, as no proposed exigent increase could ever be shown by the Postal Service to be “necessary.”

Valassis’s failure to appreciate the basic distinction between Rules 3010.63(a)(3) and (a)(4), and the statutory language they implement, is demonstrated most clearly by two statements in its Comments. It first claims that the plain language interpretation of the “necessary” provision set forth in the Postal Service’s Request means that the “upper limit equal to the net negative impact of the exigency disappears, and the Postal Service’s permissible recoupment from the exigency becomes limitless.” Valassis Comments at 11-12. This is simply false, because the “due to” clause and Rule 3010.61(a)(3) always acts as a check on the size of an exigent increase, regardless of whether an increase might be justifiable under the “necessary” language and Rule 3010.61(a)(4).[15] The Postal Service has not suggested to the contrary in this

[15] The inverse is also true, in that an increase might satisfy the “due to” clause but not the “necessary” clause. *See, e.g.*, Order No. 864 at 51.

proceeding, and in fact made that very point at pages 40-41 of the Request. Valassis, however, cites to that portion of the Postal Service's Request and expresses befuddlement as to "why [it should] make a difference whether the original net financial impact of an exigent request is still affecting the Postal Service" if "exigent increases do not need to address the effects of the exigency but may address the Postal Service's "overall financial situation." Valassis Comments at 18 fn.8 (internal quotation marks omitted). The answer is quite obvious: to the extent that the exigent circumstances are no longer affecting the Postal Service, the exigent increase is no longer valid because it no longer satisfies the "due to" requirement and Rule 3010.61(a)(3), even if the increase might still satisfy the "necessary" clause as reflected in Rule 3010.61(a)(4).

Similar to Valassis, Valpak attempts to argue that the Postal Service "believ[es] 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." Valpak Comments at 18 n.21 (emphasis in original). *See also id.* at 70-75. Valpak provides no citation reference to where the Postal Service has actually expressed such a "belief," and the Postal Service made no such statement in its Request. Rather, as discussed above, the Postal Service has made it very clear that the increase it is seeking in this docket represents a modest amount of the contribution that it has lost as a result of the recession, in compliance with the "due to" standard, while at the same time discussing why this increase is "necessary," in compliance with that portion of the statute and

Commission Rule 3010.64(a)(4).[16] The Postal Service has in no way "conflated" these two independent provisions of the statute and the Commission's rules.[17]

B. The Postal Service's Discussion of Liquidity is Fully Consistent with the Statute and the Commission's Rule

To be clear, the Postal Service in this Request is acting in full compliance with the Commission's prior determination regarding the meaning of "due to." It is this requirement that prevents the exigency provision from serving as a "general revenue enhancement mechanism." Order No. 864 at 35 ("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."). The Postal Service has explained how this increase "does not exceed the net adverse financial impact of the exigent circumstances," as required by Order No. 864. In addition, to the extent that the "relatedness" provision in Rule 3010.64(a)(3) also incorporates some (though assuredly not all) elements of "reasonable and equitable and necessary," the Postal Service explains in section VI below why an across-the-board increase at the modest level requested is a "reasonable and equitable and necessary" means of responding to the significant contribution lost as a result of the Great Recession.

Addressing the Postal Service's liquidity position as part of this Request simply implements the further requirement in the statute and the Commission's rules that the Postal Service explain how the increase is also "necessary to enable" it to continue

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[16] Valpak itself recognizes that the "necessary" provision is independent of the "due to" clause. Valpak Comments at 6.

[17] In addition, the fact that the Postal Service cannot point to a definitive end-date for this increase does not indicate that it can continue this increase without regard to the "due to" clause, as Valpak seems to suggest. This is discussed in section VII.A below.

providing “postal services of the kind and quality adapted to the needs of the United States.” Thus, it does not, as the Public Representative claims, constitute a claim by the Postal Service that this request is “due to” the Postal Service’s liquidity position. PR Comments at 10. Rather, the Request is “due to” the recession, and it is also “necessary” to implement because the Postal Service’s precariously low liquidity (which has occurred despite the Postal Service’s practice of “honest, efficient, and economical management”) threatens its ability to continue providing adequate postal services.[18]

In addition, it cannot reasonably be said that the Postal Service’s Request constitutes an attempt to “resolve shortcomings in the Postal Service’s business model,” as Valassis claims, or that approving this increase would constitute a return to “cost of service” ratemaking, as the Public Representative and Valpak claim. The Postal Service’s Request would add a modest level of liquidity from levels that are intolerably low. The maintenance of liquidity is essential for ensuring the continued provision of services “of the kind and quality adapted to the needs of the United States,” which means that this Request is tied directly to the maintenance of postal operations at quality levels. Thus, the Postal Service’s focus on liquidity adheres to the most narrow possible reading of this aspect of the exigency provision. This Request does not address the continuing large net losses that the Postal Service is suffering each year

[18] MPA et. al “question” whether this increase is “necessary” because the Postal Service “has as much case on hand today as it did a year ago, and projects that it will have the same amount of cash on hand a year from now even without an exigent rate increase.” MPA et al. Comments at 55 fn.12. However, as witness Nickerson extensively discusses in his Statement, the current level of liquidity that these commenters seem to feel is sufficient is simply too low to be prudently maintained. It gives the Postal Service absolutely no margin to deal with potential events that increase its costs or reduce its revenues (and, as he notes, Postal Service sots will be subject to upward pressures going forward). It allows the Postal Service very little capacity to make necessary capital investments. Overall, to claim that it is improper under the “necessary” clause to raise the Postal Service’s liquidity above a level that is only slightly more than the Postal Service’s bi-weekly payroll is not a valid interpretation of the statute.

due to legally mandated payments that the Postal Service has determined that it simply cannot make (the requirement that it prefund Retiree Health Benefits), so it would be absurd to dismiss this narrowly tailored Request as some sort of return to "cost of service" ratemaking.

Equally unavailing is the Public Representative's argument that giving the Postal Service additional liquidity cannot be the purpose of an exigency provision, because "exigent price increases should be used to deal with specific exigencies, and not to create a rainy-day fund to address optional expenditures."[19] As an initial matter, the expenses that the Public Representative so blithely dismisses as being "optional expenditures" are the very things that the Postal Service must prudently do in order to "maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." Does the Public Representative consider wages for Postal Service employees "optional"? Expenses paid to highway contractors and other suppliers? Fuel for postal vehicles? Furthermore, any prudent business must plan for and seek to guard against contingencies; indeed, Congress has directed that the Postal Service do so. 39 U.S.C. § 2009. Any prudent business-like organization must also, in order to continue "develop[ing]" its services, make necessary capital investments. The Public Representative's narrow conception of the exigency provision ignores the plain language of the "necessary" clause.

The views of these commenters regarding the irrelevance of liquidity would ultimately make the exigency clause a dead letter, at least in circumstances where the

[19] The Public Representative also misstates the scope of the exigency clause when he claims that it only applies to "emergencies." As the Postal Service discussed in its Request, nothing in the language of the statute or the Commission's rules limit exigent requests to "emergency" situations. The Public Representative provides no legal basis for the Commission to draw an opposite conclusion.

exigent circumstances have resulted in a loss of volume (and therefore contribution) across the Postal Service's products. The very act of improving the Postal Service's financial position can always be characterized as addressing the fact that the Postal Service is also constrained by an inflexible business model, because a loss of volume only negatively affects the Postal Service to the extent it prevents the Postal Service from covering its costs, which are in turn caused by factors such as wages, benefits, and the size of the retail, delivery, and processing networks. These factors are ultimately the result of the obligations of universal service (e.g., service standards dictating the size of the processing network) or other legal obligations (e.g., the provisions of chapter 10 and chapter 12 regarding employment at the Postal Service).), as well as of other considerations.

Therefore, it will always be possible to point to those "optional expenditures," in the words of the Public Representative, as being factors underlying an exigent request predicated on volume losses (unless the Postal Service took the step, contrary to the statute and the Commission's Rules, of not discussing why such an increase is "necessary" to maintain and continue adequate postal services). If simply pointing to the existence of those factors, and the Postal Service's discussion of them in the context of complying with the statute and Commission Rule 3010.61(a)(4), were a sufficient basis for denying an exigent request – in other words, if understanding and recognizing how an exigent increase puts the Postal Service in a better position to "maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States" were itself an impermissible consideration – then no exigent increase "due to" exigent volume losses could ever be approved, despite a statute and the Commission's rules that clearly demonstrate the intent that exigent relief be available in such circumstances.

The Public Representative also argues that this Request is improper because the Postal Service has noted that Congressional action might prompt a rescission of the exigent increase. PR Comments at 15. In particular, the Public Representative states that he "fails to understand how Congressional action is going to have any effect on ending the recession (exigency), such that exigent funding will no longer be necessary." *Id.* This reflects a failure to apply the plain language of the "necessary" provision. It is not that Congressional action would necessarily have the result of ending the exigent harm, but that it might change the Postal Service's overall financial condition such that a continuation of the exigent increase is no longer "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." In other words, while an increase may still be justified under the "due to" clause, it might nevertheless cease to be "necessary" if other conditions change. The Commission has recognized that the language of the statute may lead to this result. *See* Order No. 864 at 51.[20]

[20] The Public Representative believes that the Postal Service should have said that the additional contribution from this requested increase will be necessary "until the Postal Service has recovered from the effects of the recession." PR Comments at 15. But neither the statute nor Commission Rule 3010.64(a)(4) bases "necessity" on the continuation of the exigent circumstances. If the Postal Service were to "recover" from the Great Recession, as the Public Representative suggests, then the harm from the exigent circumstance would no longer exist. This would presumably go to the "due to" prong, not the "necessary" prong.

C. The Public Representative's View that the Request Has Not Provided Sufficient Information to Reach a Decision on the Merits Must Be Rejected

Despite having earlier questioned the Postal Service's discussion of liquidity, the Public Representative then suggests that "the purpose of exigent funding in this case is to sustain the postal network while the Postal Service right-sizes the network to the new normal." PR Comments at 20.[21] This is needed, the Public Representative believes, to "break the direct link between lost contribution and exigent recovery." *Id.*[22] Furthermore, he believes that, as part of his preferred framework, the Postal Service should present "[t]he 'one-time' cost of right-sizing the postal network" as well as a "plan . . . which explains how this would be accomplished," and it must "estimate how long right-sizing must take." *Id.* at 21. None of this, according to the Postal Representative, has been done, which necessitates a finding by the Commission that the Postal Service has not presented enough evidence to justify the necessity of the Request. For the following reasons, this argument must be rejected.

The Postal Service has provided in its Request a clear explanation of how the requested increases conform to the language of the statute and the Commission's rules. The extent to which this Request may not correspond precisely to the Public Representative's preferred framework is either irrelevant (because neither the statute nor the Commission's rules require that the Postal Service follow that framework) or immaterial. Regarding the latter point, the Postal Service has clearly indicated the

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[21] The Public Representative expresses no recognition that determining what is needed "to sustain the postal network" necessarily requires a consideration of the Postal Service's liquidity, the very thing that he previously said was a fatal flaw in the Postal Service's Request.

[22] The Postal Service has, of course, recognized that there is not always such a "direct link," since its fundamental position is that "due to" and "necessary" set forth separate tests.

precarious state of its liquidity, and as such has demonstrated that the Postal Service needs this increase in order to "sustain the postal network" for the foreseeable future, absent an exogenous event (in the form of Congressional action that renders this increase no longer "necessary" to sustain the network), and absent the unlikely return of volumes lost to the Great Recession (in which case the exigent increase could no longer be said to be "due to" exigent circumstances).

The Postal Service has also presented a "recovery plan" for how it intends to adjust to the "new normal," in the form of the Five-Year Plan, which seeks to adjust Postal Service costs downward in a prudent manner while preserving adequate, universal postal service "of the kind and quality adapted to the needs of the United States." Overall, the Postal Service's Five-Year Plan sets forth a number of initiatives to reduce costs to reflect current volumes, including initiatives to not only reduce network costs, but also to reduce labor costs, such as by improving how Postal Service health care benefits integrate with Medicare, and improving the manner by which Postal Service pension obligations are provided. To be sure, the Postal Service's plan must not correspond precisely to what the Public Representative apparently has in mind when it comes to a "recovery plan," since he does not even discuss it in his Comments. In particular, the Public Representative would seem to require that any "recovery plan" focus solely on reducing the size of the Postal Service's "network capacity" to reflect the "new normal." Even if such a path were legally open to the Postal Service (which it oftentimes will not be because of the universal service obligation), it would necessarily require diminutions in service that may not be best interests of the Postal Service or the senders and recipients of mail.[23]

In this regard, it is clearly prudent for the Postal Service, as part of its plan to adjust to the "new normal," to seek legislative reform that can enable significant cost reductions through means that do not require service reductions, rather than focusing solely on reducing the size of its "networks."[24] Indeed, the Commission and prior Public Representatives have consistently expressed concern that the Postal Service not unduly diminish service because of the current disconnect between revenues and costs. Therefore, it makes no sense to forbid the Postal Service from utilizing the exigency clause unless it presents a plan that focuses solely on reducing "network capacity" to reflect the volume decline resulting from the Great Recession, as the Public Representative seems to demand. It is equally irrelevant that the Postal Service define with certainty how long this increase will be needed, as the Public Representative's framework would seem to require. The duration issue is discussed further in section VII.A below. It will suffice to say here that the Public Representative's comments provide no basis to deny the Postal Service's Request, because there is no need to precisely specify when this increase can be rescinded, nor is there any basis to do so at this time. Because the Postal Service's "recovery plan" prudently relies on actions that can only be enabled through legislative change, it is simply not possible to predict with absolute certainty when this increase may no longer be "necessary".

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[23] As noted above, the Postal Service's network are much more of a function of its universal service obligations and service standards, rather than volume.

[24] Except for Valpak, no commenter, including the Public Representative, proposes a specific adjustment to the Postal Service's "networks" that the Postal Service is not already pursuing as part of its Five-Year Plan. The Postal Service discusses why it has not adopted the Valpak approach to door delivery in section V.B.3.

Indeed, the Public Representative does even not take into consideration the fact that the continuation of this increase, in full or in part, is dependent on it continuing to be "necessary" as defined in the statute. This standard can be violated if the Postal Service is found to not to be engaging in "honest, efficient, and economical management" in adjusting its costs to reflect reduced volumes, consistent with its legal obligations (including its obligation to provide universal service). In addition, to the extent that the Postal Service is successful in reducing its institutional costs to the point that the additional contribution from this increase is no longer "necessary" to provide "postal services of the kind and quality adapted to the needs of the United States," then it can also be rescinded. Nothing in what Mr. Nickerson said at his hearing contradicts this point. Mr. Nickerson was simply stating that it was likely that the effects of the recession might linger in terms of lost volume. He made no statement that the continuation of this lost volume necessarily meant that the increase would nevertheless continue to be "necessary." Rather, he expressly recognized during the hearing that circumstances could result that would render the increase no longer "necessary." Tr. 2/184-85.

Most fundamentally, to the extent that the Postal Service's Request fails to conform precisely to the information that the Public Representative might have wished to see, it is enough to say that the Postal Service has complied with all of the Commission's rules – which nowhere require the Postal Service to adhere to the precise framework set forth by the Public Representative – and answered all of the Commission's questions. If the Commission feels that it needs more information from the Postal Service in order to inform its decision, then the Commission has well-established means to obtain that information, and it has used those means to great effect in this proceeding. At this point, the Commission's responsibility is to issue a decision on the merits of this Request. It would be unfair to all parties if the Commission were to take the cynical way out, as the Public Representative suggests, by avoiding a true decision because of some perceived information deficiency that the Commission refrained from remedying. This would make a mockery of the importance of this proceeding, the critical need for this increase, and the Commission's own rules, which are supposed to create a "functional and flexible framework" for the expedited disposition of exigent requests, Order No. 43 at 65, rather than a process of continually kicking the can down the road based on insatiable demands for an unassailably perfect filing.

D. There is Nothing Improper About the Fact that the Governors Filed This Increase on the Basis of the Postal Service's Financial Condition

Valassis and Valpak argue that was improper for the Governors to have considered the Postal Service's liquidity situation and inflexible business model in its letter to mailers explaining why this increase was filed, and that the Request should be denied on that basis. Valassis Comments at 26-27; Valpak Comments at 18-21. These statements from the Governors do not indicate an attempt to use the exigency clause for improper reasons, however. Rather, they simply reflect why the Governors have determined that this increase is "necessary." Is it Valassis's and Valpak's position that the Governors should only consider whether an exigent event has occurred when deciding whether to seek an exigent increase? That is, would Valassis and Valpak prefer that the Governors not give consideration to the Postal Service's overall financial condition before filing for an increase above the cap, which would allow them to determine whether the Postal Service has the ability to absorb some or all of the consequences of an exigent event without piercing the cap? Based on their criticism, this would seem be the case.

Such a position ignores the fact that the Governors must also determine whether the increase is consistent with the “necessary” prong of section 3622(d)(1)(E) before authorizing a filing with the Commission. It also makes no logical sense because it would demand that the Governors make the important decision about piercing the cap in a vacuum. Clearly, it is permissible for the Governors to consider the Postal Service’s overall financial picture when deciding whether to file an exigent case, and to communicate that to mailers. The argument made by Valpak and Valassis here elevates the Commission’s statements about the narrowness of the exigency clause to absurd levels.

IV. SPECULATION ABOUT HOW AN EXIGENT RATE INCREASE MIGHT IMPACT POSTAL REFORM LEGISLATION IS IRRELEVANT

FSR/NAMIC and Valpak each urge the Commission to deny the Postal Service’s exigent rate request for extra-statutory reasons. While FSR/NAMIC warn that granting the increase will encourage Congress to delay reform, FSR/NAMIC Comments at 12, Valpak alleges that the rate request is improperly designed to pressure Congress to act. Valpak Comments at 25. Predictions about the impact that an exigent increase will have on postal reform are fundamentally irrelevant and belie the inherent unpredictability of when and how Congress will move on postal legislation. As the Commission recognized, “[i]t is not the Commission’s role in an exigent rate case proceeding to provide incentives to Congress, but rather to apply the law in a manner that is consistent with congressional intent." Order No. 864, Order Resolving Issues on Remand, PRC Docket No. R2010-4R (Sept. 20, 2011), at 42. The Postal Service's exigent request must succeed or fail based on the statute; speculation as to motive or the policy choices Congress might make with respect to postal reform legislation has no role to play in this proceeding (beyond the recognition that Congressional action might at some point allow for the full or partial rescission of this increase).

A. FSR/NAMIC's Prediction That a Rate Increase Will Impede Legislative Reform Is Misguided and Irrelevant

FSR/NAMIC claim that granting the requested rates will impede ongoing legislative reform efforts, warning that "Congress may perceive the exigent increase as a permanent fix to the USPS's fiscal issues." FSR/NAMIC Comments at 12. But, as discussed above, it is not for this or any other administrative agency to incentivize Congress to make different policy choices, such as how best to "fix" the Postal Service's financial situation. FSR/NAMIC also overlook that the requested rates are designed to provide only a modest amount of liquidity to the Postal Service, leaving significant issues such as the Retiree Health Benefits prefunding payments unaddressed. Request at 14-15. It is simply untenable to believe that Congress will conclude that postal reform is no longer needed if the Commission grants the request.[25]

[25] Indeed, Members of Congress actively working on postal reform legislation responded to the decision to seek an exigent price increase by recognizing that such an increase would not obviate the need for comprehensive postal reform legislation. Press Release, Senator Tom Carper, Chairman Carper Statement on Postal Service's Rate Increase (Sept. 25, 2013), *available at* http://www.carper.senate.gov/public/index.cfm/pressreleases?ID=2ced4810-ce9c-432f-94ab-ac9602a79eb6; Press Release, Senator Tom Coburn, Ranking Member Coburn Issues Statement on Postal Service's Rate Increase (Sept. 25, 2013), *available at* http://www.coburn.senate.gov/public/index.cfm/pressreleases?ContentRecord_id=427bd2c6-901e-4a23-b3e0-ae96544c931e&ContentType_id=d741b7a7-7863-4223-9904-8cb9378aa03a&Group_id=7a55cb96-4639-4dac-8c0c-99a4a227bd3a.

Further, FSR/NAMIC cite no authority to support the denial of a request for exigent prices where the statutory criteria are otherwise met. The case law cited for the supposed proposition that the Commission may deny the exigent request out of “deference to pending legislative developments” is plainly inapplicable. FSR/NAMIC Comments at 13. For instance, the court in each opinion cited spoke of deference to Congress in the process of considering a challenge to the validity of either an administrative practice, or a federal statute. *A. L. Mechling Barge Lines, Inc. v. United States*, 368 U.S. 324, 330-31 (1961); *Schwartz v. Brodsky*, 265 F. Supp. 2d 130, 133-34 (D. Mass. 2003). Here, however, the Postal Service is clearly not before a court challenging the validity of an administrative practice or a statute; it is seeking a rate increase pursuant to current, valid law. Further, in *A. L. Mechling Barge Lines*, while the Supreme Court indeed denied a challenge to the validity of certain practices of the Interstate Commerce Commission that were undergoing amendment, it did so specifically because “[d]eclaratory judgment is a remedy committed to judicial discretion.” 368 U.S. at 330-31. Unlike a federal court considering a request for declaratory relief, the Commission does not have the discretion to deny an exigent request where the statutory criteria are satisfied.

B. Valpak’s Allegation Regarding the Postal Service’s Motive for Filing This Case Is Unfounded and Cannot Justify Denial of the Request

Valpak asks the Commission to deny the exigent rate request because the Postal Service has allegedly based its request not on the statute, but on an improper desire to “pressure Congress . . . to enact postal reform sooner.” Valpak Comments at 25. Valpak’s allegations are baseless.

The Postal Service's statements in this proceeding regarding the need for postal reform are entirely justified on the basis of the statutory criteria. Pursuant to the statute and Commission rules, the Postal Service is required to include in an exigent rate request "[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." 39 C.F.R. § 3010.61(a)(4) (emphasis added). It is simply a fact that the Postal Service's dangerously low liquidity position rests upon a number of variables, including the statutory context in which the Postal Service must operate. The Postal Service would be remiss in discussing the necessity requirement without acknowledging that potential congressional action could obviate that need, or that in keeping with its responsibilities of prudent management, the Postal Service is actively seeking legislative reform to restore its long-term financial viability.

Postal Service comments identifying the need for reform legislation made outside of these proceedings are both appropriate and ultimately irrelevant. Valpak cites a postal press release in which the Board of Governors identified "the 'uncertain path toward enactment of postal reform legislation'" as a "primary reason" for requesting an exigent price increase. Valpak Comments at 18 (citing Press Release, United States Postal Service Board of Governors, U.S. Postal Service Announces New Prices for 2014 (Sept. 25, 2013), ***available at*** http://about.usps.com/news/national-releases/2013/pr13_077.htm). However, it is no secret that the Postal Service has been seeking postal reform for years and it is entirely proper that the Governors considered the uncertain prospect of new legislation in making the decision to file.[26] As long as the statutory criteria have been met, allegations of ulterior motive cannot reasonably enter into the Commission's consideration of this case.

V. THE POSTAL SERVICE HAS AMPLE INCENTIVE TO REDUCE COSTS AND ADJUST TO A "NEW NORMAL," INDEPENDENT OF THE REQUESTED PRICE INCREASE

A. The Postal Service Has Already Exercised Honest, Efficient, and Economical Management to Reduce Costs Within Its Control

In its Request, the Postal Service explained how its recent track record and future plans satisfy the requirement that any exigent pricing relief comply with "best practices of honest, efficient, and economical management." Request at 18-35. The Postal Service's Form 10-K for FY2013, which was filed after the date of the Request, further accentuates the Postal Service's steadfast efforts to wring efficiency and economy from the system. For example:

- Workforce: The Postal Service reduced its career complement by 37,411 (7.0 percent) in FY2013, for a total reduction since FY2010 of approximately 15.9 percent. United States Postal Service Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Fiscal Year Ended September 30, 2013 (hereinafter "FY2013 Form 10-K") at 106. The Postal Service increased its less costly non-career complement by 26,127 (26.0 percent) in FY2013, which enhanced the Postal Service's efficiency and flexibility in staffing. Even with the increase in non-career complement, total

[26] As the Postal Service noted in its Request, it sought such legislation in the hopes that it could avoid the need to file this increase. Considering the Commission's statements about the importance of the price cap, the Commission cannot say that this action on the part of the Postal Service was improper. There is nothing sinister about the fact that, having pursued this strategy, the Postal Service has cited to Congress's failure to enact legislation in explaining why it has now decided to file this Request.

workforce levels declined by approximately 11,284 (1.8 percent). *Id.* The total postal workforce has dropped by approximately 8.0 percent since the end of FY2010.

- Work-hours: The Postal Service reduced total work-hours by 12 million in FY2013, a 1.0-percent decrease from FY2012 levels, despite growth in delivery points that outstripped the number of new delivery points in the previous year. *Id.* at 29, 30. The Postal Service has sunk total work-hours by 313 million, or 22.0 percent, from their level at the end of FY2007, before the Great Recession, and by 6.2 percent since the end of FY2010. *Id.* Indeed, the Postal Service's work-hour reductions are responsible for a 3.4-percent decline since FY2002 in total compensation expense – the bottom line in terms of labor cost – despite a 33-percent increase in the hourly compensation rate and the addition of over 13 million new delivery points during the same period. *Id.* at 31.
- Compensation and benefits: The lower total wage base and the shift to less costly non-career employees has led to decreases in compensation expense of 1.8 percent (approximately $640 million), in retirement benefits of 2.0 percent, and in health benefits of 4.5 percent (approximately $236 million). *Id.* at 29, 36. The Postal Service managed to reduce health benefits expense by reducing career complement, despite an average increase in Federal Employee Health Benefits Program premiums. *See id.* at 36.[27] Overall, the

[27] The Postal Service has also begun a course of progressive reductions in its employer contributions to employee health insurance premiums. Request at 29-31.

Postal Service cut compensation and benefits by $981 million (2.0 percent) in FY2013. *Id.* at 108. If one excludes the cost of separation incentives from FY2012 and FY2013 results, the overall savings grow to $1,197 million (2.5 percent). *See id.* at 30. These cost reductions are particularly impressive when compared with the private sector, for which wages and salaries rose 1.8 percent, overall benefits rose 2.0 percent, and health benefits rose 2.7 percent during the same period. Bureau of Labor Statistics, News Release No. USDL-13-2192, Employment Cost Index – September 2013 (Nov. 19, 2013), at 1-2.[28]

- Productivity: Total factor productivity (TFP) increased by 1.9 percent in FY2013, due to work-hour reductions that more than offset a 0.9-percent decline in volume in FY2013. FY2013 Form 10-K at 44. This was the fourth consecutive year of positive TFP growth.[29]
- Retail network: The total number of retail facilities remained essentially constant in FY2013, increasing by only 65, but this overall statistic masks a shift in retail access from Postal Service-operated to contractor-operated retail facilities. The Postal Service reduced the former by 155, or 0.5 percent, while increasing retail access via the latter by 220, or 6.3 percent. *Id.* at 107.

[28] In the private-sector transportation and warehousing industries, wages and salaries rose 2.2 percent and total compensation rose 2.5 percent during FY2013. *Id.* at 12, 17.

[29] Multifactor productivity statistics for the private non-farm business sector are not yet available for comparison, because the Bureau of Labor Statistics tabulates such statistics on a calendar-year basis.

- <u>Processing network:</u> The Postal Service consolidated operations in 143 mail processing facilities, and it ended FY2013 with 97 fewer facilities in total. *Id.* at 2, 15.
- <u>Delivery routes:</u> The Postal Service reduced delivery routes by 1,437 routes, despite absorbing 77,882 new delivery points. *Id.* at 2.

Almost no commenter has taken issue with this portion of the Postal Service's Request. As discussed in the next section, the two commenters that attempt to do so register only as superficial second-guessing that is easily dismissed. The essential lack of objection to this portion of the Postal Service's case stands in stark relief against the commenters' otherwise full-throated, full-frontal attack on the Postal Service's Request. This suggests a virtual tacit consensus among the commenters that, in the Commission's words, the Postal Service has done a "commendable job" at managing its costs and improving efficiency. *See* Order No. 547 at 61 n.48, 80-86. Indeed, at least one otherwise adverse commenter acknowledges outright that the Postal Service's dangerously low cash flow has come "despite impressive efforts by the Postal Service to reduce costs and improve productivity." UPS Comments at 5.[30] Thus, there is every reason for the Commission to agree with the Postal Service that its Request fully complies with the requirement that it exercise "honest, efficient, and economical management."[31]

[30] This recognition is particularly noteworthy, coming as it does from a company that critics of the Postal Service's previous exigent pricing request upheld as a paragon of efficiency. Motion of the Affordable Mail Alliance to Dismiss Request, PRC Docket No. R2010-4 (July 26, 2010), at 3, 28, 43-45.

[31] The Public Representative falsely claims that the Postal Service's "estimates assume that the Postal Service does nothing to shed mail volume capacity to adjust to the new normal" and that this supposedly indicates a lack of "honest, efficient, and economical management" on the Postal Service's part. PR Comments at 17 & fn.10. The Public Representative appears to have skipped over the 17 pages of the

B. Commenters' Few Attempts at Nitpicking Are Forced and Can Hardly Justify Rejection or Revision of the Postal Service's Request

The rule stated in the previous section – that there is an apparent consensus over the Postal Service's exercise of honest, efficient, and economical management – is proven by the insubstantial nature of the two exceptions to it. For all the blustering broadsides in pages 89 through 106 of its comments,[32] Valpak finds fault with only a handful of concrete Postal Service actions: the maintenance of below-cost prices for certain products, the reduction of the workforce through means other than layoffs, the timing of network optimization initiatives, and the failure to forcibly convert all existing door delivery points to centralized delivery. In addition, SIIA/ABM argues that the Postal Service has supposedly failed to implement "all possible cost reductions" because the

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Postal Service's Request that explain how management has, in fact, exercised honest, efficient, and economical management in attempting to adjust its network to the "new normal." If the Postal Service's estimates show a dire financial necessity, that necessity exists above and beyond the Postal Service's best efforts to reduce costs and increase efficiency, not because the Postal Service has somehow failed to account for those efforts. The Postal Service is clearly not "do[ing] nothing[and] let[ting] losses mount" or treating this price increase as "compensat[ion] . . . for FY 2008 network capacity." Id. at 18 fn.11. Besides, as discussed in section VII below, the Commission will have several opportunities, via annual compliance reviews and its comprehensive review of the rate system in 2016, to conduct an ongoing assessment of whether the necessity presented in this case continues to exist.

[32] In its eagerness to point out supposed shortfalls in witness Nickerson's testimony, Valpak seems to have overlooked the discussion of "honest, efficient, and economical management" in the Postal Service's Request. Had Valpak not done so, Valpak would have known better than to characterize the Postal Service's view as being that "the exigent rate option [i]s a way to avoid cost cutting measures deemed more difficult." Valpak Comments at 90. It is self-evident from the Postal Service's Request that the Postal Service will hardly "be spared the lessons of living within a price cap" if the Commission approves this request, as the Postal Service has already gone to dramatic lengths to realize "the necessities of running a lean, efficient operation" and has every intention of continuing to do so. *Id.* Valassis's similar concern is likewise unfounded. Valassis Comments at 31-32. Surely Valpak and Valassis would agree that a business with only 16 days of cash on hand, as the Postal Service expects to be at the end of FY2014 upon the granting of this request, does not lack for incentive to continue its cost-cutting efforts.

Postal Service has not yet fully adjusted work-hours in response to volume declines, as detailed in a recent Postal Service Office of the Inspector General (OIG) report.[33]

The first of Valpak's points is dealt with in section VI.B below; it will suffice here to point out that the mere tolerance of underwater products for longer than Valpak would like does not, in and of itself, demonstrate a failure to exercise honest, efficient, and economical management, in light of the various other factors for which management's reasoned business judgment must account. Valpak's and SIIA/ABM's other points are likewise easily rebutted.[34]

1. Layoffs

Even Valpak cannot deny that the Postal Service has substantially reduced work-hours and complement through retirement and separation incentives, and Valpak is mostly correct when it points out that the Postal Service has managed to do so without

[33] During Mr. Nickerson's hearing, a question was raised as to whether it was prudent for the Postal Service to have made its Retiree Health Benefits prefunding payments when it had available liquidity to do so, considering the fact that the Postal Service has not been punished for defaulting on those payments in the past several years. Tr. 2/196-97. However, as witness Nickerson noted (Tr. 2/197), it cannot be said that making a legally required prefunding payment, when resources are available to do so, constitutes imprudent management inconsistent with "honest, efficient, and economical management."

[34] While most commenters may not dispute the substantial nature of the Postal Service's cost reductions, they do present arguments about those reductions' import that, if credited, would take the Commission's admonition that the exigent clause is a "narrow exception" to the price cap to absurd lengths that the statute cannot support. First, some commenters make the point that the Postal Service's cost cutting efforts are an indication of the success of the price cap, which indicates that the exigency increase must be denied lest the efficiency incentives of the cap be blunted. *E.g.*, Valassis Comments at 23-24. This argument proves too much. If the Postal Service practices "honest, efficient, and economical management," then the price cap is working well and cannot be pierced; if the Postal Service is not practicing "honest, efficient, and economical management," then the requested increase fails the "necessary" prong and would likewise be denied. While this outcome might please the various commenters, the Commission cannot apply the statute in a way that would render it meaningless. Furthermore, it is simply impossible to look at the situation facing the Postal Service and conclude that allowing this modest increase would mean that the Postal Service has less of an incentive to cut costs. Second, some commenters argue that the very act of raising prices above the cap constitutes "imprudent" management. *E.g.*, Valassis Comments at 31. Again, this would read the exigent clause out of the statute, because the very act of seeking to use that clause would mean that it cannot be exercised. This is a situation fit for a Joseph Heller novel, not the interpretation of a statute.

resort to involuntary layoffs. Valpak Comments at 92. This appears to shock Valpak, which upholds the example of for-profit mailers like itself, which have "been forced to right size [their] business during this same period" through layoffs. *Id.*

As an initial matter, Valpak's apparent criticism of the lack of layoffs has no bearing on the Commission's analysis under 39 U.S.C. § 3622(d)(1)(E), due to the operation of section 505(b) of the PAEA. *See* Request at 20-21.

At one level, Valpak's criticism of Postal Service management's supposed tactical choice is wholly immaterial in light of the fact that work-hours and complement has declined dramatically. The workforce reductions that the Postal Service has achieved speak for themselves as a testament to honest, efficient, and economical management. *See* Request at 27-29. It matters little whether they were achieved through involuntary terminations or voluntary separation incentives. As it happens, Valpak's arguments show little, if any, understanding of the size and average age of the postal workforce, which allow for substantial voluntary attrition without the need to resort to layoffs.

At another level, Valpak's comparison with a private firm is irrelevant, because the availability of layoffs to the Postal Service and to a private firm is fundamentally different. Most private firms are not subject to collective-bargaining agreements that forbid the employer from laying off the majority of its covered employees, yet the Postal Service is. It would be paradoxical to expect the Postal Service to break its contracts in order to fulfill a standard of "honest management." It should be noted that three of the four agreements that postdate the onset of the Great Recession were imposed on the Postal Service by arbitration panels; the presence of a "no-layoff" clause in these agreements, the lineage of which can be traced to the 1978 Healy Award, cannot fairly suggest a shortfall on the part of Postal Service management.

The fourth agreement, with the American Postal Workers Union, AFL-CIO (APWU), was negotiated voluntarily, and the value of that agreement to the Postal Service, in terms of greater flexibility to reduce labor costs, has been well worth the price of continuing the "no-layoff" clause. *See* Request at 29-30. As the Postmaster General has explained,

> [o]ur goal in this negotiation was work force flexibility, immediate cost reduction, and structural change. We know that you don't get that through an arbitrated decision. So we originally approached the APWU at the very beginning and talked about the layoff clause. . . . [W]e got the immediate feedback that was a nonstarter. So our feeling was we wanted to go ahead and get a negotiated contract that achieved our goals.
>
> The other thing you have to keep in mind, when you throw things into arbitration, you lose time. It could have taken us a year and a half. And the money that we were able to negotiate out of these labor costs would have been delayed perhaps a year and a half, and we would have never got the same kind of a deal that we got through negotiation.

Are Postal Workforce Costs Sustainable? Hearing Before the House Comm. on Oversight and Gov't Reform, 112th Cong. 48-49 (2011). The considered decision to reap the substantial benefits of the negotiated APWU agreement *as a whole*, rather than risk a less favorable arbitral award (which likely would have perpetuated the "no-layoff" clause in any event), clearly represents "honest, efficient, and economical management" on the Postal Service's part.

To be sure, the Postal Service is not prohibited from involuntarily terminating non-bargaining unit employees. However, other administrative burdens and offsetting costs make RIFs a less attractive alternative to measures designed to avoid RIFs. For example, the Postal Service must observe veterans' preference with respect to RIF decisions. *See* Response of the United States Postal Service to Motion of the Affordable Mail Alliance to Dismiss Request (hereinafter "USPS Response to AMA MTD"), PRC Docket No. R2010-4 (Aug. 2, 2010), at 40-41. The Postal Service is also required to offer severance pay, which increases with age and years of service, to non-bargaining unit employees terminated in a RIF and to reimburse state governments for unemployment insurance paid to those former employees. *See* Employment and Labor Relations Manual ("ELM") 435, 550; U.S. OFFICE OF PERSONNEL MANAGEMENT, THE EMPLOYEE'S GUIDE TO REDUCTION IN FORCE BENEFITS, http://archive.opm.gov/rif/general/egrifben.asp.

Without legislative changes to lift these burdens, it is hard to see how the Postal Service can be expected blithely to lay off employees as a private firm might. It is doubtless consistent with "honest, efficient, and economical management" for the Postal Service to comply with the law and its own rules and contractual obligations by using attrition and voluntary separation incentives to achieve the same goal – reducing headcount and other factors that contribute to labor costs – without incurring the burden and cost of RIFs. *See* USPS Response to AMA MTD at 40-41 (explaining why greater use of RIFs might actually be counter to "honest, efficient, and economical management").

The Postal Service has not turned a blind eye to the RIF process as a tool to achieve this goal, however. *See id.* at 38-40 (quoting, at length, interrogatory responses from Docket No. N2010-1 regarding RIF actions taken by the Postal Service); Response of the United States Postal Service to Presiding Officer's Information Request No. 5, Question 7, PRC Docket No. R2010-4 (Aug. 25, 2010). In

2011, the Postal Service began a nationwide restructuring that resulted in RIF notices being sent to non-bargaining unit employees, including postmasters in Post Offices where operating hours have been reduced. The Postal Service has also recently announced organizational changes that could include a RIF, if RIF-avoidance measures do not achieve the desired results. *See* Request at 28.

2. Network Rationalization Initiatives

As much as Valpak is constrained to admit the significance of the Postal Service's network rationalization efforts, the only palpable complaint that Valpak can muster is that the Postal Service supposedly ought to have gotten started on them sooner. Valpak Comments at 94. Such a criticism is easy with the benefit of perfect hindsight, but it does not realistically reflect the course of deliberation involved in making business decisions for a large network organization that is accountable to the public and Congress for the fulfillment of a statutory universal service mandate. *See* Request at 18-20, 27. Seen in a more appropriate light, one might accept that it can reasonably take some time to assess the organization's financial condition amid a deepening recession, formulate and internally debate various policy options, evaluate the legal, political, and business implications, and eventually prepare a request for a Commission advisory opinion. Careful deliberation is particularly important when the decision concerns reductions in the level of service provided to the American people. Reasonable minds may also differ as to the proper prioritization of various policy options. The Postal Service's decisions to proceed with one initiative or another, or to hold off on one for a time, were eminently reasonable business judgments based on the best information available to it at the time. Even if Valpak, with the benefit of hindsight, thinks that a private firm hypothetically might have done more to reduce service standards faster in order to enable a streamlining of the network that was not possible under the prior service standards, that does not mean that the Postal Service was remiss in moving carefully in that area.[35] In addition, it should not be a basis to second-guess whether the Postal Service's own significant achievements in reducing the number of processing facilities to date meet a basic standard of "honest, efficient, and economical management."

It also bears noting that Valpak cherry-picks facts to make its point. In the context of retail facility closures and reductions in hours, Valpak tries to make hay out of when the Postal Service filed its request for an advisory opinion in Docket No. N2012-2 (May 25, 2012). *Id.* Valpak fails to mention that Docket No. N2012-2, which concerned the Post Office Structure Plan (POStPlan), evolved out of an earlier initiative to optimize retail access. *See generally* PRC Docket No. N2011-1. The Postal Service approached the Commission with that initiative on July 27, 2011, yet the Commission issued a sharply critical advisory opinion on December 23, 2011. Contrary to Valpak's vision of idleness, the Postal Service evaluated its options in light of the Commission's feedback and other public and political responses and returned to the Commission in Docket No. N2012-2 only five months after receiving the Commission's advisory opinion in Docket No. N2011-1.

Valpak also fails to acknowledge the Postal Service's first initiative to optimize its network of retail stations and branches since the Great Recession began. *See*

[35] The Postal Service began considering whether to adjust service standards early after the Great Recession, as part of the creation of its March 2010 Action Plan. At the time, the Postal Service determined not to move forward with that service change.

generally PRC Docket No. N2009-1. The Postal Service filed its request for an advisory opinion on July 2, 2009, less than a year after the start of the Great Recession. Although the Commission ended up taking nine months to issue an advisory opinion in that case, the Postal Service continued with its process to evaluate stations and branches while the case was ongoing. Thus, the timing of the Postal Service's retail network initiatives – when presented in fuller context than Valpak's selective account, and with allowance for the reasonable evolution of management decisions based on feedback from the Commission and others – is consistent with the Postal Service's exercise of honest, efficient, and economical management.

With respect to both the retail and processing network rationalization initiatives, it is important to recall that section 3622(d)(1)(E)'s standard for "necessity" and "honest, efficient, and economical management" is tied to the objective of "maintain[ing] and continu[ing] development of postal services of the kind <u>and quality adapted to the needs of the United States</u>" (emphasis added). In light of this statutory objective, it is small wonder that the Postal Service has charted a careful, stepwise course to the service changes it has proposed, rather than trying to make numerous significant service changes at once and facing the opposing criticism that it was depriving Americans of service quality adapted to their needs. Once again, the Postal Service's efforts are well within the bounds of "honest, efficient, and economical management," when one considers the legal and political framework within the Postal Service must make business decisions.

3. Mode of Delivery

Next, Valpak accuses the Postal Service of leaving money on the table by not converting existing door delivery points to curbside or centralized delivery, despite a report by the Postal Service's Office of the Inspector General (OIG) recommending that the Postal Service do so. Valpak Comments at 95-99. The Postal Service recognizes that, at the time Valpak submitted its comments, Valpak did not yet have the benefit of the Postal Service's response to a POIR on this very subject (indeed, a POIR question that Valpak had proposed). *See* Response of the United States Postal Service to Presiding Officer's Information Request No. 10, Question 5, PRC Docket No. R2013-11 (Nov. 29, 2013); *see also* Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Motion for Issuance of Information Request, PRC Docket No. R2013-11 (Oct. 31, 2013), at 6.

Had Valpak been able to review that POIR response in time, Valpak might have understood that there is more to "honest, efficient, and economical management" than merely whether an action is within the Postal Service's legal authority. and will result in reduced costs. Rather, that standard calls for the exercise of prudent business judgment, particularly as to whether a decision will help the Postal Service "maintain and continue development of postal services of the kind and quality adapted to the needs of the United States."[36] As explained in the Postal Service's POIR response, the

[36] Valpak takes issue with the Postal Service's consideration of the needs of "non-paying customers," that is, of recipients of mail. Valpak Comments at 97. However, the statutory standard relevant here requires the Postal Service to develop postal services that meet "the needs of the United States," not merely of mailers. *See also* 39 U.S.C. § 101(a) (requiring the Postal Service to be operated "as a basic and fundamental service provided to the people" (emphasis added), and not specifically to the "users of the mails" to which other Title 39 provisions refer). Moreover, the value of the mail to recipients is the entire reason why "paying customers" use the mail in the first place. Hence, recipients' interests play a clear

Postal Service has not considered it prudent to mandate the conversion of existing delivery points, in light of the negative impact on volume, customers, and communities, the likely intensity of public and political resistance, and the substantial implementation costs.

Of course, Valpak did not need to await the Postal Service's POIR response to understand the OIG report's shortcomings: the Postal Service detailed them in its management response to that report, as Valpak acknowledges, and even the OIG owned up to them. OIG Audit Report No. DR-AR-11-006, Modes of Delivery (July 7, 2011), at 5 ("We recognize the $4.5 billion does not include cost associated with the project such as the potential for revenue at risk and other implementation costs. Finally, we recognize in the report, and as stated in management's comments, that this strategy and recommendations will not be easy to implement and has some significant hurdles."); *id.* at appx. E (management response); Valpak Comments at 97 fn.73.

While legislative action on converting to door delivery may not be necessary as a matter of law, the Postal Service believes that, considering the current debates about that issue in Congress, any further action is at best premature. Indeed, Congressional support may very well prove vital to reducing the political and prudential hurdles to door delivery conversion. The Postal Service disagrees with Valpak's unfounded opinion that a Congressional committee "appears not to be impressed" with these concerns, Valpak Comments at 97 fn.73, but that opinion is beside the point. The bill advanced by a single House committee does not indicate the view of the entire House, much less the

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role in the value proposition that the Postal Service has to offer to mailers, and so it makes business sense for the Postal Service to be attentive to those interests.

entire Congress, particularly in light of pending Senate legislation that is far less prescriptive. *Compare* H.R. 2748, 113th Cong. § 102(a) (2013) (mandating, by the end of FY2022, the conversion of at least 30 million delivery points extant on December 31, 2012, including through involuntary conversions), *with* S. 1486, 113th Cong. § 205 (2013) (requiring a program to convert residential delivery points only on a voluntary basis, without a target for conversions). It also bears noting that, during floor debate on a similar bill in the previous Congress, the Senate approved an amendment to remove a provision on delivery mode conversion. *See* 158 Cong. Rec. S2692 (2012). Far from "appear[ing] not to be impressed" with the Postal Service's deliberate approach to delivery mode conversions, the legislative history suggests that Congress may be perfectly content with the Postal Service continuing to be sensitive to popular opinion. *See id.* (statement of Sen. Schumer) ("What some people may not know is the Postal Service already has the authority to eliminate door delivery, but the Postal Service has not mandated such a change because they know how unpopular it would be. By removing the door delivery provisions from this bill we can ensure the Postal Service will continue to provide the door delivery service our constituents expect and rely upon.").

The Postal Service is presently following a strategic decision to work with, rather than against, Congress and the public to ensure that any centralized delivery program is "adapted to the needs of the United States." That decision, taken in light of numerous financial, operational, and political considerations, is entirely in keeping with "honest, efficient, and economical management."

4. Work-Hours

Finally, SIIA/ABM contends that the Postal Service's request should be reduced because of a different OIG report that found the Postal Service had not yet fully adjusted work-hours in response to volume declines. SIIA/ABM Comments at 3. Although SIIA/ABM does not explicitly couch its contention in terms of the failure to exercise "honest, efficient, and economical management," the argument that the Postal Service is undeserving of the requested pricing relief because it "has not implemented all possible cost reductions," *id.* at 2, amounts to the same thing. What the argument does not amount to is a justification for the Commission to deny or reduce the Postal Service's request.

The same OIG report that SIIA/ABM cites actually supports, rather than subverts, the notion that the Postal Service has been exercising honest, efficient, and economical management. To be sure, the OIG believed that it had found opportunities for the Postal Service to save up to an additional 14.3 million work-hours in processing operations. OIG Report No. NO-MA-13-007, *Assessment of Overall Plant Efficiency 2013* (Sept. 26, 2013), at 1-2, 6, 15. That finding might overstate the actual opportunity for work-hour savings, however. The OIG arrived at its excess work-hour figures by comparing each plant's productivity against the median productivity level and simply assuming that all above-average work-hours are equally capable of elimination. *Id.* at 15. The OIG did not investigate the reasons behind below-median productivity. It is possible that some portion of the allegedly excessive work-hours is intractable due to operational needs at below-median-productivity plants, in which case the true amount of potential work-hour reductions could be lower than the OIG report suggests.

Moreover, the OIG did not find that the Postal Service's track record at reducing work-hours to date has been lacking. To the contrary, the OIG praised the Postal Service for making

> substantial progress by reducing workhours in the network from the previous year. Plants that were the least productive in FY 2011 reduced more than 3.4 million workhours, achieving 23.9 percent of the recommended workhour savings.
>
> The Postal Service made these workhour reductions while achieving increases in service scores from FYs 2011 to 2012.

Id. at 1. The OIG also noted that the slight decrease in plant efficiency was partly a function of a shift in the mail mix toward packages, which are more labor-intensive to process. *Id.* at 1-2, 12.[37] Moreover, most plant consolidations have resulted in higher productivity, *id.* at 3, 14, a finding that supports the consistency with "honest, efficient, and economical management" of the Postal Service's plans to pursue further plant consolidations next year. *See* Request at 25. Due to its timing, the OIG report unfortunately does not acknowledge the fact that the Postal Service reduced mail processing work-hours by more than 6 million (3.0 percent) in FY2013, a greater decrease than the previous year (2.3 percent). FY2013 Form 10-K at 30.

The OIG report, which focuses only on processing operations, should not overshadow the larger picture. In section V.A above, the Postal Service has already described the mighty strides that it has taken in reducing overall work-hours. In the context of the Postal Service's previous exigent price increase request, when work-hours were higher and more costly than they are today, the Commission itself found that the Postal Service has done a "commendable job" of reducing work-hours. Order No. 547 at 61 fn.48, 80-86. While it may be possible to reduce work-hours further, the Postal Service is committed to continuing these efforts in the interest of honest, efficient,

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[37] Indeed, excess work-hours may sometimes be a necessary short-term consequence of larger cost-reduction initiatives. *See* FY2013 Form 10-K at 31 ("The growth in city delivery work hours reflects the hiring and training of 30,433 city carrier assistants in 2013, which increased the number of city carrier workhours, but lowered the overall cost of the function by $120 million.").

and economical management, even if it is allowed to implement the pricing relief requested here. Request at 34.

VI. PRICING PROBLEMS UNRELATED TO THE EXIGENT EVENT SHOULD NOT BE ADDRESSED IN THIS PROCEEDING

Five sets of comments (the Public Representative, the Saturation Mailers Coalition et al., Pitney Bowes, NPPC/MMA/NAPM/AMEE, and Valpak) oppose the across-the-board pricing approach employed by the Postal Service to develop the exigent prices. NPPC/MMA/NAPM/AMEE Comments at 31-39; Pitney Bowes Comments at 6-12; PR Comments at 40-46; SMC Comments at 7-12; Valpak Comments at 83-89.[38] These commenters claim that the across-the-board price increases are not reasonable and equitable because the proposed prices disregard existing problems in rates (e.g., underwater products and misaligned worksharing discounts) that could be improved, or solved, in an exigent rate case. *See, e.g.*, Valpak Comments at 85-87; Pitney Bowes Comments at 7-10. As explained in more detail below, the Postal Service believes that the requested exigent price increases are reasonable and equitable, and that an exigent rate case is not the appropriate mechanism for addressing pre-existing rate issues unrelated to the exigent event.

A. The Across-the-Board Price Increases Requested by the Postal Service Are Both Reasonable and Equitable

The purpose of the current exigent request is to recover some of the lost contribution to institutional costs that was caused by the Great Recession. Nickerson Statement at 4-5. A substantial portion of that lost contribution would have helped pay

[38] Throughout this section, these various sets of commenters will be referred to collectively as “the commenters,” to the extent that their views overlap.

for the maintenance and development of the Postal Service's national retail, processing, transportation, and delivery networks, which serve all users of the mail. This linkage supports the Governors' determination that it would be both reasonable and equitable to spread the burden of maintaining such operations among all mailers through across-the-board price increases of 4.3 percent. Contrary to Valpak's assertions on pages 8-15 of its comments, this explanation demonstrates how both the requested overall increase, and the specific proposed rate increases, directly and specifically relate to the harm from the identified exigent circumstances. Accordingly, the Postal Service has satisfied Commission Rule 3010.60(a)(3).

In addition to being reasonable and equitable, the across-the-board approach has the added benefits of (1) avoiding discrimination and undue disruption to mailers, (2) improving the cost coverage of underwater products, and (3) ensuring that no workshare passthroughs increase further above 100 percent than they currently are, while also allowing workshare passthroughs below 100 percent to increase.[39] The Postal Service believes that these benefits, in combination with the reasoning already offered, demonstrate why the across-the-board price increases proposed in this Docket represent a reasonable and equitable attempt to recover the lost contribution from the Great Recession. Taufique Statement at 3-10.

B. An Exigent Rate Case Is Not the Appropriate Mechanism to Address Systemic or Perceived Problems in the Design of Postal Rate Structures

[39] Due to rounding errors, five Periodicals passthroughs unintentionally increased further above 100 percent than they currently are. *See* United States Postal Service Notice of Revisions to the Statement of Altaf Taufique, PRC Docket No. R2013-11 (Oct. 18, 2013). Additionally, due to a cost transposition error, two Media/Library Mail passthroughs also increased further above 100 percent than they currently are. Response of Witness Taufique to POIR No. 6, Question 26.

Despite the reasonable and equitable nature of the price increases requested by the Postal Service, the commenters essentially criticize the across-the-board approach as not going far enough to address their longstanding concerns with the postal rate structure. The Postal Service notes that it has attempted to partially address these concerns (e.g., underwater products) in the price adjustments proposed in Docket No. R2013-10. Taufique Statement at 6-8. However, the Postal Service does not consider an exigent rate case to be the appropriate mechanism for correcting pricing concerns that are unrelated to the harm caused by the Great Recession.[40]

Indeed, this view appears to be consistent with that of the Postal Regulatory Commission Chairman, who stated at the press conference announcing the Commission's decision in Docket No. R2010-4 that "[t]he exigency rate case is not a forum in which to address rates that do not cover costs unless it can be part of the case that's made as an exigency[.]" Statement of Chairman Ruth Y. Goldway at Press Conference Announcing the Postal Regulatory Commission's Decision in Docket No. R2010-4 (Oct. 1, 2010), http://www.prc.gov/prc-docs/home/whatsnew/Press%20Conference%209-30-2010.mp3 (audio at 14:23). Moreover, the Commission previously found that "exigent rate adjustments are permitted only if, and to the extent that, they compensate for the net adverse financial impact of the exigent circumstances." Order No. 864, Order Resolving Issues on Remand, PRC Docket No. R2010-4R (Sept. 20, 2011), at 25. In the judicial review of its

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[40] *See* Tr. 1/22-25. For Periodicals, moreover, the substantial price increases that would be required to further reduce or eliminate the contribution deficit need to be balanced against two § 3622(c) factors: "(8) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;" and "(11) the educational, cultural, scientific, and informational value to the recipient of mail matter." *See* Tr. 1/20

decision in Docket No. R2010-4, the Commission also stated that "the authority to raise prices due to either extraordinary or exceptional circumstances was not designed to provide a 'unique opportunity' to address problems that have persisted 'for years.'" Respondent's Brief at 36, *United States Postal Serv. v. Postal Reg. Comm'n*, 640 F.3d 1263 (2011). Consistent with the Commission's repeated views, the Governors chose to propose the same percentage increase for all classes of mail.

In addition, the Commenters' statements leave the troubling misimpression that the requested exigent prices would do absolutely nothing to address their concerns. On the contrary, under the price increases proposed in this case, all classes and products will receive a substantial price increase on top of the increase in Docket No. R2013-10. As a result, all underwater classes and products will experience significant cost coverage improvement, resulting in reduced cross-subsidies. Indeed, the Public Representative's Table VI-3 shows the substantial cost coverage increases that will be realized by the exigent prices requested in this docket. PR Comments at 43. What is more, the Public Representative's Table VI-4 shows that the combined CPI and exigent price increases reduce negative contribution from underwater classes and products by $302 million (or 46-percent of the overall contribution loss without those increases). PR Comments at 44. Approximately two-thirds of this improvement comes from the 4.3-percent across-the-board price increase. The Postal Service submits that a 46-percent reduction represents significant improvement, while maintaining the reasonable and equitable nature of the 4.3-percent across-the-board price increases proposed in this case.

With respect to the commenters' concerns about worksharing discounts that deviate from 100 percent, the Commission has already approved the vast majority of the workshare discounts proposed in Docket No. R2013-10.[41] As explained in the previous section, the price increases requested in this docket were designed to maintain the approved workshare passthroughs at their present levels. Passthroughs that were below 100 percent in Docket No. R2013-10 were allowed to increase, but not to exceed 100 percent.[42]

C. Valpak's Misinterpretation of the Great Recession's Cumulative Contribution Impact Undercuts Its Challenge to the Pricing for Underwater Products

Beyond the arguments discussed above, the Postal Service also notes an error in the original comments submitted by Valpak. As witness Nickerson shows in Table 2 of his Statement, the estimated contribution impact of the Great Recession escalated from -$1.2 billion in FY 2008 to -$6.7 billion in FY 2012. Nickerson Statement at 3. Valpak misinterprets the latter impact to be the cumulative impact from FY2008 to FY2012. Valpak Comments at 48-50. Instead, as explained in section II.B above, the cumulative FY2008-FY2012 impact is -$21.9 billion.

[41] In Order No 1890, issued on November 21, 2013, the Commission directed the Postal Service to align the Commercial and Nonprofit workshare discounts for Standard Mail 5-digit automation flats. The Postal Service complied with this directive by submitting revised materials. Response of the United States Postal Service to Order No. 1890, PRC Docket No. R2013-10 (Nov. 29, 2013).

[42] Pitney Bowes pushes for a 5.1-percent price increase for First-Class Mail 3-Digit Automation Letters, in order to increase the worksharing discount for 5-Digit Automation Letters even more than the Postal Service's proposal. Pitney Bowes Comments at 14-20; *see also* NPPC/MMA/NAPM/AMEE Comments at 39-40. In Docket No. R2013-10, however, the Commission has already approved a 2.3-cent discount for First-Class Mail 5-Digit Automation Letters, compared to the estimated cost avoidance of 2.8 cents from the benchmark of 3-Digit Automation Letters. Moving the discount up to 2.5 cents, as requested in this proceeding, is all that is justified, consistent with the across-the-board 4.3-percent pricing approach and in light of the risk that the passthrough might move above 100 percent in the future, should the cost savings estimate decrease.

While the Postal Service recognizes that Valpak submitted errata that address its misinterpretation on December 5, 2013, that misinterpretation continues to underlie a portion of Valpak's commentary, rendering some of its conclusions invalid: 1) that "losses" on underwater products from FY2008 to FY2012 may be the major source of the Postal Service's liquidity problem, *id.* at 61; and 2) that the Postal Service's exigent request would be unnecessary if not for the losses on underwater products. *Id.* at 66. Contrary to these assertions, the Postal Service's liquidity problem is largely independent of the loss from underwater products.

Additionally, it is incorrect for Valpak to equate negative contribution on underwater products with "losses." While negative contribution on Standard Mail Flats could arguably have been reduced by devoting more price-cap authority to the product in past CPI-based rate adjustments,[43] this would have come at the expense of additional revenue and contribution from other products under the price cap. Such a tactic may be likely to have a positive impact on total contribution in the short run, but the impact could easily turn negative in the long run.[44] For the same reason, Valpak is incorrect to imply that cutting "losses" on underwater products would have translated dollar-for-dollar into an improved liquidity position. *Id.* at 49-51. Cap space is a zero-sum game: contribution raised from Standard Mail Flats would come at the expense of

[43] This can happen in one or both of two ways: by driving away negative-contribution volume, and/or by improving unit contribution on the volume that remains (despite the relatively large price increase).

[44] As the Postal Service has repeatedly argued, long-run average revenue per piece across all Standard Mail can be impaired to the extent that limited price-cap space is devoted to a product, such as Standard Mail Flats, that is in comparatively autonomous (independent of price) decline. Price-cap space would have been effectively wasted if it had been devoted to Standard Mail Flats volume which, for non-price reasons, will not actually be around in the long run to produce a revenue yield. *See, e.g.*, United States Postal Service Notice of Market-Dominant Price Adjustment, PRC Docket No. R2013-1 (Oct. 11, 2012), at 22-23; Library Reference USPS-LR-R2013-1/7; Reply Comments of the United States Postal Service, Docket No. R2013-1 (Nov. 9, 2012).

contribution from other Standard Mail products, so any net improvement in liquidity from Valpak's strategy might well prove more ephemeral than Valpak would care to admit.

VII. QUESTIONS OF FUTURE CIRCUMSTANCES NEED NOT AND SHOULD NOT BE RESOLVED IN THIS PROCEEDING

A. Any Future Decision About Rescission Should be Based on Whether the Continuation of This Increase Meets the Standards of the Statute, Which the Commission Can Monitor Going Forward

Numerous commenters claim that the Postal Service's Request is problematic because the Postal Service has not specified a definitive end-point for the exigent increase. This leads to claims that the increase will therefore be "permanent," because "the Postal Service has shown no inclination to rescind it in the future." *See, e.g.*, NPPC/MMA/NAPM/AMEE Comments at 11. Others propose that the Commission establish at this point a specific end-point for the increases. MPA et. al. Comments at 52; ABA Comments at 7 These concerns are misplaced. Fundamentally, the duration of an exigent increase should be based on whether that increase remains consistent with the statute. At this point in time, how long these proposed increases may be consistent with the statute cannot be predicted with certainty. But, the Commission has ample authority to monitor whether these increases continue to be consistent with the statute, and to rescind them in whole or in part when they deem that doing so is appropriate under the statute.

As an initial matter, these comments provide no basis to reject the Postal Service's request. The Postal Service has fully complied with the Commission rule that it provide "[a]n 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). This rule does not require that the Postal Service state with certainty, at the time it files a Request, the definitive endpoint of an exigent request, or require that such an increase be very short-term in duration. Rather, it simply requires an explanation of "when, or under what circumstances," rescission in whole or in part can occur. Indeed, when it issued this Rule, the Commission recognized that "the PAEA does not include a requirement that exigent increases, by definition, must be temporary. This means that adding an explicit requirement for rollback would not be fully consistent with the statute." Order No. 43 at 68.[45] Thus, the Commission's rule recognizes that the duration of exigent increases should depend on the particular circumstances. This appropriately reflects the language of the statute, which does not indicate that above-cap increases must by definition be short-lived in duration.

The Postal Service's position is that this increase should remain in the rate base until its continuation is no longer consistent with the language of the exigency clause. First, the effects of the recession might end, or be diminished to the point that the modest increase proposed in this Request would exceed the continuing impacts of the recession. In such an instance, the increase would be rolled back entirely, or reduced in size, consistent with the dictates of the "due to" clause. But, to the extent that the volume losses brought about by the Great Recession do not return, it makes perfect sense under the "due to" clause for the continuation of a rate adjustment compensating the Postal Service for the loss of contribution resulting from the lost volume. As discussed by Mr. Thress, it is highly unlikely that volumes lost due to the recession will

[45] While the Commission has previously expressed that exigent increases should "ordinarily short-lived," it recognized that this will not always be the case. Order No. 547 at 67-68.

recover in such a manner so as to render this modest increase inconsistent with the "due to" clause, at least for the foreseeable future.

Second, the increase could at a certain point no longer be "necessary": that is, the Postal Service could eventually be in a position to continue "postal services of the kind and quality adapted to the needs of the United States" without recovering the modest level of contribution lost due to the Great Recession being sought here. It is an essential aspect of the Five-Year Plan that Congress pass comprehensive legislation that allows the Postal Service to substantially reduce labor and network costs. Until such time as legislation is enacted, however, it is unlikely that this increase would be rendered "unnecessary," since the Postal Service's liquidity position will remain low for the foreseeable future.[46] Under current law, the Postal Service's ability to reduce its labor costs is constrained by statutory requirements, including the binding arbitration provisions and the fact that Postal Service employees participate in government-wide benefit programs that do not reflect private sector best practices. Reducing network costs is also subject to legal and service constraints. Fundamentally, contribution pays for the cost of networks. These networks are sized in accordance with the Postal Service's universal service obligation and service standards, and therefore cannot be readily changed without also redefining the contours of that obligation and those standards. For instance, in terms of the delivery network, the Postal Service is required, with few exceptions, to deliver to every address in the country, six days a week.; therefore, every year the number of delivery points increases, even as volume – and

[46] The mere passage of legislation would not, of course, necessarily mean that the continuation of this increase, in whole or in part, is no longer "necessary." The answer to that question depends on his is the more likely circumstancethe particular legislation that is passed, but we cannot predict in advance whether any particular piece of legislation will render the continuation of this increase unnecessary.

thus revenue per delivery point – declines. Thus, unless and until Congress makes a different policy call about what "kind and quality" of postal services are "adapted to the needs of the United States," then the Postal Service must be able to retain the contribution lost due to the recession if doing so is necessary to meet Congress's current expectations as to universal service.

The continuation of an increase until such time as it no longer is justified under the exigency provision is, of course, fully consistent with the statute.[47] Nor does it mean that the incentives of the price cap would no longer be in force: consistent with the statute, if the Postal Service stopped exercising “honest, efficient, and economical management,” the increase could be rescinded by the Commission in whole or in part (depending on the circumstances) on the grounds that it is no longer “necessary.” Furthermore, concerns that the Postal Service would, because of this increase, no longer practice “honest, efficient, and economical management” are misplaced, as the Postal Service will continue to be in poor financial shape, and will continue to face a very challenging marketplace. Therefore, the Postal Service has and will continue to seek ways to reduce its costs, consistent with the law and its provision of universal service.

[47] MPA et al. state that “[a] reasonable maximum duration for the exigent price increases would be 24 months after they take effect,” citing to the fact that this will be seven years after the Great Recession officially ended.. MPA et al. Comments at 52. However, this proposal is wholly divorced from the language of the statute, because an exigent increase can still be “due to” exigent circumstances, and still be “necessary,” years after the occurrence of the exigent circumstances. Part of determining its continued “necessity” is, furthermore, whether the Postal Service is practicing “honest, efficient, economical management” in adapting to the “new normal.” The Comments do not argue in any way that the Postal Service is violating that standard. Indeed, as discussed in the Request, the Postal Service has, and under the Five-Year Plan will continue, exercising prudent management in adapting to the “new normal.”

The Commission has ample authority to monitor these issues going forward, through the Annual Compliance Determination process or such other processes as it deems appropriate. Furthermore, it will also have the ability to consider the continuation of these increases as part of the 2016 re-design of the ratemaking system. If at any point it determines that this increase should be rescinded in whole or in part based on the provisions of the statute, it can order such a rescission. As such, there is simply no reason for the Commission to issue a definitive statement on rescission now. There is certainly no basis to pick an arbitrary end-point at which this increase must end, without regard to whether the increase is still consistent with the statutory standards.

B. Whether a Hypothetical Future Exigent Request May Be Filed Has No Role to Play in this Proceeding

A number of parties express concern that the Postal Service may file future exigent requests based on the Great Recession. However, as with the rescission issue, this does not provide any basis to deny the Postal Service's Request; at most, it may provide a basis to deny a future, purely hypothetical request, which, as the Postal Service has noted, it has no present intentions of ever filing. *See* Response to POIR No. 5, Question 2(c); Tr. 2/193, 209-10. Furthermore, concerns that the prospect of future requests might encourage the Postal Service to become lax in its efforts to reduce costs are misplaced: if the Postal Service did so, any such future request could be rejected for the failure to meet the "honest, efficient, and economical management" standard; it would also give the Commission a basis to rescind the current request. For these reasons, the Commission should decline to issue any definitive statements regarding the prospect of future exigent requests, and simply decide whether *this proposed increase* complies with the statutory standards.

VIII. THE EQUITABLE DOCTRINE OF LACHES IS NOT APPLICABLE, NOR HAS IT BEEN SATISFIED

The NPPC/MMA/NAPM/AMEE commenter group[48] asserts the equitable doctrine of laches as a bar against exigent rate requests based on FY2012 or subsequent data. NPPC/MMA/NAPM/AMEE Comments at 26. Noting that "the Postal Service has allowed more than three years to pass since it first contended that an exigency existed," the Joint Commenters argue that this "seeming abandonment" of its exigent request has injured mailers by inducing them to make "substantial investments in mailing hardware and software in reliance on the Postal Service's practice of seeking only index adjustments since 2011." *Id.* at 27, 30. This argument fails fundamentally because the Joint Commenters have not established the necessary laches elements of unreasonable delay and undue prejudice. Nor do the Joint Commenters overcome the presumption that laches does not bar actions brought by government actors before a regulatory body on behalf of the public interest, the purpose undergirding 39 U.S.C. § 3622(d)(1)(E) (providing for increases "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").

First, as a matter of protecting the public fisc, sovereign immunity has traditionally barred application of laches against the government. *E.g.*, *United States v. 93 Court Corp.*, 350 F.2d 386, 388-89 (2d Cir. 1965) (sovereign immunity bars laches absent clear congressional intent to the contrary). Indeed, "where . . . a government agency brings an enforcement action to protect the public interest, laches is not a

[48] For the sake of brevity, this group will be referred to simply as the "Joint Commenters" in this section.

defense. . . . The doctrine of laches should not be used to prevent the Government from protecting the public interest." *S.E.C. v. Silverman*, 328 Fed. Appx. 601, 605 (11th Cir. 2009) (citations omitted).[49] Courts have exempted from laches defenses one federal instrumentality that, like the Postal Service, does not otherwise enjoy sovereign immunity. *E.g.*, *Fed. Deposit Ins. Corp. v. Hulsey*, 22 F.3d 1472, 1490-91 (10th Cir. 1994) (applying sovereign immunity against laches "even when dealing with the FDIC in its corporate capacity"); *compare Village of Oakwood v. State Bank & Trust Co.*, 539 F.3d 373, 378 (6th Cir. 2008) (holding that FDIC's "sue and be sued" clause is a "broad waiver of sovereign immunity"), *with United States Postal Serv. v. Flamingo Indus. (USA) Ltd.*, 540 U.S. 736, 744 (2004) (same with respect to Postal Service). Thus, as a general matter, laches does not apply in the context of actions by federal entities.

The Joint Commenters simply assume that laches applies to the Postal Service, which they glibly characterize as operating in a commercial capacity by seeking to enforce its own "private" rights in the exigency proceeding. NPPC/MMA/NAPM/AMEE Comments at 29 (citing *United States v. Admin. Enters., Inc.*, 46 F.3d 670, 673 (7th Cir. 1995). A more nuanced reading of the cases cited by the Joint Commenters supports the conclusion that sovereign immunity applies to the Postal Service because it acts on uniquely governmental concerns in support of the public interest in the exigent rate context. *See Admin. Enters.*, 46 F.3d at 673 ("draw[ing] a line between government suits in which the government is seeking to enforce either on its own behalf or that of private parties what are in the nature of private rights, and government suits to enforce

[49] Modern standards of fairness and equity allow the availability of laches against government activity indistinguishable from private contract and tort claims. *See, e.g.*, *S.E.R., Jobs For Progress, Inc. v. United States*, 759 F.2d 1, 6-9 (Fed. Cir. 1985) (contract dispute). Such claims are clearly not analogous to the administrative rate-regulation context in this proceeding.

sovereign rights," and allowing laches as a defense in the former class of cases but not the latter) (citation omitted); *cf. Portmann v. United States,* 674 F.2d 1155, 1165 (7th Cir. 1982) ("[W]e are not dealing primarily with a statutory benefit but more directly with a written contract between the Postal Service and a private citizen."); *United States v. Philip Morris Inc*., 300 F. Supp. 2d 61, 74 (D.D.C. 2004) ("[T]here is no question that the Government has brought a RICO suit on behalf of the public and is not acting in a proprietary capacity or on behalf of individuals."); *Cayuga Indian Nation of N.Y. v. Pataki,* 413 F.3d 266, 279 n.8 (2d Cir. 2005) (not applying laches "inasmuch as this case does not involve the enforcement of a public right or the protection of the public interest").

Far from standing in the shoes of any private individual, the Postal Service seeks an exigent price increase on behalf of the public at large, in the interest of "enabl[ing] 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." The Postal Service acts here as a governmental public service provider, not as a commercial proprietor, as the Joint Commenters have characterized. NPPM/MMA/NAPM/AMEE Comments at 29. The laches doctrine is, therefore, inapplicable in this instance.

Assuming that it would make sense to consider laches at all in this context (which it does not), the Joint Commenters nevertheless fail to demonstrate its two necessary components of "lack of diligence by the party against whom the defense is asserted" and "prejudice to the party asserting the defense." *Costello v. United States*, 365 U.S. 265, 282 (1961); *see also Conagra, Inc. v. Singleton,* 743 F.2d 1508, 1517 (11th Cir. 1984) ("This doctrine is an affirmative defense which requires a party to prove: (1) a delay in a right or claim; (2) that the delay was not excusable; and (3) that the delay caused undue prejudice."). Diligent pursuit of a claim is not possible, for example, without accrual of clear, unambiguous evidence that a claim exists. *See Kansas v. Colorado*, 514 U.S. 673, 689 (1995) (holding delay to be excusable in light of vague and conflicting evidence available to claimant). Negligence and lack of vigilance are factors considered in delay, as well. *Id*. at 687.

By the Joint Commenters' own account, the Postal Service has acted diligently in pursuit of the exigent increase: clear, unambiguous evidence of the need for a renewed exigent price increase was not possible without careful monitoring of the progress of legislative reform, repeated CPI-based increases, and difficult cost cutting measures. *See* NPPC/MMA/NAPM/AMEE Comments at 27-28 (discussing Postal Service endeavors since 2011). The Postal Service faces the unavoidable process of seeking an exigent price increase only after vigilantly monitoring reform legislation and prudently pursuing other remedies before responding to Order No. 1059.

As for the necessary element of prejudice required under the doctrine of laches, the Joint Commenters also fail on this count. Although they allege that mailers have been harmed by a "potentially permanent circumvention of the cap" and by "investments in mailing that they might well not have made," *id.* at 30, they specify no concrete prejudice or consequences made unduly harsh by the passage of time. *See Costello*, 365 U.S. at 284 (looking for factors contributing to denial of due process or fundamental fairness to parties asserting laches, typically in the form of concrete impairments to the proof of defenses, such as loss of memory or life of witnesses, destruction of records, or other spoliation of relevant evidence). Again, a case cited by the Joint Commenters illustrates the inadequacy of their own allegations of harm:

> [B]eing lulled [into thinking that a claim had been abandoned] and then rudely awakened is not the kind of harm, if it is a harm at all rather than merely another metaphor, that allows laches to be used to deprive a plaintiff of his rights. A more concrete harm must be shown.

Admin. Enters., 46 F.3d at 673 (citation omitted). *See Costello*, 365 U.S. at 284 (holding that 65-year delay in revoking U.S. citizenship of defendant was, “even after the lapse of many years, . . . not so unreasonable as to constitute a denial of due process”). Claiming that “mailers may have made different decisions,” NPPC/AMM/NAPM/AMEE Comments at 30, does not begin to approach the level of concrete, unduly prejudicial harm required under the doctrine of laches.

Because the Postal Service is acting in its governmental capacity on behalf of the public interest in maintaining the viability of America’s postal system, the equitable doctrine of laches is not applicable. Even if it were, the Joint Commenters have demonstrated neither that the Postal Service has unreasonably delayed proceedings, nor that mailers have suffered undue prejudice due to the exigent request’s dormancy and renewal, and the Commission should find that the affirmative defense of laches is not viable.[50]

[50] Other commenters argue that the Postal Service’s Request is untimely under the language of the exigency clause itself, which they claim requires the Postal Service to pursue an exigent request in an “expedited” fashion after the occurrence of exigent circumstances. *E.g.*, ABA Comments at 6-7. As the Postal Service discussed in its Request, however, it makes no sense to read the exigency provision as requiring that the Postal Service immediately seek an exigent increase once “extraordinary or exceptional circumstances” occur. The commenters provide no basis to adopt such an illogical reading of the statute.

IX. RAISING THE COMPETITIVE INSTITUTIONAL COST SHARE IS NOT WARRANTED AND WILL NOT IMPROVE THE POSTAL SERVICE'S LIQUIDITY

UPS urges the Commission to increase the share of institutional costs required to be covered by competitive products, which is presently set at 5.5 percent. UPS notes that, in FY 2012, competitive products generated $525 million in revenue above the 5.5 percent institutional cost share and the assumed federal income tax, and points out that this represents 30 percent of the requested exigent increase. UPS Comments at 2. UPS argues that increasing the institutional cost share would therefore "have a material impact on the Postal Service's fiscal health." *Id.* at 6. UPS also offers other reasons for increasing the institutional cost share: growing revenues on the competitive side and falling revenues on the market-dominant side, transfers of products from the market-dominant list to the competitive list, and the need to "free" the cash in the Competitive Products Fund.

The Commission considered the institutional cost share of competitive products last year, ultimately deciding to keep it at 5.5 percent. Order No. 1449, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, PRC Docket No. RM2012-3 (Aug. 23, 2012). While parties may petition for a reevaluation of that decision at any time, doing so should require a showing that circumstances have changed from those that informed the Commission's decision in Docket No. RM2012-3. All of the secondary circumstances cited by UPS – growing competitive revenues, product transfers, and the alleged need to free liquidity – were explicitly considered by the Commission in Docket No. RM2012-3, and none have changed materially since then. Furthermore, UPS's comments do not even touch on the primary function recognized by the Commission for the appropriate share contribution, which is “to ensure a level playing field in the competitive marketplace.” *Id.* at 13.

That leaves UPS’s main argument, that increasing the institutional cost share would improve the financial health of the Postal Service. In making this argument, UPS assumes that, if the institutional cost share were raised, the Postal Service would increase revenues from competitive products. In other words, UPS assumes that the Postal Service is not already maximizing revenues from competitive products, that it is somehow leaving money on the table. That notion is belied by evidence presented by UPS itself. UPS provides a table listing the net income of competitive products, after the 5.5 percent institutional cost contribution and the assumed federal income tax, for each of the past five fiscal years. UPS Comments at 7. As that table shows, the Postal Service has consistently grown competitive revenues in every year. Clearly, then, the institutional cost share requirement is not holding the Postal Service back.

Rather, the Postal Service already has a vital interest in growing competitive revenues, which is to alleviate the grim liquidity situation outlined in the Nickerson statement. The Postal Service prices competitive products to the market. In some years, this has meant competitive price increases significantly higher than market dominant price increases, while in the most recent price change, this has meant a lower competitive increase. The overall goal remains the same: to price competitive products so as to increase revenues, based on market conditions.

Market conditions are why it is disingenuous for UPS to compare the $525 million in competitive revenues above institutional costs and federal income tax in FY 2012, on the one hand, with the amount of contribution requested in this docket, on the other hand. While $525 million does represent almost 30 percent of the contribution requested in this docket, seeking that amount through competitive products instead of through the exigent increase would require doubling the $525 million figure. As UPS well knows, market conditions make that impossible.

Finally, the Postal Service once again clarifies that the liquidity figures presented by Mr. Nickerson take into account all available liquidity, including amounts in the Competitive Products Fund. The Postal Service has already explained, first in Docket No. RM2012-3, and more recently in Docket No. PI2013-1, that cash in the Competitive Products Fund is not trapped there, and it will be used to shore up the Postal Service's liquidity. To continue to suppose otherwise, as UPS does, is to believe that, if the Postal Service Fund were ever to run out of cash, it is Congress's intent that the Postal Service would cease operations rather than tap the hundreds of millions of dollars in cash from the Competitive Products Fund. Such a notion is absurd.

X. CONCLUSION

The Great Recession was, without serious dispute, an extraordinary and exceptional circumstance, with dramatic effects on mail volumes. The resulting loss in contribution raised from those volumes delivered a crushing blow to the Postal Service's liquidity.

In response, the Postal Service embarked on an unprecedented, multi-year cost-reduction and efficiency-improving mission and will continue to pursue those efforts into the foreseeable future, waiting as long as possible before resorting to the statutory safety valve of extraordinary price increases. Despite its exercise of honest, efficient, and economical management, however, the Postal Service now finds itself but a thin margin away from being unable to maintain and continue to develop postal services of a kind and quality adapted to the needs of the United States. This Request would provide a much-needed infusion of liquidity to help ensure the Postal Service's continued ability to provide universal service. The across-the-board price increases proposed by the Postal Service are a reasonable and equitable reflection of the fact that the instant threat to universal service affects all mailers.

The extraordinary and exceptional effects of the Great Recession on the Postal Service and the need for liquidity are not expected to abate in the foreseeable future. Needless to say, the Commission will have opportunities to consider the continued justification of these price increases via the annual compliance process and its review of the price regulation system in 2016.

The Postal Service appreciates commenters' intense engagement with the complex issues and information in this case. Their criticisms wither upon inspection, however. The Commission should grant the Postal Service's Request.