

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

Before Commissioners:

Robert G. Taub, Chairman;
Mark Acton, Vice Chairman;
Tony Hammond; and
Nanci E. Langley

Statutory Review of the System
for Regulating Rates and Classes
for Market Dominant Products

Docket No. RM2017-3

ORDER ON THE FINDINGS AND DETERMINATION OF THE
39 U.S.C. § 3622 REVIEW



Washington, DC 20268-0001
December 1, 2017

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EXECUTIVE SUMMARY

In accordance with the statutory mandate set forth in 39 U.S.C. § 3622(d)(3), the Commission is required to review the past 10 years of the existing market dominant rate and classification system to determine if the system has achieved the objectives of 39 U.S.C. § 3622(b), taking into account the factors enumerated in 39 U.S.C. § 3622(c). On December 20, 2016, the Commission initiated its review of the system by issuing an Advance Notice of Proposed Rulemaking (ANPR) that provided notice and an opportunity for comments. In response, it received 82 comments from interested parties.

The Commission disposes of initial concerns challenging the scope of its review authority under section 3622(d)(3). With respect to the scope of the Postal Accountability and Enhancement Act (PAEA) system under review, the Commission determines that all aspects of the system of ratemaking and classification of market dominant products outlined in section 3622, including workshare discounts, are appropriately incorporated into its review. The Commission finds that the plain language of section 3622(d)(3) necessitates that the review include section 3622 in its entirety. To exclude some components of the system would forsake the comprehensive review of the system that Congress intended.

Congress designed the PAEA system to achieve nine objectives: (1) maximize incentives to reduce costs and increase efficiency; (2) create predictable and stable rates; (3) maintain high quality service standards; (4) allow the Postal Service pricing flexibility; (5) assure adequate revenues, including retained earnings, to maintain financial stability; (6) reduce administrative burden and increase transparency of ratemaking process; (7) enhance mail security and deter terrorism; (8) establish and maintain a just and reasonable schedule for rates and classifications; and (9) allocate the total institutional costs of the Postal Service appropriately between market dominant and competitive products. These objectives reflect the goals of the PAEA to create a flexible, stable, predictable, and streamlined ratemaking system that ensures the Postal Service's financial health (in significant part through rate adjustments, cost reductions, and increased efficiency) and maintains high quality service standards and performance.

In conducting its review, the Commission considers the evolution of the current ratemaking system. The PAEA reformed the system of setting postal rates and classifications. This marked the end of the Postal Reorganization Act (PRA) system, a cost-of-service pricing system marked by a break-even mandate where rates were set so that the total estimated revenues would equal as nearly as practicable the total

estimated costs. Lengthy document and witness-laden hearings were abandoned in favor of a more streamlined rate-setting process centered on a consumer price index for all urban consumers (CPI-U) price cap as the primary limit on rate-setting. Changes were also made to service standard performance measurement and reporting. The PAEA required the Postal Service to establish service standards and report publicly on its achievement of those standards and gave the Commission additional service performance monitoring and enforcement authority.

At the time it created the new PAEA system, Congress anticipated that the CPI-U price cap would enable the Postal Service to achieve sufficient revenues to cover all of its operating costs and statutorily mandated obligations while at the same time motivate the Postal Service to cut costs and become more efficient. The CPI-U price cap under the PAEA system was intended to allow the Postal Service to fund network expansion and necessary capital improvements because it removed the break-even restriction and allowed the Postal Service to generate retained earnings.

Shortly after the PAEA was enacted, however, the Great Recession occurred which, in concert with emergent technological trends, had a substantial negative impact on Postal Service volumes and revenues. In the aftermath of the Great Recession, there was also a rare period of deflation which constrained the Postal Service's ability to raise rates given the CPI-U price cap. The section 3622 review requirement in the PAEA allows the Commission to examine the system to determine whether, despite these changes and impacts, the system has achieved the nine objectives that formed the basis for its creation.

In its review the Commission identifies three principal areas of the PAEA system which encapsulate the nine objectives: (1) the structure of the ratemaking system; (2) the financial health of the Postal Service; and (3) service, and organizes its ultimate findings and order around these three topical areas. After extensive review, the Commission concludes that the system achieved some of the goals of these areas, but

the overall system has not achieved the objectives taking into account the factors of the PAEA.

First, with respect to the structure of the ratemaking system, the Commission concludes that the system was largely successful in achieving the goals related to the structure of the ratemaking system. The system has worked as intended to create rate adjustments that are stable and predictable with regards to both timing and magnitude; reduce the administrative burden and increase the transparency of the ratemaking system; and provide the Postal Service pricing flexibility while maintaining just prices. However, the Commission concludes that the ratemaking system has not increased pricing efficiency.

Second, with respect to finances, the Commission finds that the system has not maintained the financial health of the Postal Service as intended by the PAEA. While the Postal Service has generally achieved short-term financial stability, both medium-term and long-term financial stability measures have not been achieved. For the medium-term measure, the total revenue was not sufficient to cover total costs. For the long-term measure, the Postal Service has not been able to generate retained earnings during the PAEA era. In its review of the financial health of the Postal Service, the Commission also finds that while some cost reductions and efficiency gains occurred during the PAEA era, the incentives were not maximized in a way that allowed the Postal Service to achieve financial stability. Although the system contained a mechanism to appropriately allocate institutional costs and was able to enhance mail security and deter terrorism, there was not an adequate mechanism to maintain reasonable rates during the PAEA era because certain products and classes failed to cover their attributable costs, further threatening the financial health of the Postal Service.

Third, the Commission determines that high quality service standards have not been maintained during the past 10 years under the PAEA. While the Commission has

the ability to review service performance routinely during the Annual Compliance Determination (ACD), the current system does not effectively encourage the Postal Service to maintain service standards quality.

Taken together, the Commission's analysis of each of the three principal areas of the PAEA era system leads it to conclude that while some aspects of the system of regulating rates and classes for market dominant products have worked as planned, overall, the system has not achieved the objectives of the PAEA. As a result, the Commission concurrently issues a Notice of Proposed Rulemaking (NOPR) to address the shortcomings identified by the Commission in its review.

I. PROCEDURAL HISTORY AND LEGAL AUTHORITY

In accordance with the statutory mandate set forth in 39 U.S.C. § 3622(d)(3) to review the past 10 years of the existing market dominant rate and classification system, the Commission issued an Advance Notice of Proposed Rulemaking (ANPR) on December 20, 2016.¹ The ANPR provided notice and an opportunity for comment regarding the Commission's review and determination as to whether the market dominant ratemaking and classification system has achieved the objectives of 39 U.S.C. § 3622(b), taking into account the factors of 39 U.S.C. § 3622(c) (section 3622 review). Order No. 3673 at 10-11. The Commission sought comments on the process and structure of its review, as well as proposed metrics for analyzing the nine statutory objectives set forth in section 3622(b). *Id.* The Commission also sought responses to the question central to the section 3622 review; whether the system is achieving the objectives of the Postal Accountability and Enhancement Act (PAEA), taking into account the factors.² The Commission set forth potential definitions and key measurable concepts for each objective to provide context and guidance for commenters to consider when providing comments addressing the question of whether the system has achieved the objectives of the PAEA. Order No. 3673 at 3-11. The Commission also posed questions to commenters that sought input on the structure and framework for the section 3622 review. *Id.* at 10-11. Finally, the Commission requested proposed modifications to the system or a proposed alternative system that should be adopted to achieve the objectives from commenters that conclude the system is not achieving the objectives. *Id.* at 11.

¹ Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products, December 20, 2016 (Order No. 3673).

² *Id.* at 11. Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006).

Shortly after issuance of the ANPR, the Commission received various motions concerning the section 3622 review process and procedure. The first set of motions requested the Commission issue information requests pursuant to 39 C.F.R. § 3001.21(a).³ The Commission denied the motions, explaining that it “does not view this stage of the docket as a litigated proceeding, but (as [the ANPR] contemplates and 39 U.S.C. § 3622(d)(3) requires) an opportunity for the Commission to seek and consider public comment prior to making its initial determinations of whether the system is meeting the objectives, considering the factors.”⁴ The Commission stated that it “did not contemplate discovery within this proceeding.” *Id.* In denying a subsequent motion for reconsideration, the Commission reiterated that it “views this stage of the proceeding as an opportunity for the Commission to seek and consider public comment prior to making its initial determinations of whether the system is meeting the objectives, considering the factors.”⁵

The second set of motions sought to modify the procedural schedule and framework for the section 3622 review established in the ANPR.⁶ The motions raised objections to the Commission’s invitation to comment on potential modifications to the

³ See Motion of MPA—The Association of Magazine Media and Alliance of Nonprofit Mailers for Issuance of Information Requests, January 17, 2017; Second Motion of MPA—The Association of Magazine Media and Alliance of Nonprofit Mailers for Issuance of Information Requests, January 25, 2017.

⁴ Order on Motions for Issuance of Information Requests, January 30, 2017, at 3 (Order No. 3763).

⁵ Order No. 3807, Order Denying Motion for Reconsideration, February 24, 2017, at 6 n.6 (citing Order No. 3763 at 3 and comparing 39 U.S.C. § 3661(c), which provides for a hearing on-the-record concerning a change in the nature of postal services with 39 U.S.C. § 3622(d)(3), which prescribes no specific format for the review of the system for regulating rates and classes for market dominant products).

⁶ Motion of Alliance of Nonprofit Mailers and MPA—The Association of Magazine Media to Modify Procedural Schedule, January 17, 2017; Joint Motion for Modification of Procedural Framework, January 18, 2017 (collectively Motions to Modify). The Newspaper Association of America changed its name to News Media Alliance on September 6, 2016. See Notice of Name Change, January 23, 2017. See also Process Clarification Request of the American Postal Workers Union, AFL-CIO, January 30, 2017.

system and sought the ability to file reply comments, among other revisions to the section 3622 review process. See Motions to Modify. In response to the Motions to Modify, the Commission balanced the interests and concerns involved in the section 3622 review and denied the motions.⁷ The Commission found that the “procedure outlined in [the ANPR] is the most appropriate for the review of the system.” Order No. 3766 at 8. The Commission explained that the statute directs the Commission to conduct the section 3622 review and that there will be an opportunity to comment on any proposed changes to the current system should the Commission determine the objectives are not being met, taking into account the factors. Order No. 3766 at 7-8. Accordingly, the Commission concluded that it would not modify the framework or schedule for the section 3622 review. *Id.* at 8.

In response to the ANPR, the Commission received 82 comments regarding the section 3622 review of the ratemaking system.⁸ Commenters include industry trade groups, labor unions, users of the mail including non-profit organizations, delivery service companies, the Public Representative, and the Postal Service. The Commission summarizes comments in this order that are relevant to the topics under review.⁹

A. Framework for the Section 3622 Review

Section 3622(d)(3) sets forth the scope and context of the Commission’s review of the ratemaking system. For its review, the Commission is guided by and adheres to

⁷ Order Denying Motions to Modify Procedural Schedule, January 31, 2017, at 1-4 (Order No. 3766).

⁸ See Appendix—List of Commenters and Comments.

⁹ Numerous comments discussed matters reserved for Phase 2 of this proceeding, described in further detail below, and those comments will be addressed as relevant in that phase of the proceeding.

established judicial precedent in interpreting section 3622(d)(3) and begins with the statute's language. Section 3622(d)(3) provides:

Ten years after the date of the enactment of the Postal Accountability and Enhancement Act and as appropriate thereafter, the Commission shall review the system for regulating rates and classes for market-dominant products established under this section to determine if the system is achieving the objectives in subsection (b), taking into account the factors in subsection (c).

If the Commission determines, after notice and opportunity for public comment, that the system is not achieving the objectives in subsection (b), taking into account the factors in subsection (c), the Commission may, by regulation, make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.

By its terms, section 3622(d)(3) reflects a two phase process. Phase 1 requires the Commission to determine whether the system has achieved the objectives of the PAEA, taking into account the factors. Phase 2 permits the Commission to modify or adopt an alternative system should it find the system has not achieved the objectives of the PAEA, taking into account the factors. Phase 1 serves as a mandatory threshold inquiry; the Commission's ability to modify or adopt an alternative system in Phase 2 hinges on the Commission first finding that the system has not met the objectives of section 3622, taking into account the factors.¹⁰ On December 20, 2016, the Commission commenced Phase 1 of the section 3622 review and issued the ANPR. Although the ANPR set forth the scope of the section 3622 review, the Commission now

¹⁰ See Order No. 3237, Docket No. RM2016-9, Order Holding Petition in Abeyance, April 12, 2016, at 1-2. The legislative history of the PAEA supports this two phase approach. See 152 CONG. REC. S11, 675 (daily ed. Dec. 8, 2006) (statement by Sen. Collins that "[a]fter 10 years, the Postal Regulatory Commission will review the rate cap and, if necessary, and following a notice and comment period, the Commission will be authorized to modify or adopt an alternative system. . . . We at least will see a decade of rate stability, and I believe the Postal Rate Commission, at the end of that decade, may well decide that it is best to continue with a CPI rate cap in place. It is also, obviously, possible for Congress to act to reimpose the rate cap after it expires.").

provides a more detailed explanation of the statutory authority governing the scope and process of the section 3622 review of the ratemaking system.¹¹

Under section 3622(d)(3), the scope of the review is limited to the “system for regulating rates and classes for market-dominant products established under this section.”¹² The statute provides that the “system” for purposes of the review is the system “established under this section.” The Commission finds that the phrase “established under this section” refers to the statutory provisions (and underlying regulations) of section 3622 in its entirety. The language of section 3622(d)(3) clearly includes the entire section of 3622. This is made evident by the plain meaning of the term “section” and the fact that the same provision expressly differentiates between sections and subsections and does not exclude or limit the review to specific subsections.¹³ As the meaning of the phrase “established under this section” is clear and refers to section 3622 in its entirety, in the absence of ambiguity, the inquiry ends at the language of the statute.¹⁴

¹¹ This order does not discuss the Commission’s authority to modify or adopt an alternative system as described in section 3622(d)(3) and the following discussion of the principles of statutory interpretation is limited solely to the Commission’s review authority.

¹² Throughout this Order, the Commission uses several terms interchangeably to refer to the “system for regulating rates and classes for market-dominant products” in section 3622(d)(3). These include “system,” “market dominant ratemaking system,” “ratemaking system,” and “current system.”

¹³ See 39 U.S.C. § 3622(d)(3) (providing that the review shall cover the system established in “this section” to determine whether it is meeting the objectives and factors outlined in “subsection (b)” and “subsection (c)"); 2A Norman & Shambie Singer, *Sutherland Statutes and Statutory Construction* § 46:1 (7th ed. 2014).

¹⁴ See *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 438 (1999).

Accordingly, in the ANPR, the Commission defined the scope of the section 3622 review to include an examination of:

[A]ll aspects of the ratemaking system provided within section 3622, including the annual limitation on the percentage changes in rates, the schedule for rate changes, the 45-day notice before the implementation of rate adjustments, expedited rate changes due to extraordinary or exceptional circumstances, class level application for the annual limitation, the rounding of rates and fees, the use of unused rate authority, and workshare discounts.

Order No. 3673 at 2-3 (internal citations omitted). In response to the scope of the review provided in the ANPR,¹⁵ the Commission received comments objecting to the review of the workshare discount provisions of section 3622(e).¹⁶

The Postal Service contends that the workshare discount provisions of section 3622(e) should not be part of the Commission's section 3622 review of the ratemaking system because it submits that the "workshare discount standards are not within the 'system' as that term is used in Section 3622(d)(3), notwithstanding their formal placement within Section 3622." Postal Service Comments at 28. It claims that because the workshare discount subsection (e) is not part of the system "requirements" stated in subsection (d) and falls after the provision establishing the review of the system, subsection (e) should be considered outside of the system of ratemaking.¹⁷

¹⁵ In defining the scope of review in the ANPR, the Commission resolved the Postal Service's previous petition "to clarify the scope of the statutory review." Order No. 3673 at 2 n.4 (*citing* Docket No. RM2016-9, Petition of the United States Postal Service for the Initiation of a Proceeding to Clarify the Scope of the Review of the System for Regulating Market-Dominant Rates and Classes, April 7, 2016).

¹⁶ See, e.g., APWU Comments at 5; Postal Service Comments at 28-30; GCA Comments at 36-37. In contrast, numerous commenters presume worksharing is within the scope of this proceeding and suggest worksharing related changes. See, e.g., ABA Comments at 11; ANM *et al.* Comments at 11-12, 82; Chairman Chaffetz and Chairman Meadows Comments at 2; MMA, NAPM, and NPPC Comments at 19, 71; Pitney Bowes Comments at 3-4; PSA Comments at 6. Comments proposing worksharing related changes will be addressed in Phase 2.

¹⁷ *Id.* at 28-30. See also APWU Comments at 5.

The Commission does not agree. The Postal Service fails to cite any legal authority for its interpretation of the statutory language, and it does not point to any relevant legislative history contrary to the Commission's inclusion of workshare discounts in the section 3622 review. Its interpretation of section 3622(d)(3) ignores the clear language defining the system under review as the system "established in this section," meaning section 3622 in its entirety.

Accordingly, as set forth in the ANPR, the scope of the Commission's section 3622 review includes an examination of "all aspects of the ratemaking system provided within section 3622, including the annual limitation on the percentage changes in rates, the schedule for rate changes, the 45-day notice before the implementation of rate adjustments, expedited rate changes due to extraordinary or exceptional circumstances, class-level application for the annual limitation, the rounding of rates and fees, the use of unused rate authority, and workshare discounts." Order No. 3673 at 2-3 (internal citations omitted).

B. Statutory Considerations Related to the Section 3622 Review

The PAEA mandated that the Commission review the market dominant ratemaking system established under section 3622 to determine if it has achieved the objectives, taking into account the factors, established by Congress. 39 U.S.C. § 3622(d)(3). The phrases that establish the framework for the Commission's review, "achieving the objectives," "applied in conjunction with the others," and "taking into account the factors," are not defined by the statute and require the Commission to look to the plain or ordinary meaning of those phrases and terms.¹⁸ In addition, to implement the plain meaning of the phrases and terms used in sections 3622(b) and (d)(3), the

¹⁸ See *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187 (1995) ("When terms used in a statute are undefined, we give them their ordinary meaning.").

Commission's review also reflects consideration of the structure and additional text of the statute.¹⁹

1. "Achieving the Objectives"

Section 3622(d)(3) requires the Commission to review the market dominant ratemaking system to "determine if the system is achieving the objectives in subsection (b), taking into account the factors in subsection (c)." As a result, the nine statutory objectives listed in section 3622(b) are central to the section 3622 review. They are:

Objective 1: to maximize incentives to reduce costs and increase efficiency.

Objective 2: to create predictability and stability in rates.

Objective 3: to maintain high quality service standards established under section 3691.

Objective 4: to allow the Postal Service pricing flexibility.

Objective 5: to assure adequate revenues, including retained earnings, to maintain financial stability.

Objective 6: to reduce the administrative burden and increase the transparency of the ratemaking process.

Objective 7: to enhance mail security and deter terrorism.

Objective 8: to establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.

Objective 9: to allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

39 U.S.C. § 3622(b).

¹⁹ See *U.S. Nat. Bank of Ore. v. Indep. Ins. Agents of America, Inc.*, 508 U.S. 439, 454-455 (1993) ("Statutory construction 'is a holistic endeavor'["] (internal citation omitted); see also *Chemehuevi Tribe of Indians v. FPC*, 420 U.S. 395 (1975).

While the statute does not define the word “achieving,” the Commission looks to its root word “achieve” and applies its ordinary meaning. The dictionary defines “achieve” as “to accomplish” or “to get or attain as the result of exertion.”²⁰ Therefore, the system is “achieving” an objective when the desired outcome has been accomplished or reached.

In the ANPR, the Commission set forth definitions and key measurable concepts it proposed using in this review to determine whether the objectives of section 3622(b) have been met. Order No. 3673 at 3. Specifically, the Commission presented “preliminary definitions for the objectives as well as potential methods that may be used to evaluate whether the objectives, taking into account the factors, are being achieved.” *Id.* The definitions and key measurable concepts were based on several considerations, including relevant legislative history and existing precedent regarding the application of the objectives, in order to create a preliminary framework for the Commission’s review.²¹

In response to the ANPR, the Public Representative contends that the process for conducting the section 3622 review is “patently ambiguous.” PR Comments at 10. He notes the absence of guidance in both the statutory language and legislative history for how the objectives are to be applied or interpreted to assess the system’s performance. *Id.* at 11.

The Commission agrees with the Public Representative that the statute does not specify the exact mechanics or steps for how the Commission should conduct the

²⁰ See Merriam-Webster Dictionary, available at <https://www.merriam-webster.com/dictionary/achieve>.

²¹ Order No. 3673 at 3 (“Based on research of legislative history, Commission precedent, stakeholder comments in various past dockets, and other sources, the Commission presents preliminary definitions for each objective.”).

section 3622 review.²² However, the statute designated 9 specific objectives and 14 separate factors for the Commission to consider in its review. Accordingly, in the ANPR, the Commission set forth preliminary definitions and potential key measurable concepts for each objective and sought comments on their application as a basis for determining whether the system achieved the objectives during the PAEA era.

2. “In Conjunction with the Others”

Section 3622(b) states that the system “shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others.” The Commission reads both sections 3622(b) and (d)(3) together to require the Commission to determine if the system has achieved the objectives by analyzing them “in conjunction.”²³ A key principle in statutory interpretation is to give proper meaning to all provisions of the statute.²⁴ The Commission determines that the reading of the first clause under section 3622(b) and the review provision of section 3622(d)(3) together achieves this requirement.²⁵

The Commission received numerous comments debating how the Commission should apply the objectives “in conjunction with the others.” Comments range from contending that the Commission should elevate certain objectives over the others based on arguments of centrality or importance to the system established under section

²² Although the statute does not prescribe an exact process for conducting the section 3622 review, this does not render the directive to determine whether the objectives have been “achieved” unclear.

²³ See *U.S. Nat. Bank of Ore.*, 508 U.S. at 455 (“[I]n expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.”) (internal citations omitted).

²⁴ See *Hibbs v. Winn*, 542 U.S. 88, 101 (2004) (quoting 2A Norman & Shambie Singer, *Sutherland Statutes and Statutory Construction* § 46.06, pp.181–86 (rev. 6th ed. 2000) (“A statute should be construed so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant . . .”).

²⁵ See *Winterboer*, 513 U.S. at 189.

3622,²⁶ to comments arguing that the Commission should apply equal weight to all of the objectives,²⁷ and comments stating that all objectives need to be met.²⁸ Specifically, MMA, NAPM, and NPPC submit comments concerning the application of the phrase “in conjunction with the others” and contend that the phrase should be interpreted to mean that the objectives are on equal footing with each other. MMA, NAPM, and NPPC Comments at 17. Further, MMA, NAPM, and NPPC express concern regarding how the Commission will apply the objectives together and request that the Commission “explain how it applies the Objectives in conjunction with one another.” *Id.* at 18. The Public Representative also questions how the Commission will assess the objectives “in conjunction with other objectives.” PR Comments at 13.

The term “in conjunction” is not defined in the statute. The dictionary definition of the term “conjunction” comes from the root word conjoin, defined as “to join together (things such as separate entities) for a common purpose.”²⁹ As the Commission previously stated, “[s]ection 3622(b) . . . states that the objectives are to be applied in conjunction with one another, implying that they all carry equal weight.”³⁰ In the

²⁶ See, e.g., NALC Comments at 3 (Objective 5 should receive “paramount importance.”); compare APWU Comments at 7 (“Even if any single Objective may seem to be met, therefore, it is important to view them as part of a whole.”) with APWU Comments at 12 (Objectives 3 and 5 should be prioritized).

²⁷ See, e.g., ANM *et al.* Comments at 9, 14 (“The question to be answered by the Commission is not how well the current system is meeting each objective individually, but how well it is balancing all of them.”); GCA Comments at 21 (“[T]he revenue objective, like all the rest, must be applied in conjunction with the others.”).

²⁸ See Postal Service Comments at 5 (“The objectives, which the system must be ‘designed to achieve,’ set forth a variety of policies that are to be applied ‘in conjunction’ with each other, meaning they must all be appropriately accommodated and balanced within the regulatory system. There is not an appropriate balance if the system is failing to achieve one or more objectives.”).

²⁹ See Merriam-Webster Dictionary, available at <https://www.merriam-webster.com/dictionary/conjoining>.

³⁰ Docket No. ACR2008, Annual Compliance Determination, March 30, 2009, at 36 (rejecting argument that certain objectives should be given a “higher priority” over the others) (FY 2008 ACD); Docket No. ACR2015, Annual Compliance Determination, March 28, 2016, at 5 (FY 2015 ACD).

Commission's review, the objectives are "presented as a group and the application of each is conditioned upon the need to recognize and reflect the others."³¹ Therefore, applying the plain meaning of the term "in conjunction," the Commission considers the objectives together as they apply to the system as a whole.

In order to do this, the Commission identifies three principal areas of the PAEA system as set forth by the objectives of section 3622(b): (1) the structure of the ratemaking system; (2) financial health; and (3) service. The objectives, when viewed topically under the three principal areas, operate together to form the goals of the ratemaking system that the PAEA was designed to achieve. In the analysis that follows, the Commission evaluates achievement of the objectives as they relate to those three principal areas. The Commission finds that the objectives of section 3622(b) reflect the goals of the PAEA to create a flexible, stable, predictable, and streamlined ratemaking system that ensures the Postal Service's financial health (in significant part through rate adjustments, cost reductions, and increased efficiency) and maintains high quality service standards and performance.

This approach is consistent with the Commission's previous discussions of how the objectives should be analyzed. As the Commission acknowledged throughout the PAEA era, the objectives must be applied together and no individual objective should be elevated above another.³² For example, the Commission previously explained that "[s]ection 3622(b) establishes a tension between the restrictions of an inflation-based price cap on Market Dominant price increases and the objective that the Postal Service must be self-sufficient and maintain financial stability."³³ As expressed by the

³¹ Docket No. RM2009-3, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, September 14, 2010, at 36 (Order No. 536) (*citing* the preamble to section 3622(b)).

³² Order No. 536 at 36 (no statutory language or legislative history exists that would justify treating any specific objective or factor as "overarching" the remaining group).

³³ Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2015, January 6, 2016, at 22 (FY 2015 Annual Report).

Commission in the initial rulemaking to establish a system of ratemaking after passage of the PAEA, “[t]he revamped ratemaking under the PAEA is designed to achieve various goals . . . [and t]hese joint goals will best be achieved if they are balanced with one another.”³⁴

The Commission’s instant evaluation of each objective’s unique considerations is consistent with this approach. For instance, some objectives require making comparisons to the period prior to the PAEA; others do not. Some are evaluated on a qualitative basis while others are evaluated with quantitative metrics. The Commission previously acknowledged these differences. In the FY 2009 ACD, the Commission explained that some of the objectives “individually do not easily lend themselves to a quantifiable measure of compliance”³⁵ and that some objectives “are matters of degree, and would have to be developed over time through the application of the discretion of the Commission” *Id.* Therefore, in the analysis that follows, the Commission recognizes where appropriate both the tensions among the objectives and differences in analysis as it makes its final determination based on an evaluation of the objectives applied together.

3. “Taking into Account the Factors”

In its determination of whether the system has achieved the objectives of the PAEA, the Commission must also take into account the factors in subsection (c). 39 U.S.C. § 3622(d)(3). Subsection(c) of section 3622 lists 14 factors to be taken into account during the section 3622 review process. They are:

³⁴ Docket No. RM2007-1, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007, at 78 (Order No. 26).

³⁵ Docket No. ACR2009, Annual Compliance Determination, March 29, 2010, at 15 (FY 2009 ACD).

Factor 1: the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;

Factor 2: the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;

Factor 3: the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;

Factor 4: the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

Factor 5: the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

Factor 6: simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;

Factor 7: the importance of pricing flexibility to encourage increased mail volume and operational efficiency;

Factor 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;

Factor 9: the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery;

Factor 10: the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that— (A) either— (i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or (ii) enhance the performance of mail preparation, processing, transportation, or other functions; and (B) do not cause unreasonable harm to the marketplace;

Factor 11: the educational, cultural, scientific, and informational value to the recipient of mail matter;

Factor 12: the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services;

Factor 13: the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail; and

Factor 14: the policies of this title as well as such other factors as the Commission determines appropriate.

39 U.S.C. § 3622(c).

The statute does not define the phrase “taking into account” the factors in subsection (c). The dictionary provides that the phrase “to take into account” is the definition for the word “consider.”³⁶ The Commission applies the plain meaning of the phrase “taking into account” and determines that it will consider the factors when making its determination of whether the system under section 3622 has achieved the objectives.

As set forth in the ANPR, “[b]ecause the statute does not require that factors be independently achieved, the Commission is not proposing definitions or measurement methods for the factors.”³⁷ Although the Commission does not set a specific structure for considering the factors,³⁸ the Commission will take into account all of the factors set

³⁶ See Merriam-Webster Dictionary, available at <https://www.merriam-webster.com/dictionary/consider>; see also, *Small Refiner Lead Phase-Down Task Force v. EPA*, 705 F.2d 506, 515 (D.C. Cir. 1983) (confirming the plain language reading of “taking into account” as requiring the agency “consider” the statutory factors).

³⁷ Order No. 3673 at 3. The Commission has previously treated objectives and factors differently, noting that the factors fall at the bottom of the statutory hierarchy. See, e.g., Order No. 536 at 36; Docket No. ACR2010, Annual Compliance Determination, March 29, 2011, at 18-19 (discussing hierarchy of objectives and factors) (FY 2010 ACD).

³⁸ See *Weyerhaeuser Co. v. Costle*, 590 F.2d 1011, 1046 (D.C. Cir. 1978) (the requirement for the agency to “take into account” specific factors does not prescribe any particular structure or set of weights for the agency’s consideration of the factors).

forth in section 3622(c) and each factor will be considered where it bears upon the topic at issue.³⁹ In this order, the Commission indicates where it has considered each factor, or the goals of specific factors, in the section 3622 review.

4. Additional Considerations

As part of its determination of whether the system has met the objectives, taking into account the factors of section 3622, the Commission also considers general statutory considerations as relevant to specific objectives.

Factor 14 specifically authorizes the Commission to take into account the policies of title 39 “as well as such other factors as the Commission determines appropriate.” 39 U.S.C. § 3622(c)(14). As set forth in the ANPR, some objectives require an analysis of additional considerations, specifically whether the Postal Service is able to respond to changes in its environment, including changes to the market, changes to the legal or regulatory framework, and statutory obligations. See Order No. 3673 at 4, 6-7, 9. The Commission has previously stated that the market dominant ratemaking system established under the PAEA includes consideration of the broader statutory obligations of the Postal Service, including 39 U.S.C. § 101(d). Order No. 536 at 17. Accordingly, the Commission takes into account additional statutory considerations of title 39 where relevant to the system’s achievement of the objectives.

5. Conclusion and Next Steps

In summary, in Phase 1 of this proceeding the Commission must determine if the system for regulating rates and classes for market dominant products has achieved the objectives of 39 U.S.C. § 3622(b), considering the factors of 39 U.S.C. § 3622(c).

³⁹ See, e.g., *Weyerhaeuser*, 590 F.2d at 1046 (“[S]o long as EPA pays some attention to the congressionally specified factors, the section on its face lets EPA relate the various factors as it deems necessary.”).

39 U.S.C. § 3622(d)(3). In accordance with 39 U.S.C. § 3622(b), the nine statutory objectives must be analyzed in conjunction with each other.

In order to analyze the objectives in conjunction with one another, the Commission adopts a topical approach, which allows application of the objectives together as they relate to specific areas of the system in order to examine whether the objectives have been achieved for the system as a whole. The three principal areas the Commission identifies are the structure of the ratemaking system, financial health of the Postal Service, and service. In the review that follows, the Commission further divides the three principal areas by major subtopic. The structure of the ratemaking system is divided into the subtopics of the ratemaking process and pricing. The financial health of the Postal Service is divided into financial stability, costs and operational efficiency, reasonable rates, mail security and terrorism deterrence, and institutional cost allocation. The service section is divided into service standards and service performance.

Under each applicable topic or sub-topic, the Commission analyzes whether the system has achieved the objectives applicable to that topic or sub-topic during the PAEA era⁴⁰ by applying the definitions and measurable key concepts set forth in the ANPR to determine whether the objectives have been achieved.⁴¹ Each section also includes a discussion of the relevant factors taken into account pursuant to 39 U.S.C. § 3622(c) as well as any relevant additional considerations, including applicable statutory obligations, that the Commission used to inform its analysis. Finally, the

⁴⁰ For purposes of this Order, the Commission uses “PAEA era” or the period represented by FY 2007 – FY 2016 to describe the 10-year period beginning with the passage of the PAEA on December 20, 2006, and ending on December 20, 2016. Because 39 U.S.C. § 3622(d)(3) calls for the 3622 review to occur “[t]en years after the enactment of the Postal Accountability and Enhancement Act,” the Commission limits its review of the system to that 10-year period.

⁴¹ In some instances, the Commission makes minor changes to the proposed definitions and measurable key concepts. Those changes are addressed in the relevant analysis.

Commission provides its conclusion as to whether the system as a whole has achieved the objectives of the PAEA.

II. 10 YEAR REVIEW OF THE RATEMAKING SYSTEM

A. Evolution of the Current Ratemaking System

This section presents a discussion of the impetus for the PAEA. It begins with a summary of the ratemaking system that existed prior to the enactment of the PAEA, including a discussion of perceived shortcomings of that system. It then provides a summary of the changes made to the ratemaking system by the PAEA, followed by a brief comparison of the conditions impacting the Postal Service's financial health immediately preceding the enactment of the PAEA and after enactment. Finally, a comparison of the requirements related to measuring and reporting service performance under the PRA and PAEA is offered.

1. Summary of the PRA Ratemaking System

a. System of Ratemaking Under the PRA

Prior to 1970, postal services were provided to the nation by the Post Office Department and largely paid for by public funds.⁴² The PRA, enacted in 1970, gradually phased out most of the public subsidy.⁴³

The PRA established the Postal Rate Commission to review rates proposed by the Postal Service and, after review, recommend a complete set of postal

⁴² Postal Regulatory Commission, Report on Universal Postal Service and the Postal Monopoly, December 19, 2008, at 62 (Universal Service Report), available at <https://www.prc.gov/docs/61/61628/USO%20Report.pdf> (discussing the law in place prior to the PRA, the Public Policy Act of 1958).

⁴³ See Pub. L. 91-375, 84 Stat. 743 (codified in former 39 U.S.C. § 2401).

rates.⁴⁴ The PRA used a cost-of-service model to set postal rates that enabled the Postal Service to generate “sufficient revenues so that the total estimated income and appropriations to the Postal Service [would] equal as nearly as practicable total estimated costs”⁴⁵ This provision was interpreted to require the Postal Service to break even over a period of years rather than each year.⁴⁶ Within a rate case, the revenue necessary for the Postal Service to break even was calculated for a single year, known as the “test year.” Strasser Testimony at 2. Consequently, recommended rates were designed to achieve an estimated revenue requirement for the given test year.

The revenue requirement included projected operating expenses, an amount for the recovery of prior years’ losses, and a contingency amount. *Id.* Estimated operating expenses for the test year were based on projections from the most recently reported annual costs. *Id.* In most rate filings, the contingency ranged from 2 percent to 4 percent of the estimated operating costs in the test year. *Id.* Recovery of all estimated costs plus prior year losses and a contingency amount meant that the Postal Service had little incentive to cut costs.

However, the break-even mandate also meant that there was no mechanism for sustained net income and, therefore, no mechanism to generate retained earnings. The

⁴⁴ See Postal Reorganization Act (PRA), Pub. L. 91-375, 84 Stat. 719 (1970). The PAEA changed the agency’s name from the Postal Rate Commission to the Postal Regulatory Commission and altered the agency’s responsibilities, as described in more detail throughout this Order. See 39 U.S.C. § 501. Throughout this Order, the Commission uses “Commission” to refer to both the current Postal Regulatory Commission as well its predecessor, the Postal Rate Commission. For dates prior to December 2006, references to the Commission should be construed as the Postal Rate Commission. For dates after December 2006, references to the Commission should be construed as the Postal Regulatory Commission.

⁴⁵ Pub. L. 91-375, 84 Stat. 760 (codified in former 39 U.S.C. § 3621).

⁴⁶ United States Department of the Treasury, President’s Commission on the United States Postal Service, February 20, 2003, at 2 (statement of Richard J. Strasser, Jr., Chief Financial Officer and Executive Vice President, U.S. Postal Service) (Strasser Testimony), available at <http://govinfo.library.unt.edu/usps/offices/domestic-finance/usps/witness-testimony.html>.

Postal Service had \$15 billion in borrowing authority available to it for paying operating expenses and funding capital investments.⁴⁷ Annual borrowing limits for the Postal Service were set at \$2 billion for capital improvements and \$1 billion for operating expenses. *Id.*

When the Postal Service deemed a rate adjustment necessary (*i.e.*, on the basis of projected adjustments to historical costs), it filed a request for the Commission to submit a recommended decision on the proposed rates.⁴⁸ This request included a set of proposed rates designed to achieve the proposed revenue requirement. The Commission then conducted an on-the-record review of the proposed rates.⁴⁹

Rate adjustment proceedings were formally litigated and often adversarial.⁵⁰ All interested persons could participate in the Commission's on-the-record review of proposed rate changes.⁵¹ The Postal Service's rate requests included a vast amount of information – a schedule of proposed rates, witness testimony, supporting financial documents, and data files.⁵² A typical omnibus rate case might involve 75-100 parties, 100-150 witnesses, and tens of thousands of pages of testimony, as well as days of public hearings.⁵³ The testimony covered not only the proposed rates but the

⁴⁷ Pub. L. 101-227, 103 Stat. 1944 (1989). The maximum limit was \$10 billion in FY 1990, \$12.5 billion in FY 1991, and \$15 billion starting in FY 1992.

⁴⁸ Pub. L. 91-375, 84 Stat. 719, 760 (codified in former 39 U.S.C. § 3622(a)). The Commission also notes that in this section it uses the terms “planned rates” and “proposed rates” interchangeably.

⁴⁹ Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010, at 7-8 (Order No. 547); see Pub. L. 91-375, 84 Stat. 761 (codified in former 39 U.S.C. § 3624).

⁵⁰ See, e.g., Order No. 547 at 7-9 (“[M]any viewed the ratemaking process as unnecessarily time consuming, expensive, and litigious.”).

⁵¹ See Order No. 547 at 7-8; see also Pub. L. 91-375, 84 Stat. 762 (codified in former 39 U.S.C. § 3624).

⁵² See, e.g., Docket Nos. R2006-1, R2005-1, R2001-2.

⁵³ *General Oversight of the U.S. Postal Service: Hearings Before the Subcomm. on the Postal Service of the H. Comm. on Gov't Reform*, 104th Cong. 79 (1995) (statement of Edward J. Gleiman, Chairman, Postal Rate Commission) (Gleiman Testimony).

underlying cost and demand data as well.⁵⁴ The hearings assured mail users (both senders and recipients), competitors, suppliers, and an officer of the Commission appointed to represent the interests of the general public, with an opportunity to discover relevant and material information from the Postal Service, and to present their views through testimony and briefs. Order No. 547 at 8. At the same time, the process was complex, expensive, and time-consuming.⁵⁵ These quasi-judicial proceedings generally took 10-18 months to complete.⁵⁶

After reviewing the evidentiary record, the Commission issued an opinion and recommended decision to the Postal Service Board of Governors. The Commission's opinion included recommended rates that often differed from the rates suggested by the Postal Service.⁵⁷ The Board of Governors could reject that recommendation only under

⁵⁴ See, e.g., Docket Nos. R2006-1, R2005-1, R2001-2.

⁵⁵ Order No. 547 at 7-8; see also *Postal Reform: Sustaining the Nine Million Jobs in the \$900 Billion Mailing Industry Before the S. Comm. on Govt. Affairs*, 108th Cong. 53, 57 (2004) (NNA testified that the current ratemaking process was ineffective because it was "too lengthy, too litigious, and too expensive.").

⁵⁶ Docket No. R2009-2, Order Reviewing Postal Service Market Dominant Price Adjustments, March 16, 2009, at 1 (Order No. 191). During the 2004 hearings, Senator Susan Collins, one of the primary sponsors of postal reform in the Senate, stated:

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

Postal Reform: The Chairmen's Perspectives on Governance and Rate-Setting Before the S. Comm. on Govt. Affairs, 108th Cong. 11 (2004).

⁵⁷ See, e.g., Docket No. R97-1 (*compare* proposed price for Library Mail (\$1.440) *with* approved price (\$1.130)); Docket No. R2000-1 (*compare* proposed price per piece for Outside County Periodicals, presorted to 3-digits (\$0.318) *with* the approved price and (\$0.283)); Docket No. R2001-1 (*compare* proposed price for Parcel Post – Intra-BMC Rate Zones 1 and 2 for parcels weighing up to 2 pounds (\$2.960) *with* approved price (\$3.530)); Docket No. R2006-1 (*compare* proposed price for First-Class Mail flat, automation-mixed (\$0.465) *with* approved price (\$0.686)).

certain circumstances.⁵⁸ After approving the Commission's recommended decision, the Board of Governors set an effective date for those rates.⁵⁹ Rates would typically remain in effect for 3 to 4 years.

Under the PRA, the specific amount that rate categories contributed to the total institutional costs of the Postal Service were based on "non-cost factors."⁶⁰ These non-cost factors were applied to ensure that "each subclass or type of mail made a reasonable contribution to the Postal Service's overhead." Order No. 26 at 72. The amount of contribution to total institutional costs from classes of mail and rate categories involved individual policy considerations made by the Commission after input from interested parties, in order to yield "rates that were fair and equitable and subsidy-free." *Id.* Therefore, under the PRA, rates were set to ensure sufficient contribution was generated from all rate categories, over a period of years, to cover institutional costs. Rate levels under the PRA "equate[d] with maximum rates for the subclass or type of mail, as rates are not designed to generate a surplus." *Id.* The PRA required that the Commission consider "the establishment and maintenance of a fair and equitable" schedule or mail classification system when making a recommended decision on a request for changes in rates or fees or mail classification.⁶¹ Moreover, the PRA required the Postal Service to "not . . . make any undue or unreasonable discrimination among users of the mails[.]"⁶²

⁵⁸ Order No. 547 at 8; see Pub. L. 91-375, 84 Stat. 761-62 (codified in former 39 U.S.C. §§ 3624, 3625).

⁵⁹ Pub. L. 91-375, 84 Stat. 762 (codified in former 39 U.S.C. § 3625(f)).

⁶⁰ Order No. 26 at 71 n.62 (non-cost factors used to assign institutional costs included "value of service, impact on mailers and competitors, availability of alternatives, and simplicity of rate structure").

⁶¹ Pub. L. 91-375, 84 Stat. 760-761 (codified in former 39 U.S.C. § 3622(b)(1), 3623(c)(1)).

⁶² Pub. L. 91-375, 84 Stat. 719-720, 723 (codified in former 39 U.S.C. §§ 101(d), 403(c)).

b. Shortcomings of PRA Ratemaking System

Over time, many came to view the ratemaking process under the PRA as unnecessarily time consuming, as well as expensive and litigious.⁶³ It was generally thought that the length of these proceedings and the intervals between rate cases prevented the Postal Service from competing effectively.⁶⁴ The process was complex and much of the underlying Postal Service data were generally only updated during the proceedings themselves as there was no comprehensive annual reporting requirement.⁶⁵

The timing and magnitude of rate increases was unpredictable under the PRA system because the Postal Service Board of Governors suggested rate adjustments to the Commission whenever it deemed necessary.⁶⁶ The Postal Service was also able to initiate a rate proceeding without providing prior notice to mailers. *Id.* In addition, the use of a multi-year rate cycle exacerbated the lack of rate stability for mailers, as less frequent rate changes generally involved a much larger percentage increase in rates.⁶⁷ In addition, the Commission's recommended rates often differed from rates proposed by the Postal Service at the initiation of the rate adjustment proceeding. See n.57, *supra*.

⁶³ Order No. 547 at 7-8; see also *Postal Reform: Sustaining the Nine Million Jobs in the \$900 Billion Mailing Industry Before the S. Comm. on Govt. Affairs*, 108th Cong. 53, 57 (2004).

⁶⁴ See, e.g., *U.S. Postal Service: What is Needed to Insure its Future Viability Before the S. Comm. on Govt. Affairs*, 109th Cong. 5 (2005) (Senator Joe Lieberman remarked that “[t]he Postal Service is unable to challenge this formidable competition [from electronic communications] effectively partly because it operates under a cumbersome system that prevents quick rate adjustment to meet the changing needs of customers and the changing strategies of competitors”).

⁶⁵ See, e.g., Docket Nos. R2006-1, R2005-1, R2001-2.

⁶⁶ See Pub. L. 91-375, 84 Stat. 719, 760 (codified in former 39 U.S.C. § 3622); see also Order No. 547 at 8.

⁶⁷ See, e.g., Docket No. R2000-1 (average price increase of 4.4 percent); Docket No. R2001-1 (average price increase of 7.5 percent); Docket No. R2005-1 (average price increase of 5.0 percent); Docket No. R2006-1 (average price increase of 7.6 percent).

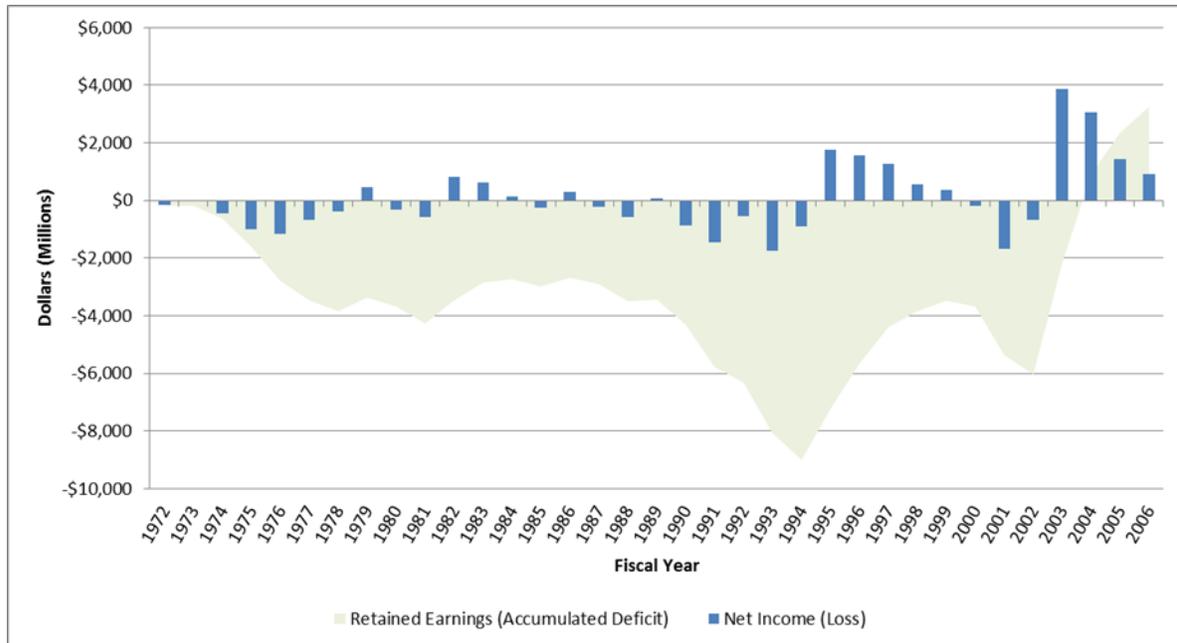
The combination of the multi-year rate cycle and the process of litigation prevented mailers from being able to predict the magnitude of price increases. Mailers sought predictability and stability after facing large, unpredictable price increases that hindered their ability to plan their budgets.⁶⁸ Consequently, the postal community broadly supported replacing the PRA's cost-of-service ratemaking with the PAEA's price cap model.⁶⁹

As mentioned above, the multi-year rate cycle and break-even mandate meant that there was no mechanism to generate retained earnings. As shown in Figure II-1 below, the ratemaking cycle led to fluctuations between net income and net losses and large accumulated deficits.

⁶⁸ See *Hearing Before the S. Comm. on Homeland Sec. and Gov't Affairs*, 2013 WL 5274754, September 19, 2013 (statement of Ruth Y. Goldway, Chairman Postal Reg. Comm'n).

⁶⁹ See *The Postal Service in Crisis: A Joint Senate-House Hearing on Principles for Meaningful Reform Before the H. Comm. On Govt. Reform and the S. Comm. On the Judiciary*, 108th Cong. 54 (2004) (statement of David Fineman, Chairman, Postal Service Board of Governors) (“[To replace the current system], we would support a system including a well-constructed price cap model that properly addresses the Postal Service’s economic situation.”); see also *Postal Reform: The Chairman’s Perspective on Governance and Rate-Setting Before the S. Comm. On Govt. Affairs*, 108th Cong. 4 (2004) (testimony of Ann Moore, CEO, Time Warner) (“[I]t is also critical to establish a rational rate cap system to be put in place by Congress.”).

**Figure II-1
Net Income (Loss) and Retained Earnings (Accumulated Deficit)
FY 1972 – FY 2006**



Source: Library Reference PRC-LR-RM2017-3/1

As seen in Figure II-1, although the Postal Service had 5 years of net income between FY 1995 and FY 1999, by FY 2000 it was again experiencing net losses and the accumulated deficit remained. In FY 2001, the Government Accountability Office (GAO) placed the Postal Service’s long-term outlook on its High-Risk list.⁷⁰ GAO stated: “USPS’s financial outlook is becoming increasingly dire. USPS has continuing deficits, severe cash-flow pressures, rising debt, and liabilities that exceed its assets. USPS also lacks sufficient income to fund growing capital asset needs for safety,

⁷⁰ See U.S. Gov’t Accountability Office, GAO-02-355, *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, February 2002, at 2 (GAO Report).

maintenance, expansion, and modernization as well as to fund its liabilities.” GAO Report at 3. As discussed in section II.A.4., *infra*, a statutory change in pension funding in FY 2003 alleviated some of the Postal Service’s financial issues and contributed to net income in FY 2003 through FY 2006 and the retained earnings balance at the end of FY 2006.

2. PAEA Ratemaking System

After several years of analysis and discussion, Congress enacted the PAEA to address the perceived shortcomings of the PRA ratemaking system.⁷¹ The PAEA significantly altered postal law with respect to the system of ratemaking. It provided for increased transparency and accountability and enhanced the authority and responsibilities of the Commission.⁷² The PAEA also ended the break-even mandate and encouraged the Postal Service to generate retained earnings as an objective. See 39 U.S.C. §§ 3622(b)(5), (d)(1)(A). The law separated postal products and services into two discrete categories, market dominant and competitive, and provided the Postal Service with increased pricing flexibility.⁷³

Under the PAEA, the Postal Service retained authority for initiating rate cases and was able to implement new rates on a substantially shorter timeline than under the PRA.⁷⁴ The Postal Service also determined the frequency of rate changes under the

⁷¹ For example, H.R. 3717, the Postal Reform Act of 1996, was first introduced in the House on June 25, 1996, and on December 11, 2002, the Bush Administration announced the formation of a presidential commission on the Postal Service tasked with identifying challenges facing the Postal Service; examine potential solutions; and recommend legislative actions necessary to ensure the long-term viability of postal service in the United States.

⁷² See, e.g., 39 U.S.C. §§ 3622, 3652, 3653, 3662.

⁷³ See Postal Regulatory Commission, Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006, September 22, 2011, at 2 (2011 701 Report).

⁷⁴ For an extended discussion of the Postal Service’s pricing flexibility under the PAEA, see section II.B.3.a., *infra*.

PAEA.⁷⁵ In PAEA era rate cases, the Postal Service was required to file planned rates no fewer than 45 days prior to the planned implementation date. 39 U.S.C. § 3622(d)(1)(C). The PAEA also removed the requirement for on-the-record hearings for proposed rate changes, allowing for a shorter and more streamlined process. See 39 U.S.C. § 3622(d); 39 C.F.R. part 3010. The PAEA required periodic reporting from the Postal Service, which the Commission implemented in its regulations. See 39 U.S.C. §§ 3652, 3654; 39 C.F.R. parts 3050, 3055.

In contrast to the PRA cost-of-service model for setting rates, the PAEA employed a price cap system as the primary limit on rate-setting. 39 U.S.C. § 3622(d)(1)(A). As set forth in 39 U.S.C. § 3622(d)(1)(A), the price cap system involved “an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that [would] be equal to the change in the consumer price index for all urban consumers [CPI-U] unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates.”⁷⁶

A primary motivation for the PAEA’s requirement of the inclusion of the CPI-U price cap in the new system of ratemaking was to provide the incentive for the Postal Service to reduce costs and increase efficiency. The market dominant ratemaking system, including the CPI-U price cap, established by the PAEA was intended to incentivize the Postal Service to reduce its costs as a way to achieve retained earnings.⁷⁷ The economic theory is that price cap regulation “severs the link between

⁷⁵ For an extended discussion of the intervals between price adjustments under the PAEA, see section II.B.a.(2)(a), *infra*.

⁷⁶ See also Order No. 547 at 11-12 (discussing legislative history surrounding price cap).

⁷⁷ Postal Accountability and Enhancement Act, S. Rep. 108-318, at 9 (2004).

the rate the firm can charge and its costs.”⁷⁸ As explained in a previous Commission order, “[a] regulated entity can only charge prices up to the cap, and if it can reduce its costs, it can retain part or all of the resulting profit.” *Id.* As a result, “the PAEA places an inflation-based cap on market dominant rate increases while simultaneously setting forth the objective that the Postal Service must maintain financial stability,” and “[t]his puts pressure on the Postal Service to reduce costs and increase efficiency.”⁷⁹ Under the PAEA, losses cannot be recovered by increasing rates beyond the cap.⁸⁰

The PAEA also provided for an exception to the price cap. Under 39 U.S.C. § 3622(d)(1)(E), rates could be increased greater than what was allowable under the price cap if the Commission determined that such an increase was “due to either extraordinary or exceptional circumstances” and such adjustment was “reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” 39 U.S.C. § 3622(d)(1)(E).

The PAEA also changed the Postal Service’s borrowing authority. Section 502 of the PAEA removed the specified limits for capital improvements and operating expenses in favor of a combined total of \$3 billion annually that the Postal Service could borrow and allocate between those two categories as it saw fit. See 39 U.S.C. § 2005. The PAEA retained the \$15 billion overall borrowing cap. See *id.*

In addition to major changes in how the Postal Service set its rates, the PAEA set forth reporting requirements concerning the Postal Service’s finances. 39 U.S.C.

⁷⁸ Order No. 547 at 11 (citing H.R. Hrg. 105-40 at 57 (testimony of Kenneth Rose, Senior Economist, National Regulatory Research Institute)).

⁷⁹ Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2009, January 1, 2010, at 23 (FY 2009 Annual Report).

⁸⁰ Postal Accountability and Enhancement Act, H.R. Rep. 109-66, pt. 1, at 44 (2005).

§ 3654. The PAEA mandated that the Postal Service prepare financial reports in accordance with the U.S. Securities and Exchange Commission rules and file them with the Commission.⁸¹ This financial reporting succeeded in “aid[ing] in the standardization and streamlining of business practices, processes, and systems,” . . . “increased accountability,” and as the Postal Service indicated, “resulted in substantial indirect cost savings through the strengthening of controls over business mail processes, including the prevention of lost revenue.” *Id.* at 26-27.

The PAEA directly addressed worksharing in 39 U.S.C. § 3622(e).⁸² Specifically, the PAEA directed the Commission to “ensure that [workshare] discounts do not exceed the cost the Postal Service avoids as a result of worksharing activity.” 39 U.S.C. § 3622(e)(2). The PAEA also provided for four exceptions to this requirement. See 39 U.S.C. §§ 3622(e)(2)(A)-(D). The PAEA was silent with regard to workshare discounts set less than avoided costs. Throughout the PAEA era, the Commission analyzed discounts to determine whether they complied with applicable statutory provisions and approved any applicable exceptions.⁸³

Under the PAEA, the ratemaking process was changed so that “[m]arket dominant rates are limited by a price cap, not by policy considerations.” Order No. 26 at 72. The prices set in Docket No. R2006-1 (the final prices set under the PRA) were the starting point for the PAEA prices that were then adjusted consistent with the price cap. As a result, a certain amount of contribution was already built into the market

⁸¹ 39 U.S.C. § 3654(a)(3). Prior to the PAEA, the Postal Service was not required to follow Sarbanes-Oxley Act financial reporting requirements. 2011 701 Report at 25. The Postal Service did voluntarily implement parts of the act’s requirements on its own initiative after the Sarbanes-Oxley Act was passed in 2002. *Id.*

⁸² For a detailed discussion of worksharing, see section II.B.3.d., *infra*.

⁸³ See, e.g., FY 2015 ACD at 9-41; Docket No. R2015-4, Order on Revised Price Adjustments for Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, May 7, 2015, at 26-32, 35-39, 50-53, 59-60 (Order No. 2472).

dominant prices at the beginning of the PAEA era. The PAEA contained a transition rule, which would have allowed the Postal Service to modify market dominant rates in accordance with the provisions in effect before the date of enactment of the PAEA. 39 U.S.C. § 3622(f). This would have permitted changes to the amount of contribution built into the market dominant rates. However, the Postal Service did not avail itself of this rule. The PAEA kept the provisions that rates apportion the costs to users on a “fair and equitable basis” and that the Postal Service “shall not . . . make any undue or unreasonable discrimination among users of the mails[.]” See 39 U.S.C. §§ 101(d), 403(c).

For competitive products, the PAEA provided the Postal Service with the “flexibility to price competitive products however it wishes, provided its rates satisfy the statutory standards of lawfulness.” Order No. 26 at 72. The PAEA set forth provisions applicable to rates for competitive products prohibiting the subsidization of competitive products by market dominant products; ensuring that each competitive product covers its attributable costs; and ensuring that “all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service.” 39 U.S.C. § 3633(a)(3). Section 3633(b) required the Commission to set the initial appropriate share of institutional costs for competitive products and review the appropriate share every five years thereafter. *Id.* § 3633(b).

In 2007, the Commission promulgated rules implementing the statutory requirements of 39 U.S.C. §§ 3622, 3633, and 3691.

3. Comparing the Conditions Impacting the Postal Service’s Financial Health Prior to and After Implementation of the PAEA

When the PAEA was enacted in December 2006, the Postal Service was operating in a much different environment than today. Despite volume declines in

First-Class Single-Piece Mail, overall volume was increasing.⁸⁴ The Postal Service had generated net income for 4 years in a row and had paid off most of its debt and accumulated retained earnings.⁸⁵

This sustained net income, retained earnings balance, and low level of debt was largely due to a change in the law related to pension funding. In FY 2003, the Postal Civil Service Retirement System Funding Reform Act was enacted. This resulted in savings to the Postal Service, the specific usage of which was set forth in the law:

(a) IN GENERAL.—Savings accruing to the United States Postal Service as a result of the enactment of this Act—

(1) shall, to the extent that such savings are attributable to fiscal year 2003 or 2004, be used to reduce the postal debt (in consultation with the Secretary of the Treasury), and the Postal Service shall not incur additional debt to offset the use of the savings to reduce the postal debt in fiscal years 2003 and 2004;

(2) shall, to the extent that such savings are attributable to fiscal year 2005, be used to continue holding postage rates unchanged and to reduce the postal debt, to such extent and in such manner as the Postal Service shall specify (in consultation with the Secretary of the Treasury); and

(3) to the extent that such savings are attributable to any fiscal year after fiscal year 2005, shall be considered to be operating expenses of the Postal Service and, until otherwise provided for by law, shall be held in escrow and may not be obligated or expended.

⁸⁴ Docket No. ACR2007, Annual Compliance Determination, March 27, 2008, at 29-30 (FY 2007 ACD).

⁸⁵ United States Postal Service Annual Report 2006 at 6, 60 (Postal Service Annual Report 2006).

See Pub. L. 108-18, 117 Stat. 627. As a result, the Postal Service's financial position appeared to be stable near the time of the enactment of the PAEA.

In addition to the relatively stable financial position of the Postal Service in FY 2006, increases in Postal Service expenses tended to track increases in the consumer price index (CPI) prior to enactment of the PAEA. See Figure II-2 below. As a result, increases in postal revenues over time were generally of the same magnitude as the increase in CPI. *Id.*

Given this environment, Congress anticipated that the CPI-based price cap system set forth by the PAEA would enable the Postal Service to generate sufficient revenue to "respond to all circumstances it is likely to face in the normal course of business."⁸⁶ The price cap system under the PAEA was intended to allow the Postal Service to "fund network expansion and necessary capital improvements" and incentivize employees with bonuses because it removed the break-even restriction and allowed the Postal Service to generate retained earnings.⁸⁷

The PAEA created a new obligation for the Postal Service.⁸⁸ It stipulated that the funds held in escrow as a result of the Postal Civil Service Retirement System Funding Reform Act were to be transferred to a Retirement Health Benefits Fund (RHBF) set up in Treasury. *Id.* The PAEA also specified future RHBF payments into this fund, with the goal of fully funding the liability by FY 2017.⁸⁹ Such payments were to average \$5.6 billion per year.⁹⁰

⁸⁶ S. Rep. 108-318 at 11; H.R. Rep. 109-66, pt. 1, at 118.

⁸⁷ S. Rep. 108-318 at 8; H.R. Rep. 109-66, pt. 1, at 44.

⁸⁸ Postal Accountability and Enhancement Act, Pub. L. 109-435 § 803, 120 Stat. 3198 (2006).

⁸⁹ *Id.* For an extended discussion of the RHBF, see section II.C.2.b., *infra*.

⁹⁰ See Pub. L. 109-435 § 803; 5 U.S.C. § 8909a(d)(3)(A).

Shortly after passage of the PAEA, however, the Great Recession occurred, which had a substantial negative impact on Postal Service volume and revenues.⁹¹ The economic downturn occurred in concert with emergent technological trends that resulted in even greater declining volumes for First-Class Single-Piece Mail.⁹² During this time, the Commission found that “[t]he cumulative result of those events has been the most severe volume declines since the Great Depression, and significant financial losses for the Postal Service.” Universal Service Report at 2. In the aftermath of the Great Recession, there was also a period of deflation, which constrained the Postal Service’s ability to raise rates given the CPI-based price cap.⁹³ This period of deflation represented “the first 12-month decrease in the [CPI] index since 1955.” *Id.*

As mentioned earlier, increases in Postal Service expenses tended to generally track increases in the CPI prior to enactment of the PAEA. In FY 2006, the correlation between the growth in Postal Service expenses and revenue and the growth in CPI began to diverge. This divergence is illustrated in Figure II-2, which provides a comparison of CPI, total cost, and total revenue for the Postal Service from FY 1995 to FY 2016.⁹⁴

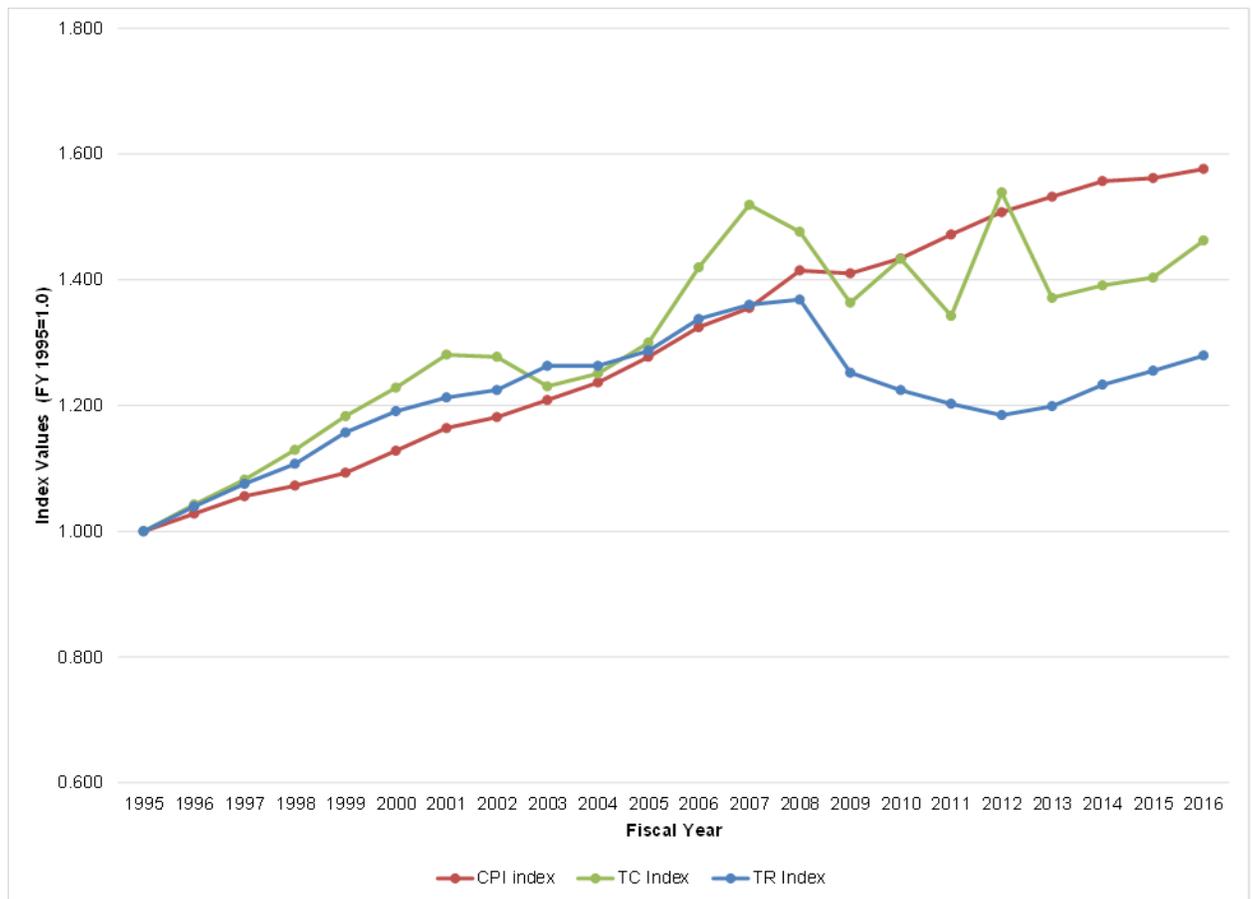
⁹¹ The Commission granted the Postal Service’s request for an exigent rate increase due to contribution losses that resulted from the Great Recession. See Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013 (Order No. 1926).

⁹² For a discussion of the use of econometric modeling to distinguish between volume loss due to the Great Recession and volume loss due to electronic diversion and other factors, see Order No. 1926 at 61-83.

⁹³ See United States Department of Labor, Bureau of Labor Statistics, One Hundred Years of Price Change: The Consumer Price Index and the American Inflation Experience, April 2014, available at <https://www.bls.gov/opub/mlr/2014/article/one-hundred-years-of-price-change-the-consumer-price-index-and-the-american-inflation-experience.htm>.

⁹⁴ Figure II-2 contains an index for each of the three variables and indexes each to 1 in FY 1995.

**Figure II-2
CPI, Total Cost, and Total Revenue Indices FY 1995 – FY 2016**



Source: Library Reference PRC-LR-RM2017-3/1

As shown in Figure II-2, during every year of the period prior to the enactment of the PAEA, the Postal Services Total Revenue index (TR index) was above the CPI index. Similarly, the Total Cost index (TC index) was also greater than the CPI index value for every year between FY 1995 and FY 2006. As demonstrated in Figure II-2, while the TR index and the TC index were above the CPI index, all three indexes changed in similar ways. The sharp spike in the TC index in FY 2007 was due, in large part, to the recognition of the RHBF payments as an expense. The fluctuations in the TC index after FY 2007 could be the result of numerous factors, such as the RHBF payments, expanding delivery network, reductions in total volume, and Postal Service

cost saving initiatives. The results of the TC index show that the Postal Service's total costs were greater than total revenue after the enactment of the PAEA.

As shown in Figure II-2, the first full fiscal year after the implementation of the PAEA, FY 2008, was the first year where the TR index was below the CPI index. Prior to FY 2008, the TR index was above the CPI index in every year. Every year after FY 2008, the TR index was below the CPI index. This TR index decline between FY 2007 and FY 2011 reflects the volume losses that occurred during that time period. Although volume continued to decline after FY 2011, as shown in Figure II-2, the TR index began to increase. This was due in part to the exigent price increase in place from January 2014 to April 2016.

The sudden divergence in total Postal Service expenses and revenues and the CPI index shown in Figure II-2 made it extremely challenging for the Postal Service to manage retained earnings through sustained net income. In FY 2007 and FY 2008, the Postal Service made the required payments into the RHBF by drawing on its borrowing authority.⁹⁵ These expenses contributed to the total net losses in those fiscal years. In FY 2009 and FY 2010, in addition to the accruals for RHBF prefunding, significant reductions in volume and revenue related to internet diversion and the extensive business downturn exacerbated the net losses.⁹⁶ Increases in non-cash workers' compensation expenses and a slow economic recovery resulted in a net loss in

⁹⁵ See Postal Regulatory Commission, Analysis of United States Postal Service Financial Results and 10-K Statement for Fiscal Year 2013, March 18, 2014, at 1 (FY 2013 Financial Report) ("In FY 2007 and FY 2008, the added expense of funding the Postal Service Retiree Health Benefits Fund (RHBF) was the primary cause of the overall net loss as the Postal Service reported income from operations for both years."); see also *id.* at 18 ("The Postal Service's overall liquidity, the combination of the end of year cash balance and the Postal Service's remaining borrowing capacity, is significantly lower due to the Postal Service's use of debt to finance operations and the overly ambitious RHBF payments.").

⁹⁶ See FY 2013 Financial Report at 1 ("[I]n addition to the RHBF payment requirements, the significant loss of volumes and revenues from internet diversion and extensive business downturns resulted in operating losses for FY 2009 and FY 2010.").

FY 2011 despite the deferral of the RHBF prefunding payment.⁹⁷ Major factors influencing the net losses from FY 2012 to FY 2016 were increases in accruals for non-cash workers' compensation expense and the RHBF payments.⁹⁸ The Commission provides extensive analysis of the Postal Service's finances during the PAEA era in section II.C.2., *infra*.

⁹⁷ See United States Postal Service, 2011 Report on Form 10-K, November 16, 2011, at 6 (Postal Service FY 2011 Form 10-K) ("In addition, to the extent that the recovery from the recent recession in the U.S. and in other countries takes longer than anticipated, our business, financial position and results of operations continue to be adversely impacted."); see also *id.* at 15 ("The losses for the years ended September 30, 2011, 2010, and 2009 include expenses due to discount rate changes and actuarial estimations that increased the workers' compensation expense by \$2,242 million, \$2,500 million, and \$1,343 million for each of the respective years."); Docket No. ACR2011, Annual Compliance Determination, March 28, 2012, at 21 (FY 2011 ACD) ("The net loss of \$5.1 billion in FY 2011 would have been significantly higher if the payment of \$5.5 billion for the Retiree Health Benefits Fund had not been deferred by Congress.").

⁹⁸ See United States Postal Service Reports on Form 10-K, FY 2007 – FY 2016; see also Postal Regulatory Commission, Financial Analysis of United States Postal Service Financial Results and 10-K Statement Fiscal Year 2016, March 31, 2017, at 1 (FY 2016 Financial Report) ("The increase in the total net loss is largely driven by a \$1.5 billion increase in overall compensation and benefits costs and an increase in non-cash workers' compensation expense of \$0.9 billion caused by a decrease in the discount rate."); Postal Regulatory Commission, Financial Analysis of United States Postal Service Financial Results and 10-K Statement Fiscal Year 2015, March 29, 2016, at 7 (FY 2015 Financial Report) ("After accounting for the non-cash adjustment to the workers' compensation liability and the RHBF payment, the Postal Service had a total net loss of \$5.1 billion in FY 2015."); Postal Regulatory Commission, Financial Analysis of United States Postal Service Financial Results and 10-K Statement Fiscal Year 2014, April 1, 2015, at 2 (FY 2014 Financial Report) ("The Postal Service's total net loss of \$5.5 billion in FY 2014 exceeded the net loss recorded in FY 2013 by \$500 million. This is primarily due to increases in workers' compensation costs and Retiree Health Benefit Fund (RHBF) payments."); United States Postal Service, 2013 Report on Form 10-K, November 15, 2013, at 20 (Postal Service FY 2013 Form 10-K):

During 2013, major drivers of operating results included overall customer demand and the mix of postal services, the contribution margins associated with those services, the volume of mail and packages processed through our network, and our ability to manage our cost structure, which includes wages and fuel prices, to match declining volume levels. In addition, the annual legally-mandated PSRHBF prefunding expense and fluctuations in workers' compensation expense due to discount (interest) rates also greatly impacted our results, although these items are not under our control."; see also *id.* at 48 ("A major factor incorporated in the net loss of \$15,906 million was the \$11,100 million of PSRHBF expenses that were accrued during the year but not paid.

4. Comparison of Service Performance Regulation Under the PRA and the PAEA

Under the PRA, the Commission addressed issues related to service primarily in three ways. First, service performance was a factor in the Commission's recommendations for setting rates and determining mail classifications. See 2011 701 Report at 58. Second, the Postal Service was required to seek a non-binding advisory opinion from the Commission concerning proposed changes affecting nationwide service.⁹⁹ Third, the Commission had the authority to issue a recommended decision with regard to service complaints.¹⁰⁰ However, despite this non-binding provision authority, the PRA left service performance largely unregulated.

Prior to the PAEA, the Postal Service was not required to measure or report on service performance for any of its products. 2011 701 Report at 57-58. The Postal Service predominantly measured service performance for purposes of internal network evaluation diagnostics. *Id.* Results of these measurements were not publicly disseminated, except for the performance of First-Class Single-Piece Mail. *Id.* The major change mandated by the PAEA in the area of service was the requirement that the Postal Service establish service standards for each of its market dominant products and publicly report service performance.¹⁰¹

The PAEA mandated that the Postal Service, in consultation with the Commission, promulgate an initial set of service standards for market dominant products to take effect within 1 year after the PAEA was enacted. 39 U.S.C. § 3691(a).

⁹⁹ See Pub. L. 91-375, 84 Stat. 764; 39 U.S.C. § 3661.

¹⁰⁰ See Pub. L. 91-375, 84 Stat. 764 (codified in former 39 U.S.C. § 3662).

¹⁰¹ 39 U.S.C. § 3691(a). See also 2011 701 Report at 56-57.

These service standards were to be consistent with specific objectives¹⁰² and factors¹⁰³ provided in the PAEA. These service standard objectives and factors are listed in 39 U.S.C. §§ 3691(b) and (c), and they are separate from the objectives and factors for the market dominant ratemaking system contained at 39 U.S.C. § 3622, which are at issue in this review. Consultation between the Commission and the Postal Service concluded on November 19, 2007, and the Postal Service published a final rule establishing the initial service standards on December 19, 2007.¹⁰⁴

In addition to requiring set service standards, the PAEA also created measurement and reporting requirements with respect to service. The PAEA required the Postal Service to measure service performance relative to the service standards in place and report this information to the Commission each year as part of the Postal Service's Annual Compliance Report (ACR). See 39 U.S.C. § 3652(a)(2). Specifically, the Postal Service must "provide . . . measures of the quality of service afforded by the

¹⁰² The objectives are: to enhance the value of postal services to both senders and recipients; to preserve regular and effective access to postal services in all communities, including those in rural areas or where post offices are not self-sustaining; to reasonably assure Postal Service customers delivery reliability, speed, and frequency consistent with reasonable rates and best business practices; and to provide a system of objective external performance measurements for each market dominant product as a basis for measurement of Postal Service performance. 39 U.S.C. § 3691(b)(1).

¹⁰³ The factors are: the actual level of service that Postal Service customers receive under any service guidelines previously established by the Postal Service or service standards established under [section 3691]; the degree of customer satisfaction with Postal Service performance in the acceptance, processing and delivery of mail; the needs of Postal Service customers, including those with physical impairments; mail volume and revenues projected for future years; the projected growth in the number of addresses the Postal Service will be required to serve in future years; the current and projected future cost of serving Postal Service customers; the effect of changes in technology, demographics, and population distribution on the efficient and reliable operation of the postal delivery system; and the policies of [title 39] and such other factors as the Postal Service determines appropriate. 39 U.S.C. § 3691(c).

¹⁰⁴ See Modern Service Standards for Market-Dominant Products, 72 Fed. Reg. 72216 (December 19, 2007) (Initial Service Standards); see also Docket No. RM2009-11, Order Establishing Final Rules Concerning Periodic Reporting of Service Performance Measurements and Customer Satisfaction, May 25, 2010, at 5-6 (Order No. 465); Docket No. PI2008-1, Order Concerning Proposals for Internal Service Standards Measurement Systems, November 25, 2008, at 3 (Order No. 140).

Postal Service in connection with [each market dominant product],[¹⁰⁵] including . . . the level of service (described in terms of delivery and reliability)[¹⁰⁶] provided; and . . . the degree of customer satisfaction with the service provided.”¹⁰⁷ Congress delegated authority to the Commission to prescribe the content and form of the reported information, and the Commission promulgated rules regarding service performance reporting on May 25, 2010.¹⁰⁸

The PAEA also carried forward the requirement from the PRA that the Postal Service must seek an advisory opinion from the Commission before implementing any changes in the nature of service that have at least a substantially nationwide effect, which include changes to service standards. 39 U.S.C. §§ 3661(b)-(c). The Commission, in turn, is required to conduct a public hearing on-the-record before issuing the advisory opinion. 39 U.S.C. § 3661(c). This advisory opinion process is intended to ensure that interested persons have the opportunity to have their views considered with respect to whether nationwide (or substantially nationwide) service changes contemplated by the Postal Service comply with the policies of title 39.¹⁰⁹ The

¹⁰⁵ By statute, service performance is required to be measured using an objective external measurement system, unless the use of an internal measurement system is specifically approved by the Commission. 39 U.S.C. §§ 3691(b)(1)(D), (b)(2). In 2008, the Commission approved a proposal by the Postal Service to employ a combination of internal and external measurement systems. See Docket No. PI2008-1, Second Notice of Request for Comments on Service Performance Measurement Systems for Market Dominant Products, June 18, 2008, Order No. 83; Order No. 140 at 6.

¹⁰⁶ Speed of delivery is evaluated based on the mailpiece reaching its destination within a given service standard, while reliability refers to consistency of delivery. See Docket No. ACR2016, Annual Compliance Determination, March 28, 2017, at 90 (FY 2016 ACD).

¹⁰⁷ 39 U.S.C. § 3652(a)(2)(B)(ii). With regard to customer satisfaction, the Commission has promulgated regulations specifying reporting requirements, which can be found at 39 C.F.R. part 3055, subpart C. The required reporting includes data addressing consumer access to postal facilities, as well as data based on customer experience surveys which the Postal Service is required to administer.

¹⁰⁸ See Service Performance Measurement, 75 Fed. Reg. 38725 (July 6, 2010) (codified at 39 C.F.R. part 3055); see also Order No. 465.

¹⁰⁹ See Docket No. N2010-1, Advisory Opinion on Elimination of Saturday Delivery, March 24, 2011, at 6 (Docket No. N2010-1, Advisory Opinion).

Commission's advisory opinions are non-binding and do not require the Postal Service to act on or respond to interested persons' views or the Commission's recommendations. Under the PRA, there were a total of five advisory opinion cases. During the PAEA era, there have been six.

Finally, the PAEA also enhanced the Commission's power to remediate service failures. Under the PRA, persons who believed that their service was not in accordance with the policies of the PRA were entitled to file a complaint with the Postal Rate Commission.¹¹⁰ If the Postal Rate Commission deemed a complaint to be justified, a recommended decision would follow. *Id.* By contrast, the PAEA expanded the Commission's authority to remediate complaints or cases of deliberate non-compliance related to service. 39 U.S.C. §§ 3662(c)-(d).

5. Conclusion

The ratemaking system under the PRA was a cost-of-service model with a break-even mandate which did not provide effective incentives for the Postal Service to reduce costs and increase efficiency or allow the Postal Service to generate retained earnings or have much control over setting its prices. Rate adjustment proceedings were time consuming, costly, and litigious, and rate changes were not predictable or stable for mailers. The PAEA was designed to address these issues through the application of a CPI-based price cap and numerous procedural changes. It provided increased pricing flexibility to the Postal Service coupled with stronger regulatory oversight. However, the operating environment on which the PAEA was designed changed quickly and dramatically after the PAEA was passed. As the Commission explains below, this made it challenging for the ratemaking system under PAEA to achieve the goals it was designed to achieve.

¹¹⁰ Pub. L. 91-375 § 3662, 84 Stat. 764.

B. Structure of the Ratemaking System

As outlined in section I.B., *supra*, the Commission evaluates whether the system has achieved the objectives as they fall under three principal areas of the PAEA system (the structure of the ratemaking system, financial health of the Postal Service, and service). This section evaluates the first principal area, as to whether the current system has fulfilled the goals of the PAEA as those goals relate to the structure of the ratemaking system. Discussion of the Postal Service's financial health and service follow this section. See sections II.C. and II.D., *infra*.

The Commission's adoption of a topical approach allows application of the objectives in conjunction with one another to determine whether the relevant objectives have been achieved for the structure of the ratemaking system as a whole.¹¹¹ For purposes of this evaluation, the structure of the ratemaking system is further divided into a review of two subtopics: (1) the ratemaking process; and (2) pricing. With respect to the ratemaking process, the Commission considers the goals of Objectives 2 and 6. Objective 2 provides that the ratemaking system should "create predictability and stability in rates." 39 U.S.C. § 3622(b)(2). As set forth in the ANPR, Objective 2 contains a "timing" component and a "magnitude" component to determine whether the system has fostered rates,¹¹² "including prices for all market dominant products and promotions, that are capable of being consistently forecast with regard to timing and magnitude and that do not include sudden or extreme fluctuations." Order No. 3673 at 5. In reviewing the structure of the ratemaking process, the Commission reviews the "timing" component of Objective 2 to determine whether the ratemaking system

¹¹¹ As the Commission explained earlier, it considers the objectives together as they apply to the system as a whole and it does not elevate any individual objective above another. See section I.B., *supra*. The order in which these objectives are discussed facilitates the Commission's topical approach to its review.

¹¹² The Commission notes that it uses the terms "prices" and "rates" (as well as variations thereof) interchangeably throughout this Order.

established under section 3622 resulted in predictably and stably timed price adjustments. *Id.*

Next, the Commission reviews Objective 6 and whether the system has “reduce[d] the administrative burden and increase[d] the transparency of the ratemaking process.” 39 U.S.C. § 3622(b)(6). For this analysis, the Commission reviews whether the system has reduced the complexity of rate proceedings and increased the availability of comprehensive understandable material relating to rate proceedings. Order No. 3673 at 8.

With respect to pricing, the Commission first reviews Objective 4, which requires that the ratemaking system “allow the Postal Service pricing flexibility.” 39 U.S.C. § 3622(b)(4). The Commission evaluates whether the system has provided the Postal Service the discretion to set prices, the price structure, and the timing of price adjustments. See Order No. 3673 at 6.

Next, the Commission analyzes the component of Objective 2 related to the magnitude of predictable and stable price adjustments. For the magnitude component, the Commission analyzes whether the system has fostered rates that are capable of being consistently forecast and that do not include sudden or extreme fluctuations. Order No. 3673 at 5.

The Commission then looks to whether the system has established and maintained just rates as provided by Objective 8. Objective 8 requires the system to allow the Postal Service to “establish and maintain a just and reasonable schedule for rates and classifications.” 39 U.S.C. § 3622(b)(8). As explained in more detail below, the Commission considers the just rates and reasonable rates prongs separately. The Commission reviews just rates as part of the structure of the ratemaking system in this section. The just prong looks to whether the amount charged for each service has been excessive to the mailer. See Order No. 3673 at 9. The reasonable prong looks to

whether the amount charged for any service has threatened the financial integrity of the Postal Service and is reviewed in section II.C.4., *infra. Id.*

The Commission also reviews whether the system has increased pricing efficiency. Objective 1 requires that the system “maximize incentives to reduce costs and increase efficiency.” 39 U.S.C. § 3622(b)(1). As explained in more detail below, the Commission considers operational efficiency and pricing efficiency separately. The Commission reviews pricing efficiency as part of the structure of the ratemaking system in this section. The Commission reviews costs and operational efficiency in the financial health section II.C.3., *infra.*

Finally, after reviewing the subtopics of the ratemaking process and pricing, the Commission concludes by applying the objectives in conjunction with one another to analyze whether the system as a whole has achieved the goals relating to the structure of the ratemaking system. The Commission concludes that the structure of the ratemaking process created by PAEA has worked as intended to create predictably and stably timed price adjustments, reduce the administrative burden by reducing the complexity of rate proceedings, and increase the transparency of the ratemaking process due to the availability of comprehensive and understandable material. With respect to pricing, the Commission concludes that the system has allowed the Postal Service pricing flexibility and achieved rates that are just and predictable and stable in magnitude. However, the Commission finds the system has not resulted in increased pricing efficiency.

1. Relevant Factors

In determining whether the system has achieved the objectives related to the ratemaking system, the Commission considers Factors 1, 2, 3, 4, 5, 6, 7, 10, 11, and 14 as discussed below. Factors 1, 2, 5, 7, 10, 12, 13, and 14 are discussed in section II.C.1., *infra.* Factors 1, 4, 9, 12, and 14 are discussed in section II.D.1., *infra.*

Factor 1 states that consideration should be given to “the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery.” 39 U.S.C. § 3622(c)(1). Factor 1 is relevant to establishing and maintaining a just schedule of rates and classifications because the relative value of the mail matter and mail service for both the sender and the recipient may influence mailers’ perceptions of whether rates are just. The impact of Factor 1 on the Postal Service’s financial health is discussed in section II.C.1., *infra*, and the impact on service is discussed in section II.D.1., *infra*.

Factor 2 states that consideration should be given to “the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type.” 39 U.S.C. § 3622(c)(2). Factor 2 is relevant to pricing efficiency because classes and types of mail service that do not cover their marginal or attributable costs are not priced efficiently. The impact of Factor 2 on the Postal Service’s financial health is discussed in section II.C.1., *infra*.

Factor 3 states that consideration should be given to “the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters.” 39 U.S.C. § 3622(c)(3). Factor 3 is relevant to creating predictability and stability in rates (both in timing and in magnitude) to enable members of the general public, business mail users, and private delivery enterprises to better forecast those changes and better prepare for rate increases. Factor 3 is also relevant to just rates because evaluation of whether the rates are excessive to mailers requires consideration of the effect of rate increases on the general public and business mail users.

Factor 4 states that consideration should be given to “the available alternative means of sending and receiving letters and other mail matter at reasonable costs.” 39 U.S.C. § 3622(c)(4). Factor 4 is relevant to just rates because alternative means to send and receive letters and other mail matter and the prices associated with those alternatives may influence mailers’ perceptions of whether rates are just. The Commission considers the impact of Factor 4 on service in section II.D.1., *infra*.

Factor 5 states that consideration should be given to “the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service.” 39 U.S.C. § 3622(c)(5). Factor 5 is relevant to pricing efficiency because efficient mail preparation by the mailer is the basis of workshare discounts. The Commission considers the impact of Factor 5 on the Postal Service’s financial health in section II.C.1., *infra*.

Factor 6 states that consideration should be given to “simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services.” 39 U.S.C. § 3622(c)(6). Factor 6 is relevant to transparency and administrative burden because simplicity in the rate schedule and simple, identifiable relationships between rates may increase transparency and reduce administrative burden.

Factor 7 states that consideration should be given to “the importance of pricing flexibility to encourage increased mail volume and operational efficiency.” 39 U.S.C. § 3622(c)(7). Factor 7 is relevant to pricing flexibility because pricing flexibility may be used for two specific purposes: (1) to encourage increased mail volume; and (2) to

increase operational efficiency.¹¹³ The Commission considers the impact of Factor 7 on the Postal Service's financial health in section II.C.2., *infra*.

Factor 10 states that consideration should be given to:

[T]he desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that— (A) either— (i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or (ii) enhance the performance of mail preparation, processing, transportation, or other functions; and (B) do not cause unreasonable harm to the marketplace.

39 U.S.C. § 3622(c)(10). Factor 10 is relevant to pricing flexibility because it sets forth the legal requirements for market dominant negotiated service agreements (NSAs),¹¹⁴ which are among the ways the Postal Service may utilize pricing flexibility subject to certain limitations under the law. The Commission considers the impact of Factor 10 on the Postal Service's financial health in section II.C.1., *infra*.

Factor 11 states that consideration should be given to “the educational, cultural, scientific, and informational value to the recipient of mail matter.” 39 U.S.C. § 3622(c)(11). Factor 11 is relevant to just rates because their evaluation includes consideration of the relative value of the mail matter in the postal system, such as the educational, cultural, scientific, and informational value.

Factor 14 states that consideration should be given to “the policies of this title as well as such other factors as the Commission determines appropriate.” 39 U.S.C.

¹¹³ Pitney Bowes comments that Factor 7 shows that “the PAEA was not promoting pricing flexibility as a good in and of itself, but rather as a means of encouraging increased mail volume and operational efficiency.” Pitney Bowes Comments at 19.

¹¹⁴ A “negotiated service agreement” is “a contract negotiated between the Postal Service and another entity, most likely a mailer, for service and rates different from those of general applicability.” Order No. 26 at 58 n.36. See *also* 39 C.F.R. § 3001.5(r).

§ 3622(c)(14). The Commission considers other policies of this title and other factors where appropriate.

2. Ratemaking Process

The PAEA was enacted with the intent to achieve a streamlined ratemaking process by ensuring predictably and stably timed prices, while reducing administrative burden and increasing transparency. This section considers whether the system has fulfilled those goals of the PAEA. The Commission analyzes the goals of Objectives 2 and 6 separately. The Commission summarizes relevant comments received. For each objective, the Commission then analyzes and applies the definitions and the key measurable concepts as outlined in the ANPR and discusses any deviations from the ANPR it makes.

a. Predictability and Stability of Rates (Timing)

In reviewing the predictability and stability of rates during the PAEA era, the Commission analyzes Objective 2, which looks to whether the system has “create[d] predictability and stability in rates.” 39 U.S.C. § 3622(b)(2). In this analysis, the Commission reviews whether the system fosters prices for all market dominant products that, with regard to both timing and magnitude, are capable of being consistently forecast and do not include sudden or extreme fluctuations. See section II.B.a.(2), *infra*. In this section, the Commission focuses on the timing aspect.

(1) Comments

Commenters generally conclude that the current ratemaking process has resulted in predictable and stable price adjustments. For example, AF&PA states that since Congress passed the PAEA, price adjustments have occurred at regular intervals. AF&PA Comments at 9. Similarly, GCA states that the current ratemaking process results in a regular schedule of rate adjustments. GCA Comments at 13. GCA points to

the pre- and post-PAEA price adjustment intervals as evidence of predictable and stable price adjustments. *Id.* PSA states that except for the exigent price increase and rollback, the timing of price adjustments has been very predictable and stable. PSA Comments at 4.

MMA, NAPM, and NPPC agree that the current ratemaking process has allowed predictably and consistently timed price changes. MMA, NAPM, and NPPC Comments at 22. They note that the principal rule responsible for the fairly predictable and stable timing of price changes is the requirement that the Postal Service maintain a schedule for regular and predictable price changes. *Id.*

SMC *et al.* state that advertisers and marketers have integrated the current ratemaking process, with its 90-day notice and annual price adjustments, into their budget planning and annual cycle and the process has created an environment of consistency. SMC *et al.* Comments at 7.

The Postal Service states that the current ratemaking process, including the CPI-U price cap, the annual price increase schedule, and advance notice of proposed rates, generally promotes predictable and stable rates. Postal Service Comments at 138. However, the Postal Service notes that the current ratemaking process has resulted in some instances of unpredictably timed price adjustments. *Id.* at 205. The Postal Service states that low or negative inflation, which characterized much of the PAEA period, contributed to this unpredictability. *Id.* Specifically, the Postal Service notes that, after following a predictable pattern in 2008 and 2009, low and negative inflation prevented the Postal Service from requesting price adjustments in 2010. *Id.* The Postal Service notes that low inflation also prevented the Postal Service from requesting price adjustments in 2016. *Id.* at 205-206.

(2) Application of Measurement

In reviewing the predictability and stability of rates with respect to timing, the Commission analyzes Objective 2, which looks to whether the system has “create[d] predictability and stability in rates.” 39 U.S.C. § 3622(b)(2). As set forth in the ANPR, the Commission proposed to define a system achieving Objective 2 as one that “fosters rates, including prices for all market dominant products and promotions, that are capable of being consistently forecast with regard to timing and magnitude and that do not include sudden or extreme fluctuations.” Order No. 3673 at 5. The ANPR also proposed two key measurable concepts for Objective 2, predictability and stability. *Id.*

After further consideration, the Commission makes the following modifications and clarifications to the definition and key measurable concepts. First, the Commission determines that a separate analysis of promotions is not appropriate with regard to Objective 2. Objective 2 looks at the predictability and stability of rates with regard to timing and magnitude. As explained below, the objective contemplates the effects of price adjustments on mailers. Promotions are temporary discounts or rebates offered to mailers which the Postal Service uses to create awareness of innovative uses of mail and to encourage mailers to adopt and invest in technologies that enhance how recipients interact and engage with mail.¹¹⁵ Given that promotions offer mailers discounts and rebates, mailers view them positively and no commenters raise concerns about them with regard to predictability and stability.¹¹⁶ Because promotions are intended to be temporary to achieve specific purposes and are viewed favorably by

¹¹⁵ United States Postal Service, Promotions & Incentive Programs for First-Class & USPS Marketing Mail, (last accessed November 21, 2017), available at <https://ribbs.usps.gov/index.cfm?page=mailingpromotions>.

¹¹⁶ See, e.g., MMA, NAPM, and NPPC Comments at 27-28, 36 (promotions are examples of how the Postal Service has used its pricing flexibility to introduce innovations in rate design); SMC *et al.* Comments at 4, 6, 9-10 (price cap and annual schedule for filing price adjustments has given the Postal Service and mailing industry time to explore promotions).

mailers, the Commission does not conduct a separate analysis of promotions under this objective and removes the term from its definition of Objective 2. Second, the Commission determines that the key measurable concepts are timing and magnitude, as the Commission provides separate analyses of predictability and stability applied to both timing and magnitude. As a result, the Commission also restructures the definition to clarify that the entire definition applies to both timing and magnitude. Third, the Commission removes the term “rates” from the definition as it is now redundant with “prices” in the clause that follows it.

Taking these modifications and clarifications together, a system achieving Objective 2 fosters prices for all market dominant products that, with regard to both timing and magnitude, are capable of being consistently forecast and do not include sudden or extreme fluctuations. In this section, the Commission discusses predictability and stability with respect to the timing of price adjustments. In section II.B.3.b.(2), *infra*, the Commission provides its analysis of predictability and stability with regard to the magnitude of price adjustments.

In the ANPR, the Commission suggested two potential approaches to measure whether the current ratemaking system has resulted in predictably and stably timed price adjustments. One, the Commission suggested measuring the interval between notices of market dominant price adjustments. Order No. 3673 at 5. Two, the Commission suggested measuring the duration between when the Postal Service files a notice of market dominant price adjustment and the effective date (*i.e.*, implementation date) of those prices. *Id.* The Commission proposed comparing these measurements to price adjustments under the PRA or other relevant benchmarks. *Id.* No comments were submitted on the proposed definition or measurement approach discussed in the ANPR with respect to the timing of price adjustments.

In this Order, the Commission utilizes the measurement methods as outlined in the ANPR, but also adds emphasis to a new measure that informs each of the two

quantitative analyses: (1) the qualitative commenter views of the timing aspect of predictability and stability during the PAEA era; and (2) the perceptions of the level of predictable and stable timing in the system in place prior to the PAEA era. The addition of this emphasis is necessary as part of the Commission's review, because, as acknowledged in the ANPR, mailers' ability to "consistently forecast" the timing of a rate adjustment is an integral part of the timing aspect of predictability and stability. *Id.* at 5. Mailers' ability to consistently make such forecasts is not measurable, in an objective quantifiable fashion, with data available to the Commission (and it is not captured in the potential metrics proposed by the Commission in the ANPR). Therefore, in order to understand to what degree mailers have been able to consistently forecast the timing of rate adjustments, the Commission must rely on the mailers' perceptions as expressed in the comments.

Accordingly, in order to determine whether the system created predictably and stably timed price adjustments, the Commission reviews the intervals between notices of market dominant price adjustments, the duration between the notice and effective date, and mailer ability to consistently forecast the timing of both aspects. The Commission also discusses how changes, such as sudden or extreme fluctuations, may detract from predictably and stably timed price adjustments.

Based on the measurement methods discussed above, informed by a qualitative evaluation of mailer experience, the Commission determines that the system creates predictably and stably timed price adjustments if the intervals between price adjustment notices and the duration between price adjustment notices and implementation are timed at regular intervals compared to a benchmark and are able to be consistently forecast by mailers.

(a) Intervals Between Price Adjustments

The Commission conducts its interval analysis to determine whether the system has created predictably and stably timed price adjustments by considering the intervals between notices of market dominant price adjustments, using the schedule of regular and predictable price adjustments (required by 39 U.S.C. § 3622(d)(1)(B)) as the relevant benchmark. The PAEA required the Postal Service to “establish a schedule whereby rates, when necessary and appropriate, would change at regular intervals by predictable amounts.” 39 U.S.C. § 3622(d)(1)(B). For this analysis, the Commission determines that price adjustments were predictably and stably timed if the intervals between notices of price adjustments were consistent with the schedule for regular and predictable price changes.

For the most part, the Postal Service’s notices have been consistent with its schedules for regular and predictable price changes. Since the Commission established the current ratemaking system, there have been eight dockets evaluating

CPI-U price adjustment proposals¹¹⁷ for all classes.¹¹⁸ Table II-1 below provides the intervals between notices of price adjustments for the eight large-scale price adjustment dockets during the PAEA era.

¹¹⁷ When the Commission analyzes large-scale price adjustments throughout this review, unless otherwise noted, the Commission generally includes the eight non-exigent price adjustments that proposed price adjustments for all market dominant classes beginning with Docket No. R2008-1 and ending with Docket No. R2017-1. Although using information from FY 2017 differs from much of the analysis in this Order, it is appropriate to consider Docket No. R2017-1 in this review because Docket No. R2017-1 was approved by Commission before the 10 year anniversary of the passage of the PAEA. Moreover, the underlying data supporting Docket No. R2017-1 were collected prior to FY 2017. The majority of the other data used by the Commission in this review is provided for an entire fiscal year, and in those cases FY 2017 data are not used.

¹¹⁸ See Docket No. R2008-1, United States Postal Service Notice of Market-Dominant Price Adjustment, February 11, 2008; Docket No. R2008-1, Review of Postal Service Notice of Market Dominant Price Adjustment, March 17, 2008 (Order No. 66); Docket No. R2009-2, United States Postal Service Notice of Market-Dominant Price Adjustment, February 10, 2009; Order No. 191; Docket No. R2011-2, United States Postal Service Notice of Market-Dominant Price Adjustment, January 13, 2011; Docket No. R2011-2, Order No. 653, Order Revising Postal Service Market Dominant Price Adjustments, February 16, 2011; Docket No. R2012-3, United States Postal Service Notice of Market-Dominant Price Adjustment, October 18, 2011; Docket No. R2012-3, Order No. 987, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 22, 2011; Docket No. R2013-1, United States Postal Service Notice of Market-Dominant Price Adjustment, October 11, 2012; Docket No. R2013-1, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 16, 2012 (Order No. 1541); Docket No. R2013-10, United States Postal Service Notice of Market-Dominant Price Adjustment, September 26, 2013; Docket No. R2013-10, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 21, 2013 (Order No. 1890); Docket No. R2015-4, United States Postal Service Notice of Market-Dominant Price Adjustment, January 15, 2015; Docket No. R2015-4, Order No. 2365, Order on Price Adjustments for First-Class Mail Products and Related Mail Classification Changes, February 24, 2015; Docket No. R2017-1, United States Postal Service Notice of Market-Dominant Price Adjustment, October 12, 2016; Docket No. R2017-1, Order on Price Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, November 15, 2016 (Order No. 3610).

There have been other market dominant price adjustment dockets during the PAEA era, but these dockets either addressed: market dominant promotions, price adjustments that affected a limited number of products, new classifications for market dominant products, market dominant negotiated service agreements, or exigent price adjustments. For example, Docket Nos. R2016-2 and R2016-5 related to promotions for First-Class Mail and Standard Mail products and Docket No. R2013-7 related to the price decrease in the Special Services class for automatic insurance coverage for some Priority Mail mailpieces. The Postal Service also requested exigent price adjustments in Docket Nos. R2010-4 and R2013-11.

Table II-1
Market Dominant Rate Adjustment Dockets after the PAEA¹¹⁹

Docket No.	R2008-1	R2009-2	R2011-2	R2012-3	R2013-1	R2013-10	R2015-4	R2017-1
Notice Date	2/11/2008	2/10/2009	1/13/2011	10/18/2011	10/11/2012	9/26/2013	1/15/2015	10/12/2016
Days Between Notices	649	365	702	278	359	350	476	636

Source: Library Reference PRC-LR-RM2017-3/1

Pursuant to 39 C.F.R. § 3010.9 in Docket No. R2008-1, when the Postal Service provided notice of the first price adjustment under the current ratemaking system, it also filed a schedule for regular and predictable price changes.¹²⁰ The 2008 Schedule stated that the Postal Service expected to implement price changes for all market dominant classes on May 12, 2008, and in mid-May of each subsequent year. 2008 Schedule at 3. Therefore, the schedule contained two components, first the month that price adjustments would occur, and second that price adjustments would occur annually. As explained in section II.B.2.a.(2)(b), *infra*, the duration between a notice of price adjustment and the implementation of new prices has been between 90 and 136 days during the PAEA era. Consistent with the 2008 Schedule in Docket Nos. R2008-1, R2009-2, and R2011-2, the Postal Service filed notices of price adjustment in mid-January or mid-February and implemented the price changes in mid-April or mid-May. However, in FY 2010, the Postal Service did not adjust market dominant prices, resulting in a 23-month gap between the notices of price adjustment filed in Docket Nos. R2009-2 and R2011-2.¹²¹

¹¹⁹ Time was calculated from the Docket No. R2006-1 Notice, which was filed during the PRA era. Docket No. R2006-1, Notice of the United States Postal Service of Decision of the Governors, March 19, 2007.

¹²⁰ Docket No. R2008-1, United States Postal Service Filing of Schedule of Regular and Predictable Price Changes, February 11, 2008 (2008 Schedule).

¹²¹ The notice of price adjustment in Docket No. R2011-2 was filed 23 months after the notice of price adjustment in Docket No. R2009-2. During that span the Postal Service filed a request for an exigent price adjustment and for part of that span the CPI-U annual limitation authority was negative.

The current ratemaking system provided that the Postal Service could file a revised schedule for regular and predictable rate adjustments with the Commission whenever it deemed it appropriate. 39 C.F.R. § 3010.9(e). The Postal Service filed a revised schedule in Docket No. R2012-3 and announced its plan to implement price adjustments each January instead of each May.¹²² This revision resulted in the Docket No. R2012-3 price adjustment occurring only 9 months after the Docket No. R2011-2 price adjustment. However, consistent with the 2012 Schedule, in Docket Nos. R2012-3, R2013-1, R2013-10,¹²³ and R2017-1, the Postal Service filed notices of price adjustment in late-September or mid-October and implemented the price changes in late January of fiscal years 2012, 2013, 2014, and 2017, respectively.

There were two deviations from the 2012 Schedule during this period. First, because the price adjustments proposed in Docket No. R2015-4 were requested in January and implemented in May, the FY 2015 price adjustments were inconsistent with the 2012 Schedule.¹²⁴ Additionally, the Postal Service did not adjust prices for all market dominant classes in FY 2016, resulting in the Docket No. R2017-1 adjustment occurring 21 months after the Docket No. R2015-4 adjustment.¹²⁵

¹²² See Docket No. R2012-3, United States Postal Service Filing of Updated Schedule of Regular and Predictable Price Changes, October 18, 2011 (2012 Schedule).

¹²³ The Commission notes that Docket No. R2013-10 was filed late in FY 2013 rather than early in FY 2014, resulting in two FY 2013 dockets. Consistent with the 2012 Schedule, the new rates resulting from Docket No. R2013-1 and R2013-10 were implemented in January of 2013 and 2014, respectively.

¹²⁴ The notice of price adjustment in Docket No. R2015-4 was filed 15 months after the notice of price adjustment in Docket No. R2013-10. During this span the exigent surcharge was in effect, there was a pending appeal of the duration of the surcharge, and there was a limited amount of CPI-U annual limitation authority.

¹²⁵ The notice of price adjustment in Docket No. R2017-1 was filed 21 months after the notice of price adjustment in Docket No. R2015-4. During the 21-month period, the 12-month percentage change in CPI-U was low, and the exigent surcharge was removed. This delay also put the Postal Service back on the schedule established in Docket No. R2012-3.

For the most part, the Postal Service has implemented price adjustments consistent with its schedules for regular and predictable price changes with the three exceptions described above. Those exceptions related to the implementation of new prices in FY 2010, FY 2015, and FY 2016. With regard to each, the Commission finds that for informed mailers and postal customers the fact that the Postal Service would forego or delay implementing a price change was not unpredictable. For FY 2010 and FY 2016, the percent change in CPI-U was low or negative and limited the amount by which the Postal Service could increase prices, a fact known to mailers.

In addition, the exigent surcharge was in effect from January 2013 to April 2015.¹²⁶ In October 2014, the Postal Service announced that it would not be adjusting prices effective in January 2015, in part because of the ongoing appeal of the exigent rate docket.¹²⁷ The Postal Service instead adjusted prices in May 2015.

These examples demonstrate that there are external influences that may impact the Postal Service's ability or intent to adjust prices at a particular time. These influences are known to mailers and postal customers and are generally communicated by the Postal Service to mailers through a variety of channels. When determining whether the Postal Service files notices of price adjustments at regular intervals, such external influences must be taken into consideration. In addition, the deviations

¹²⁶ Concurrent with the Postal Service's notice of price adjustment in Docket No. R2013-10, the Postal Service filed a request for an exigent rate increase in Docket No. R2013-11 to help recover revenue lost during the Great Recession. See Docket No. R2013-11, Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059, September 26, 2013 (Docket No. R2013-11 Exigent Request). On December 24, 2013, the Commission approved a temporary 4.3 percent exigent surcharge. Order No. 1926 at 158. The exigent surcharge is discussed in more detail with regard to price changes of a predictable and stable magnitude in section II.B.3.b., *infra*.

¹²⁷ See United States Postal Service, Pricing Update, (last accessed November 21, 2017), available at <https://liteblue.usps.gov/news/link/2014/10oct/news02s4.htm>. In addition, the press release informed mailers that the Postal Service would evaluate its pricing strategies and would communicate about any potential price adjustment filings in "early 2015." The Postal Service filed a notice of market dominant price adjustment on January 15, 2015; see Docket No. R2015-4, United States Postal Service Notice of Market-Dominant Price Adjustment, January 15, 2015 (Docket No. R2015-4 Notice).

themselves, as well as the communication from the Postal Service regarding the deviations, show that none rose to a level that would be considered a sudden or extreme fluctuation. See Order No. 3673 at 5.

Accordingly, although the Postal Service has not implemented a price adjustment in each fiscal year, because the intervals between notices of price adjustments have been consistent with its schedules for regular and predictable price changes or explained by external influences observable to mailers, the Commission concludes that the intervals between notices of price adjustment demonstrate that the timing of price adjustments has been predictable and stable. The Commission notes, however, that the PAEA era system did not require the Postal Service to update its schedule of regular and predictable price changes, which resulted in mailers' need to refer to other sources to get updated information if the schedules changed.

(b) Duration Between Notice and Implementation

Next, the Commission analyzes the time between a notice of price adjustment and the implementation of the new prices as a measure to determine whether the system has resulted in predictably and stably timed rates. For this duration analysis, the Commission uses the 45-day notice requirement of 39 U.S.C. § 3622(d)(1)(C) as the relevant benchmark.

The PAEA requires the Postal Service to provide public notice of price adjustments at least 45 days before the implementation of any adjustment, which the Commission incorporated when it established the current ratemaking system.¹²⁸ In

¹²⁸ See 39 U.S.C. § 3622(d)(1)(C). Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007, at 115 (Order No. 43); see 39 C.F.R. § 3010.10(a). In Order No. 43, the Commission adopted final rules that require the Postal Service to provide public notice of price adjustments no later than 45 days prior to the intended implementation date and to transmit notice of price adjustments to the Commission no later than 45 days prior to the intended implementation date. *Id.*

addition, the Commission has encouraged the Postal Service to provide notice of price adjustments “as far in advance of the 45-day minimum as practicable.”¹²⁹

The Commission finds, based on a review of the relevant price adjustments identified in section II.B.2.a.(2)(a), *infra*, that the Postal Service provided notice between 90 and 136 days¹³⁰ before the proposed implementation date of each price adjustment. The Postal Service, at a minimum, has provided twice the notice required by the benchmark measure during the PAEA era. Further, the relative consistency with regard to the amount of advance notice supports a finding that mailers did not experience sudden or extreme fluctuations with regard to advance notice during the PAEA era. Therefore, mailers have received notice of price adjustments further in advance than contemplated by the Commission’s rules or the statute, which has encouraged the predictability and stability of price adjustments with respect to timing.

(c) Mailer Ability to Consistently Forecast

Several mailers identify the lack of predictability and stability in timing under the PRA era.¹³¹ The Commission considered using the PRA era as a benchmark to measure the duration between notice of a price adjustment to a mailer and implementation. See Order No. 3673 at 5. Using the PRA era as a benchmark to

¹²⁹ Order No. 43 at 115; see 39 C.F.R. § 3010.10(b).

¹³⁰ In Docket No. R2015-4, the Postal Service filed a notice of price adjustment 102 days before the proposed implementation date. Docket No. R2015-4 Notice at 1. However, in the Postal Service Response to Order No. 2398, the Postal Service announced that the new implementation date for all market dominant price adjustments would be May 31, 2015, which was 136 days after January 15, 2015. Docket No. R2015-4, Response of the United States Postal Service to Order No. 2398, April 16, 2015.

¹³¹ See DMA *et al.* Comments at 2; SMC *et al.* Comments at 3. During the PRA era, as discussed in section II.A.1., *supra*, the Postal Service would request a recommended decision from the Commission for new prices; these requests would include the Postal Service’s proposed prices and fees. After reviewing numerous library references, expert witness testimonies, and comments, the Commission would recommend prices. The Postal Service’s Board of Governors would then review and vote whether to approve the recommended prices. Once the prices were approved, the Board of Governors would set an implementation date for the price adjustments.

evaluate that interval, however, is problematic because pinpointing the appropriate event for measuring when mailers had notice during the PRA era is not straightforward, as the Commission substantially modified the Postal Service's proposed prices in its recommended decisions.¹³² In the last 10 years of the PRA era there were five price adjustments (with two adjustments noticed more than 3 years apart).¹³³

Compared to the PRA era, nearly all mailers and the Postal Service view the predictability and stability in timing as being met in the PAEA era.¹³⁴ Mailers emphasize

¹³² See, e.g., Docket No. R2006-1, Opinion and Recommended Decision, February 26, 2007, at 112, 125 (Commission recommended an increase of 2 cents instead of 3 cents for First-Class Mail Single-Piece Letters and Postcards; Commission did not adopt Postal Service's proposal to "de-link" First-Class Mail Single-Piece from worksharing rates); see Docket No. R2006-1, Errata Notice, March 14, 2007. The Board of Governors adopted the prices in the recommended decision except in specific instances. See, e.g., Docket No. R2006-1, Notice of the United States Postal Service of Decision of the Governors, March 19, 2007, at 2-3 (approving the recommended decision, but asking the Commission to reconsider three issues related to Standard Mail Flats, the non-machinable surcharge for First-Class Mail Letters, and the Priority Mail Flat Rate Box).

¹³³ See Docket No. R97-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates for Postage and Fees for Postal Services, July 10, 1997; Docket No. R97-1, Opinion and Further Recommended Decision, September 24, 1998; Docket No. R97-1, Notice of the United States Postal Service of Decision of the Governors, October 13, 1998; Docket No. R2000-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services, January 12, 2000; Docket No. R2000-1, Opinion and Recommended Decision on Further Reconsideration, April 10, 2001; Docket No. R2000-1, Decision of the Governors of the United States Postal Service on the Recommended Decision on Further Reconsideration of the Postal Rate Commission on Postal Rate and Fee Changes, Docket No. R2000-1, May 8, 2001; Docket No. R2001-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services and Request for Expedition, September 24, 2001; Docket No. R2001-1, Opinion and Recommended Decision Approving Stipulation and Agreement, March 22, 2002; Docket No. R2001-1, Decision of the Governors of the United States Postal Service on the Recommended Decision of the Postal Rate Commission on Postal Rate and Fee Changes, Docket No. R2001-1, April 9, 2002; Docket No. R2005-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services, April 8, 2005; Docket No. R2005-1, Opinion and Recommended Decision, November 1, 2005; Docket No. R2005-1, Notice of the United States Postal Service of Decision of the Governors, November 15, 2005; Docket No. R2006-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services, May 3, 2006; Docket No. R2006-1, Opinion and Recommended Decision, February 26, 2007; Docket No. R2006-1, Notice of the United States Postal Service of Decision of the Governors, March 19, 2007.

¹³⁴ See MMA, NAPM, and NPC Comments at 1-2; SMC *et al.* Comments at 5-6; Pitney Bowes Comments at 16; DMA *et al.* Comments at 2; Postal Service Comments at 138.

the improvement in the timing aspect of predictability and stability during the PAEA era as compared to the PRA era. DMA *et al.* explains that during the PRA era businesses could not reliably predict price adjustments. DMA *et al.* Comments at 2. Likewise, SMC *et al.* emphasizes that the PRA era reflected unpredictable prices. SMC *et al.* Comments at 3. When discussing the PAEA era, however, the comments consistently acknowledge that the timing of price adjustments has been predictable and stable. MMA, NAPM, and NPPC assert that the timing of price adjustments is fairly predictable due to the schedule despite the impact of the Great Recession. MMA, NAPM, and NPPC Comments at 1-2, 22. Similarly, SMC *et al.*, Pitney Bowes, DMA *et al.*, and the Postal Service all concur that Objective 2, especially with regard to timing, is met in the PAEA era.¹³⁵

Accordingly, because the Postal Service provided notice that exceeded the benchmark measure, and mailers have had the ability to consistently forecast the timing of rate adjustments in the PAEA era, the Commission concludes that its analysis of the intervals between notices of price adjustment and between notices and implementation of those price adjustments demonstrates that the timing of price adjustments has been predictable and stable.

b. Administrative Burden and Transparency

In reviewing administrative burden and transparency during the PAEA era, the Commission analyzes Objective 6, which looks to whether the system has “reduce[d] the administrative burden and increase[d] the transparency of the ratemaking process.” 39 U.S.C. § 3622(b)(6). As discussed in more detail below, the Commission finds that a system meeting Objective 6 is one which balances the (sometimes competing) concepts

¹³⁵ SMC *et al.* Comments at 5-6; Pitney Bowes Comments at 16; DMA *et al.* Comments at 2; Postal Service Comments at 138.

of reducing the complexity of rate proceedings and increasing the availability of comprehensive understandable material relating to each rate proceeding.

(1) Comments

As discussed below, commenters generally conclude that the system has reduced the administrative burden and increased the transparency of the ratemaking process, although some commenters assert there is less transparency in the current system. Some commenters conclude that either administrative burden has decreased, transparency has increased, or both, without providing additional information.

Many commenters note that PAEA ratemaking proceedings are more streamlined and less burdensome than those under the PRA because the new system does not require lengthy adversarial proceedings.¹³⁶ DMA *et al.* specifically states that the “administrative savings for [its] members have been tremendous.” DMA *et al.* Comments at 4. Similarly, MH and NAAD state that proceedings under the PAEA “entail a significantly lower amount of litigation (and cost) than resulted from the earlier process.” MH and NAAD Comments at 8. Although the Commission does not include cost savings as part of the analysis, as discussed below, these comments support the Commission’s ultimate conclusions regarding administrative burden and transparency.

As it relates to transparency, many commenters note the CPI-U price cap itself, by setting a firm limit on price increases at the class-level, has made the new system more transparent.¹³⁷ ANM *et al.* state that with the price cap information publically available, it has reduced the need to “investigate and evaluate Postal Service cost allocation methodologies when evaluating rates.” ANM *et al.* Comments at 21. In

¹³⁶ ANM *et al.* Comments at 21; DMA *et al.* Comments at 4; GCA Comments at 24; MH and NAAD Comments at 8; MMA, NAPM, and NPPC Comments at 49; Postal Service Comments at 138.

¹³⁷ ANM *et al.* Comments at 21; GCA Comments at 24-25.

addition, PSA contends that the Postal Service is “very transparent” because it discloses “a massive amount of information,” more so than competitors. PSA Comments at 6. The Postal Service states transparency is higher and asserts other proceedings such as advisory opinion proceedings or the annual compliance process “have been effective in increasing transparency” See Postal Service Comments at 122 n.235, 138.

While MMA, NAPM, and NPPC conclude that the administrative burden has decreased, they state transparency has also decreased. MMA, NAPM, and NPPC explain that the former system was more transparent because rates resulted from adversarial proceedings, and that, under the current system, rates change by varying amounts with no explanation as to why. MMA, NAPM, and NPPC Comments at 49. MMA, NAPM, and NPPC observe that decreased transparency is an “unnecessary consequence” of increased pricing flexibility under the price cap. *Id.* at 49-50.

Other commenters conclude that Objective 6 is met without in-depth discussion. SMC *et al.* state simply that “[t]he current rate setting process has done much to reduce administrative burdens, and increase the transparency, of rate making.” SMC *et al.* Comments at 4. Similarly, MH and NAAD state “the transparency of the rate setting process is no longer an issue of concern for ratepayers.” MH and NAAD Comments at 8.

(2) Application of Measurement

In analyzing whether the ratemaking process has achieved the goals of the PAEA, the Commission analyzes Objective 6 to determine whether administrative burden has decreased and transparency has increased. 39 U.S.C. § 3622(b)(6).

As set forth in the ANPR, the Commission proposed that “[a] system achieving Objective 6 balances the (sometimes competing) concepts of reducing the costs imposed by rate proceedings or regulatory requirements generated by those

proceedings, and the availability of comprehensive understandable material relating to each rate proceeding.” Order No. 3673 at 8. No commenters submitted comments on the proposed definition or measurement approach discussed in the ANPR.

After further consideration, the Commission makes three modifications to the proposed definition. First, the Commission revises this definition to replace the concept of “costs imposed by rate proceedings” with the concept of “the complexity of rate proceedings.” The Commission makes this change because it determines that it is unable to accurately quantify “costs” (*i.e.*, it is unable to quantify the time and money spent by participants in rate proceedings). Second, the Commission also revises this definition to eliminate the phrase “regulatory requirements generated by those proceedings.” The Commission makes this change because it determines that, for the purposes of this review, the proper focus of “administrative burden” is on the proceedings themselves, rather than the regulatory requirements generated from those proceedings. Third, the Commission adds “increasing” before “the availability of comprehensive understandable material.”

Taking these modifications together, a system achieving Objective 6 balances the (sometimes competing) concepts of reducing the complexity of rate proceedings and increasing the availability of comprehensive understandable material relating to each rate proceeding.

In the ANPR, the Commission identified two key measureable concepts: reduce the administrative burden and increase the transparency. The Commission also suggested that the system must balance the two concepts to achieve the objective. *Id.* The Commission suggested separate measurement approaches for administrative burden and transparency. *Id.*

For administrative burden, the Commission suggested two potential approaches to measure whether the current ratemaking system has reduced the administrative burden of the ratemaking process. *Id.* One approach was to evaluate the complexity of

rate adjustment filings and proceedings on a qualitative basis. *See id.* The other approach was to quantify the length, number of information requests, and staff hours required to review the price adjustment proposal, ACRs, complaints, or dockets related to price setting. *Id.* After further consideration, as its determinative analysis, the Commission determines that the administrative burden should be assessed by measuring the duration of Commission review against an appropriate benchmark, while also taking into account the participants' views to evaluate the complexity of rate proceedings. The Commission attempted to compare levels of complexity between the PRA and PAEA eras, but concluded that given the differences in the nature of proceedings and theory of regulation, those comparisons are not apt. The Commission includes several of these analyses to supplement its determinative analysis, and also to provide relevant context for the participants' comments about the administrative burden and how it has been reduced during the PAEA era. The Commission does not review the staff hours as suggested in the ANPR because research demonstrated there were no accurate data available to perform such an analysis.

For transparency, the Commission suggested two potential measurement approaches in the ANPR. *Id.* One approach was to conduct an analysis of the necessary interaction between stakeholders, the Postal Service, and the Commission. *Id.* Another approach was to analyze the amount and type of information filed under seal compared to publicly available information. *Id.* In the ANPR, the Commission suggested both of “[t]hese features could be compared to levels of transparency and administrative burden present prior to the passage of the PAEA.” *Id.* However, after further consideration, the Commission has decided not to pursue these potential approaches as meaningful analysis with regard to transparency.

In its determinative analysis of transparency, the Commission reviews the necessary interaction between stakeholders, the Postal Service, and the Commission by taking into account the participants' views in determining that transparency has

increased. The Commission notes that both goals of reducing administrative burden and increasing transparency are necessarily subjective and best evaluated from the perspective of the participants in the ratemaking process. Therefore, as mentioned above, the Commission considers as part of its determination the participants' views, as expressed in the comments, of whether burden has been reduced and transparency increased. To supplement the Commission's determinative analysis and provide context for participants' views, the Commission reviews the number of motions for additional information and the number and frequency of Postal Service and Commission reports.

(a) Administrative Burden

As set forth above, the Commission reviews whether the system reduced the complexity of rate proceedings by measuring the duration of Commission review against an appropriate benchmark, taking into account participants' views. The Commission determines whether administrative burden was reduced during the PAEA era by measuring the duration of Commission review of rate adjustment filings compared to a 90-day benchmark. The 90-day benchmark is appropriate because it marks the minimum time the Postal Service provided during the PAEA era from the beginning of a price adjustment proceeding (notice) to its presumed conclusion (planned implementation).¹³⁸ This customary 90-day span between notice and planned

¹³⁸ While the PAEA only required a minimum of 45-days' notice, for purposes of administrative burden, the Commission finds it appropriate to benchmark the complexity against the time available to review and approve (or review, remand, and approve) price adjustment proposals during the PAEA era. The time between notice and planned implementation during the PAEA era ranged from 90 to 136 days. See section II.B.2.a.(2)(b), *supra*. Because 90 days represents the minimum time available between a notice of price adjustment and planned implementation during the PAEA era, it is an appropriate benchmark to evaluate whether rate adjustment proceedings are of a level of complexity that they may be adjudicated in that time period. The 90-day benchmark implies that the Postal Service's notices for market dominant price adjustments would be at a level of complexity that the Commission could consistently review them in the 90-day window between notice and planned implementation. Therefore, it is appropriate to benchmark the duration of market dominant price adjustment proceedings in the PAEA era against a standard of 90 days.

implementation during the PAEA era was a marked change from the requirements of the PRA, which was revised after several early PRA rate cases to allow the Commission 10 months after the Postal Service's request to issue an opinion and recommended decision. The intent of the PAEA change was to reduce the time and burden related to rate changes.¹³⁹

The Commission takes into account the participants' views on complexity by considering the comments relating to Objective 6. To provide context for the Commission's consideration of participants' views, the Commission also compares the following aspects of the ratemaking process in the PRA era and PAEA era: the number of filings per proceeding; length of filings; number of library references filed; duration of hearings and technical conferences; and the number of information requests.

Overall, the Commission finds that administrative burden is decreased where the complexity of price adjustment proceedings is at a level where they are readily adjudicated within an appropriate period, *i.e.*, the 90-day benchmark between notice and planned implementation that was the norm throughout the PAEA era, and where other qualitative indicators, such as participants' views, reflect a reduction in administrative burden.

(i) Duration of Commission Review (Days)

The Commission compares the duration of Commission review for all the non-exigent¹⁴⁰ market dominant price adjustment dockets during the PAEA era as compared to the 90-day benchmark.

¹³⁹ Order No. 191 at 1. See also, section II.A.2., *supra*.

¹⁴⁰ The Commission excludes both exigent rate requests from its review of duration for general rate adjustments because the exigent request is by definition not a regular occurrence, and is subject to different notice and evaluation requirements.

During the PAEA era, large-scale price adjustments, excluding exigent cases, lasted an average of 62 days.¹⁴¹ Only one of the large-scale price adjustment cases did not meet the 90-day benchmark.¹⁴² In six of the eight large-scale price adjustment proceedings, there were significant issues with the Postal Service's notices of price adjustment filings resulting in durations of between 58 and 112 days. For example, in Docket No. R2017-1, the Postal Service filed a notice of price adjustment on October 12, 2016. Order No. 3610 approved rate adjustments for First-Class Mail, Standard Mail,¹⁴³ Periodicals, and Package Services on November 15, 2016.¹⁴⁴ However, rate adjustments related to Special Services were not approved until December 15, 2016, due to the Postal Service's submission of imprecise and inadequate workpapers, which included billing determinants that differed from the billing determinants submitted to the Commission quarterly. *Id.* at 2. As a result, the docket lasted 64 days.

Accordingly, even when issues arose, the duration of the Commission's review of large-scale market dominant price adjustments during the PAEA era was nearly always less than the 90-day benchmark. This indicates that the complexity of rate adjustment proceedings in the PRA era has been accommodated within 90 days.

¹⁴¹ Small-scale price adjustments lasted an average of 37 days. See Table II-2, *infra*.

¹⁴² In Docket No. R2015-4, the Commission found that planned price adjustments for Standard Mail, Periodicals, and Package Services failed to comply with applicable requirements and ordered the Postal Service to file amended price change notice proposals. The Postal Service filed a revised proposal, and the Commission again found the planned adjustments failed to comply. In Docket No. R2015-4, the Postal Service's first two proposals contained many errors and inconsistencies, lacked the information required by title 39 and the Commission's regulations, and required 16 Chairman's Information Requests to attempt to cure the deficiencies. See Order No. 2472.

¹⁴³ The Commission notes that as a result of Docket No. R2017-1, the Standard Mail class was renamed USPS Marketing Mail. Because the name change did not go into effect during the PAEA era, the Commission uses Standard Mail throughout this review for consistency. Order No. 3610 at 39.

¹⁴⁴ Docket No. R2017-1, Order on Price Adjustments for Special Services and Related Mail Classification Changes, December 15, 2016, at 1 (Order No. 3670).

(ii) Qualitative Views on the Reduction of Administrative Burden and PRA Era Comparisons

The Commission takes into account the participants' views on the complexity of the price adjustment process during the PAEA era. Commenters generally conclude that the system of ratemaking under the PAEA is simplified and not as complex as under the PRA.¹⁴⁵ Enlightened Connections asserts that complexity has increased since the onset of the PAEA, but that the Postal Service and Commission have worked to accomplish Objective 6 as best they could. Enlightened Connections Comments at 11-12.

The Commission finds that the vast majority of the qualitative views expressed in the comments conclude that Objective 6 is met in the PAEA era. These views may be contextualized by examining the differences in the PRA era versus the PAEA era since the participants in rate adjustment proceedings are implicitly (and at times, explicitly)¹⁴⁶ commenting based on their experience with the ratemaking system during the PRA era.

(iii) Supplementary Analysis

As previously discussed, a direct comparison of complexity between the PAEA and PRA eras is not conclusive due to the differences in proceeding types, information provided, and theory of regulation.¹⁴⁷ The Commission includes this supplementary analysis to provide context to participant views. Therefore, to contextualize participant views, and understand how the reduction in burden is supported by the qualitative views

¹⁴⁵ See, e.g., Postal Service Comments at 138; DMA *et al.* Comments at 4; ANM *et al.* Comments at 21; GCA Comments at 24-26; SMC *et al.* Comments at 4.

¹⁴⁶ See, e.g., DMA *et al.* Comments at 4; ANM *et al.* Comments at 21 (referencing 10-month proceedings during the PRA era were replaced with streamlined CPI-U proceedings in the PAEA era).

¹⁴⁷ For example, rate cases during the PRA era included changes in costing methodologies, which are now separate dockets that examine "changes in analytical principles." See Table II-2, *infra*.

as expressed in the comments, the following sections discuss the complexity and volume of work associated with market dominant rate proceedings during the PRA and PAEA eras in greater detail.

Specifically, the Commission compares the number of filings, length of filings, number of library references, number of information requests, and duration of review during the PAEA era and the last 10 years of the PRA era, as summarized in Table II-2.

Table II-2
Comparison of Administrative Burden of Regulatory Filings Pre- and Post-PAEA¹⁴⁸

		PRA (1997- 2006)			
		Omnibus Rate Cases	Changes in Analytical Principles	Large-Scale Rate Cases	Small-Scale Rate Cases
Number of Filings (per docket)		3,836	15	114	19
Postal Service Initial Filing (pages)		244	15	155	26
Postal Service Initial Library References (filed per case)		156	2	6	1
Participant input and information collection	Hearing /Technical Conference (days)	16	0.4	1	0.13
	Number of Briefs (filed per case)	67	-	-	-
	CHIRs/CIRs/POIRs (per case)	18 ¹⁴⁹	2	8	1.2
Commission Final Order (pages)		798	18	118	19
Duration of Review (days)		253	129	62 ¹⁵⁰	37

Source: Library Reference PRC-LR-RM2017-3/1

¹⁴⁸ Figures in Table II-2 are averages. References to page numbers are to actual pages filed, and make no attempt to account for differences in formatting among different documents. Rate adjustments can be separated into two types: large-scale and small-scale. Large-scale rate cases are those that involve rate or classification changes that affect each class of market dominant mail. For the purposes of Table II-2, the large-scale dockets include Dockets Nos. R2017-1, R2015-4, R2013-11, R2013-10, R2013-1, R2012-3, R2011-2, R2010-4, R2009-2, and R2008-1. Small-scale rate cases at most affect two classes of mail (e.g., Standard Mail and First-Class Mail in Docket Nos. R2012-9, R2012-6, and R2011-5) or as little as one product or promotion (e.g., Standard High Density Flats in Docket No. R2009-4 or the Technology Credit promotion in Docket No. R2013-6). For the purposes of Table II-2, the small-scale dockets include Dockets Nos. R2016-5, R2016-2, R2014-1, R2013-7, R2013-6, R2012-9, R2012-7, R2012-6, R2011-5, R2011-1, R2010-3, R2010-1, R2009-5, R2009-4, and R2009-3.

¹⁴⁹ The CHIR figure does not include interrogatories propounded as part of discovery in omnibus rate cases, which numbered on average close to 700 during the last five omnibus rate cases.

¹⁵⁰ In cases that did not involve exigent circumstances (Docket Nos. R2017-1, R2015-4, R2013-10, R2013-1, R2012-3, R2011-2, R2009-2, and R2008-1), the average duration of review was 62 days. Including the cases involving exigent circumstances results in an average duration of review of 67 days.

Under the PRA, the Commission accepted and maintained a large number of filings as part of the record. As demonstrated in Table II-2, the average number of filings for omnibus rate cases between 1997 and 2006 was approximately 3,836 per case and included the initial request, library references with supporting workpapers, testimony, presiding officer's rulings, and participant briefs.

Under the PAEA, although the Postal Service did not file a large-scale market dominant rate adjustment each calendar year, the overall average number of filings was approximately 114 per docket. See Table II-2. Small-scale market dominant rates cases were also not filed every year, but the overall average number of filings was approximately 19 per docket. Overall, comparing the average number of filings between the last 10 years of the PRA era and the PAEA era, the average during the PAEA era was significantly lower, which supports participants' views of a reduced administrative burden.

The Commission also compares the length of Postal Service initial filings, the number of library references, and the length of Commission final orders.

As shown in Table II-2, for omnibus rate cases in the 10 years immediately preceding the implementation of PAEA, the Postal Service's initial requests for a recommended decision averaged 244 pages excluding other supplemental documents,

and were supported by an average of 156 initial library references per case.¹⁵¹

Under the PAEA, large-scale market dominant price adjustment requests averaged approximately 155 pages in length and were typically accompanied by 6 library references that contained workpapers for the 5 classes of mail (First-Class Mail, Standard Mail, Periodicals, Package Services, and Special Services) as well as a separate library reference for First-Class Mail International.¹⁵² For small-scale rate cases, the notices of price adjustment averaged approximately 26 pages in length and were supported by an average of approximately 1 library reference per docket. See Table II-2. The average number of library references filed with notices of rate adjustment represents a stark reduction from the number of initial supporting library references filed in omnibus rate cases during the PRA era.

The Commission also measures the length of Postal Service filings for other dockets. The Postal Service's petitions for a change in analytical principles were approximately 15 pages on average. See Table II-2.

As shown in Table II-2, the length of Commission final orders was also reduced during the PAEA era. Under the PRA, the Commission reviewed and analyzed all the

¹⁵¹ For example, Docket No. 97-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates for Postage and Fees for Postal Services, July 10, 1997; Docket No. R2000-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services, January 12, 2000; Docket No. R2001-1, Request of the United States Postal Service for Recommended Decision on Changes in Rates of Postage and Fees for Postal Services and Request for Expedition, September 24, 2001; Docket No. R2005-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Services, April 8, 2005; Docket No. R2006-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Service, May 3, 2006. The initial library references ranged from pricing spreadsheets, projected volumes, cost avoidance, transportation costs, rate design worksheets, testimonial support, and Amtrak analysis.

¹⁵² See Table II-2. Additionally, in Docket Nos. R2010-4 and R2013-11, which dealt with an exigent surcharge, there were additional library references and witness statements filed due to the nature of the rate adjustment and, as they were outside the norm, were not included in the figures presented in this document. Small-scale rate cases only have workpapers for the affected product, promotion, or class.

testimony and filings in the record and then issued an Opinion and Recommended Decision approving rates, classification changes, and revisions to analytical principles. The Commission also provided various appendices with, for example, information on participants and witnesses, the revenue requirement and cost roll forward adjustments, and volume projections. Over the five omnibus rates cases between 1997 and 2006, these Opinion and Recommended Decision orders averaged 798 pages.¹⁵³

This was much higher than the average page length of final orders in large-scale rate cases during the PAEA era, which averaged 118 pages. The Commission's final orders in small-scale rate cases were an average of 19 pages in length. Similarly, the Commission's final decisions on changes to analytical principles dockets averaged 18 pages in length.¹⁵⁴

Accordingly, a review of the length of Postal Service filings, number of library references, and length of Commission orders during the PRA and PAEA eras shows all three were reduced during the PAEA era, which supports participants' views of reduced administrative burden.

¹⁵³ See Table II-2. Docket No. R97-1, Commission's Opinion and Recommended Decision, on Postal Rate and Fees Changes, 1997, Volumes 1 & 2, May 11, 1998; Docket No. R2000-1 Opinion and Recommended Decision, November 13, 2000; Docket No. R2001-1, Opinion and Recommended Decision Approving Stipulation and Agreement in Docket No. R2001-1, March 22, 2002; Docket No. R2005-1, Opinion and Recommended Decision, November 1, 2005; Docket No. 2006-1, Opinion and Recommended Decision, February 26, 2007. In some instances, a final order was reconsidered or the Commission issued further recommendations. Those final orders averaged 42 pages. Docket No. 97-1, Opinion and Further Recommended Decision, September 24, 1998; Docket No. R2000-1, Opinion and Further Recommended Decision (Reconsideration), February 9, 2001; Docket No. R2000-1, Opinion of Recommended Decision on Further Reconsideration, April 10, 2001; Docket No. R2006-1, Opinion and Recommended Decision on Reconsideration, April 27, 2007; Docket No. R2006-1, Second Opinion and Recommended Decision on Reconsideration, May 25, 2007. The largest omnibus rate case during the relevant time period was Docket No. R2000-1. The Commission accepted 5884 filings into the record, dealt with 119 witnesses and nearly 90 participants. It issued 3 opinions totaling 1152 pages over 454 days.

¹⁵⁴ Although the average duration of these dockets is longer than the average duration of rate cases, the final decisions tend to be much shorter. This is partly due to the fact that changes in analytical principles do not alter the Mail Classification Schedule (MCS), so the final orders do not require an MCS attachment be prepared.

The Commission also reviews the number of information requests to determine whether they have been reduced during the PAEA era. In reviewing the PRA era information requests, the Commission uses the number of hearing days and briefs filed by the parties as comparison points for the number of information requests, because hearings and briefs were how comparable information was gathered during the PRA era.¹⁵⁵ Omnibus rate cases were heard “on-the-record,” requiring an average of 16 hearing days per case, where the Commission and other participants in attendance listened to testimony by, and in some cases conducted cross-examination of, Postal Service employees and experts, as well as representatives, experts outside of the Postal Service, or participants’ witnesses.¹⁵⁶ In addition, as shown in Table II-2, participants provided an average of 67 total (initial and reply) written briefs per case in support of, or in opposition to, the proposed changes.

¹⁵⁵ This excludes interrogatories, which were between the parties and resolved without Commission involvement unless there was a refusal to answer requiring a motion to compel.

¹⁵⁶ See Table II-2. See Docket No. 97-1, Presiding Officer’s Ruling Scheduling Witnesses No. 97-1/22, September 18, 1997; Docket No. R2000-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2000-1/19, March 24, 2000; Docket No. R2000-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2000-1/80, June 22, 2000; Docket No. R2000-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2000-1/120, August 16, 2000; Docket No. R2001-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2001-1/9, November 14, 2001; Docket No. 2005-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2001-1/22, June 14, 2005; Docket No. R2005-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2005-1/27, June 20, 2005; Docket No. R2006-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2006-1/21, July 24, 2006; Docket No. R2006-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2006-1/77, October 6, 2006; and Docket No. R2006-1, Presiding Officer’s Ruling Scheduling Witnesses No. 2006-1/112, November 21, 2006.

In contrast, under the PAEA, “on-the-record” hearings are no longer required for rate cases¹⁵⁷ and additional information in proceedings is obtained through Chairman’s Information Requests (CHIRs), Commission Information Requests (CIRs), or Presiding Officer’s Information Requests (POIRs).¹⁵⁸ As shown in Table II-2, there was an average of eight issuances of information requests per docket in large-scale rate cases.¹⁵⁹

Participants did not have the opportunity to question Postal Service witnesses in each market dominant related docket, but commenters did have the opportunity to request that questions be proffered to the Postal Service in order to clarify certain aspects of workpapers or to receive additional information. Despite this allowance, in 10 large-scale rate cases, only 5 dockets contained requests for additional information and 22 total requests were made. In 15 small-scale rate cases, only 2 requests for additional information were made. In both large and small-scale rate cases, it was most commonly the Public Representative that sought additional information. During 50 proceedings to consider changes in analytical principles, only 8 requests for additional information were made by commenters.

¹⁵⁷ The Commission may hold hearings or technical conferences to obtain information from the Postal Service or specific Postal Service witnesses on more technical questions as they may present the best opportunity to collect very technical information in a short period of time. Since 2007, these hearings or technical conferences occurred a total of 9 times in large-scale rate cases, including exigent cases, and only twice in small-scale rate cases, and each lasted an average of 3 days per docket. Prior to these events, participants were encouraged to submit questions in advance to the Commission (hearings) or Postal Service (technical conference). For changes in analytical principles dockets, only 2 out of 50 included a hearing or technical conference. One public hearing was conducted in Docket No. RM2009-3, and one technical conference was conducted in Docket No. RM2008-2.

¹⁵⁸ The Commission also issued questions through Notices of Inquiry (NOIs), but these types of notices were rare and generally not used in rate cases. CHIRs, CIRs, and POIRs were used with much greater frequency to procure information during rate cases. For the 15 small-scale rate cases, the Commission issued approximately 18 CHIRs and 1 CIR, an average of under 2 issuances per docket. In dockets related to changes in analytical principles, the Commission issued a total of 86 CHIRs over the 50 dockets of this type, less than 2 CHIRs on average.

¹⁵⁹ The Commission observes there were approximately 47 CHIRs, 4 CIRs, and 26 POIRs issued for the 10 large-scale rate cases.

As shown in Table II-2, during the last 10 years of the PRA era, the Commission presided over 5 omnibus rate cases and the average duration was 253 days.¹⁶⁰ Previously, as the metric for measuring complexity in the price adjustment proceedings, the Commission compared the PAEA era duration of market dominant price adjustment proceedings to the 90-day benchmark. See section II.B.2.b.(2)(a). Compared to a benchmark of the average PRA era duration, it is clear there was a significant improvement to the duration of cases during the PAEA era.

(b) Transparency

To evaluate the transparency of the ratemaking system, the Commission reviews the necessary interaction between stakeholders and the Postal Service/Commission by taking into account participants' views on the transparency of the ratemaking process, and provides a supplementary analysis of the number of motions for additional information (motions to compel and motions for issuance of information requests),¹⁶¹ and the number and frequency of Postal Service and Commission reports to support its determinative analysis. For this analysis, the Commission finds that the system increased transparency during the PAEA era if comprehensive and understandable material relating to each rate proceeding was available to stakeholders. Similar to the

¹⁶⁰ Docket Nos. R97-1, R2000-1, R2001-1, R2005-1, and R2006-1. Some cases required further review after additional comments were received or other issues identified. For example, in Docket No. R97-1, the Commission issued a Further Opinion and Recommended Decision, which extended the docket by 136 days. Docket No. R97-1 lasted for a total of 441 days. See Docket No. R97-1, Commission's Opinion and Recommended Decision, on Postal Rate and Fee Changes, 1997, Volumes 1 & 2, May 11, 1998 and Docket No. R97-1, Commission's Opinion and Further Recommended Decision, in Docket No. R97-1, on Postal Rate and Fee Changes, September 24, 1998. In Docket No. R2000-1, the Commission issued a reconsideration order on its initial Opinion and Recommended Decision and, after a request for further consideration, issued a Further Opinion and Recommended Decision, both of which extended the docket by 148 days combined. Docket No. R2000-1 lasted for a total of 454 days.

¹⁶¹ In developing a metric to evaluate material filed under seal, the Commission determined that it would be more meaningful to evaluate whether participants sought additional information. This approach relies on the inference that if the availability of information has increased, participants would seek less additional information. Whereas, analyzing the material filed under seal does not provide insight as to whether the participants in the ratemaking process viewed the material as necessary.

Commission's review of administrative burden *supra*, the Commission attempted to perform a direct comparison of the potential metrics identified in the ANPR¹⁶² between the PRA and PAEA eras but concluded that given the differences in the nature of proceedings and theory of regulation, those comparisons were not probative for the analysis of administrative burden or transparency. Furthermore, the necessary interaction between stakeholders and the Postal Service/Commission is highly subjective.

Therefore, in evaluating transparency, the Commission takes into account perceptions of the availability of comprehensive understandable material relating to each rate proceeding and participants' views of whether such availability has increased. To supplement the Commission's determinative analysis and provide context to participants' views of transparency, the Commission then analyzes motions for additional information during rate proceedings and conducts an analysis of Postal Service and Commission reports.

(i) Qualitative Views on the Increase in Transparency and PRA Era Comparisons

The Commission takes into account comments on the availability of comprehensive understandable material relating to each rate proceeding during the PAEA era. Most commenters conclude that transparency has increased.¹⁶³ Commenters note a reduced need to investigate methodologies when evaluating rates

¹⁶² See Order No. 3673 at 8.

¹⁶³ See, e.g., ANM *et al.* Comments at 21; GCA Comments at 24-25; Postal Service Comments at 122, 138; SMC *et al.* Comments at 4.

and the disclosure of significantly more information.¹⁶⁴ However, several commenters state that transparency has decreased, citing unexplained rate changes. MMA, NAPM, and NPPC Comments at 49-50.

To provide context to these views, the Commission evaluates how often participants sought additional information during price adjustment proceedings and how often information was provided to the public regarding these proceedings, other Postal Service information (such as costs, revenues, service performance, financial results), and the Commission's regulation of the Postal Service. Thus, the following sections discuss participants' use of motions for additional information in ratemaking proceedings and the number and frequency of Postal Service and Commission reports during the PAEA era.

(ii) Supplementary Analyses

The Commission reviews the number of motions for additional information and the number and frequency of Postal Service and Commission reports during PAEA era cases as a supplementary measure of transparency. The Commission considers the availability of material related to rate proceedings by reviewing the total number of requests for additional information (e.g., Motions for Access to Protected Materials or Motions for Issuance of Information Requests). An increase in the volume of comprehensive understandable material related to each rate proceeding would imply that the need for motions for additional information would be minimal. During the PAEA era, there were 9 motions for an issuance of an information request and 1 motion for

¹⁶⁴ ANM *et al.* Comments at 21; PSA Comments at 6. *See also* Postal Service Comments at 122 n.235, 138 (noting that other proceedings such as advisory opinion proceedings or the annual compliance process "have been effective in increasing transparency . . .").

access to protected materials over 10 cases.¹⁶⁵

The Commission also reviews the number and frequency of Postal Service and Commission reports as a measure of transparency during the PAEA era. Under the PAEA, the Postal Service has been required to file annual reports to the Commission related to costs, revenues, rates, service, workshare discounts, and market tests, as well as performance reports and performance plans. 39 U.S.C. § 3652. The Postal Service must file other financial reports pursuant to 39 U.S.C. § 3654. See 39 U.S.C. § 3654. Similarly, the PAEA requires the Commission to file annual reports such as the Report to the President and Congress pursuant to 39 U.S.C. § 3651 and its Annual Compliance Determination (ACD). See 39 U.S.C. §§ 3651 and 3653.

Each year since the PAEA's enactment, the Postal Service filed its ACR, accompanied by a public (and non-public) Cost and Revenue Analysis (CRA) report, and in each year the Commission filed its ACD. The Commission issued its Annual

¹⁶⁵ The Commission reviewed motions filed in 10 rate proceedings. See Docket Nos. R2008-1, R2009-2, R2011-2, R2012-3, R2013-1, R2013-7, R2013-10, R2015-4, R2016-2, and R2017-1. There were only 9 motions for issuance of information requests across the 10 proceedings. See Docket No. R2013-10, Public Representative Motion for Issuance of Information Request, September 30, 2013; Docket No. R2013-10, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Motion for Issuance of Information Request, October 17, 2013; Docket No. R2013-10, Public Representative Motion for Issuance of Information Request, November 8, 2013; Docket No. R2015-4, Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Motion for Issuance of Information Request, January 23, 2015; Docket No. R2015-4, Motion of Alliance of Nonprofit Mailers for Issuance of Chairman's Information Request, January 28, 2015; Docket No. R2015-4, Parcel Shippers Association Motion for Issuance of Information Request, January 30, 2015; Docket No. R2015-4, Motion of National Newspaper Association for Chairman's Information Request, February 3, 2015; Docket No. R2017-1, Public Representative Motion to Request Issuance of Information Request, October 20, 2016; Docket No. R2017-1, Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. Motion for Issuance of Information Request, October 20, 2016. Only 1 motion for access was filed across all 10 proceedings. See Docket No. R2009-2, Motion of Platinum Coalition to Allow its Outside Counsel to Review USPS-R2009-2/NP1 as Filed with the Commission and Motion to Shorten Period for Response, March 10, 2009. In Docket No. R2008-1, although there were zero motions for information requests or for access in the docket, the Commission noted that there were oral requests for access to materials. See Docket No. R2008-1, Order No. 60, Order Establishing Protective Conditions, February 21, 2008.

Report to the President and Congress after each fiscal year ended.¹⁶⁶ Since 2014, the Commission issued reports on the Postal Service's financial results, and the Performance Report and Performance Plan.¹⁶⁷ Beginning in the first quarter of FY 2012, the Postal Service filed quarterly service performance reports on its market dominant products for a total of 20 reports.¹⁶⁸ These reports all provided a wide range of detailed information relevant to the ratemaking system during the PAEA era.

Overall, the Commission finds transparency was increased because the reports provided by the Postal Service and the Commission during the PAEA era provided comprehensive, understandable material regarding rate proceedings.

3. Pricing

After reviewing the ratemaking process in accordance with the goals of Objectives 2 and 6, the Commission turns to the subtopic of pricing. The PAEA was intended to provide the Postal Service with pricing flexibility, while maintaining rates that are just, efficient, and predictable and stable in magnitude. This section considers

¹⁶⁶ See Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2008, December 23, 2008; Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2009, January 8, 2010; Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2010, December 27, 2010; Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2012, January 3, 2013; Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2013, January 9, 2014; Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2014, January 5, 2015; Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2015, January 6, 2016.

¹⁶⁷ See Docket No. ACR2013, Analysis of United States Postal Service Financial Results and 10-K Statement for Fiscal Year 2013, March 18, 2014; Docket No. ACR2014, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2014, April 1, 2015; Docket No. ACR2015, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2015, March 29, 2016; Docket No. ACR2013, Review of Postal Service FY 2013 Performance Report and FY 2014 Performance Plan, July 7, 2014; Docket No. ACR2014, Analysis of the Postal Service's FY 2014 Program Performance Report and FY 2015 Performance Plan, July 7, 2015; Docket No. ACR2015, Analysis of the Postal Service's FY 2015 Annual Performance Report and FY 2016 Performance Plan, May 4, 2016. Prior to 2014, the information in these reports was included in the ACD.

¹⁶⁸ See <https://www.prc.gov/dockets/quarterly-performance>.

whether the system has fulfilled these goals of the PAEA.

In this section, the Commission analyzes the objectives in the following order: Objectives 4, 2, 8, and 1. In reviewing pricing, these objectives express four goals of pricing during the PAEA era: (1) pricing flexibility; and maintaining rates that are (2) predictable and stable in magnitude; (3) just; and (4) efficient.

For each objective, the Commission summarizes relevant comments and analyzes and applies the definitions and the key measurable concepts as outlined in the ANPR and discusses any deviations from the ANPR it makes. Finally, the Commission discusses its overall conclusion that the current ratemaking system has provided the Postal Service pricing flexibility, while maintaining just prices that are predictable and stable in magnitude.

a. Pricing Flexibility

The Commission reviews Objective 4 and whether the system has “allow[ed] the Postal Service pricing flexibility.” 39 U.S.C. § 3622(b)(4). For this analysis, the Commission reviews whether the system allowed for the Postal Service to exercise discretion over prices, the price structure, and the timing of price adjustments for market dominant products, subject to other requirements under the law.

(1) Comments

Most commenters that address pricing flexibility conclude that the current system has allowed the Postal Service pricing flexibility.¹⁶⁹ They characterize the Postal Service’s pricing flexibility as both procedural and substantive.

¹⁶⁹ See, e.g., SIIA Comments at 8; MH and NAAD Comments at 6-7.

Procedural pricing flexibility focuses on the rate-setting process (*e.g.*, no requirements for an on-the-record hearing, more frequent adjustments than under the PRA). Some commenters assert that the current ratemaking system has achieved procedural pricing flexibility because the Postal Service has been able to adjust prices more often and more quickly compared to the cost-of-service rate system under the PRA.¹⁷⁰ MMA, NAPM, and NPPC, and NMA contend that the PAEA provided the Postal Service greater pricing flexibility because there is less time between the notice of rate change and implementation date, and the Postal Service has increased rates annually without having to justify rate increases on the basis of costs.¹⁷¹ Pitney Bowes asserts that the PAEA streamlined the ratemaking process by eliminating the PRA's "requirement for an advance, on-the-record Commission review and approval of price adjustments." Pitney Bowes Comments at 18.

Several commenters contend that the PAEA has allowed the Postal Service substantive pricing flexibility, which focuses on pricing decisions (*e.g.*, the Postal Service's pricing flexibility within each class of mail to set different prices for different products). Pitney Bowes asserts that the Postal Service has substantive pricing flexibility to set different prices for different products. *Id.* at 18. Similarly, DMA *et al.* and ANM *et al.* contend that the current ratemaking structure provides the Postal Service pricing flexibility for market dominant products within each class of mail.¹⁷² Pitney Bowes and GCA observe that the Commission reviews rates for compliance

¹⁷⁰ GCA Comments at 16-18; Pitney Bowes Comments at 18; MMA, NAPM, and NPPC Comments at 27; SMC *et al.* Comments at 4; DMA *et al.* Comments at 3; ABA Comments at 3; NMA Comments at 4.

¹⁷¹ MMA, NAPM, and NPPC Comments at 3; NMA Comments at 4.

¹⁷² DMA *et al.* Comments at 3; ANM *et al.* Comments at 11, 20-21.

after-the-fact and with minimal oversight.¹⁷³ GCA and MMA, NAPM, and NPPC state that the Postal Service has much more control over its prices compared to the PRA.¹⁷⁴

The Postal Service, Public Representative, employee unions, and other commenters contend that the current ratemaking system does not allow the Postal Service pricing flexibility. *See, e.g.,* ARA *et al.* Comments. The Postal Service explains that Congress eliminated the break-even regime and the PRA rate case procedures to provide the Postal Service greater pricing flexibility compared to the PRA. Postal Service Comments at 7, 37, 40. Nevertheless, the Postal Service asserts that it lacks sufficient pricing flexibility because it cannot set rates at levels that ensure its financial stability. *Id.* at 54.

The Postal Service states that the price cap limits its pricing flexibility by preventing it from increasing rates on market dominant products to address declining volumes. *Id.* at 11. Specifically, it contends, “the class-level price cap inhibits the Postal Service’s ability to make rational and efficient pricing decisions and to ensure that each class or type of mail covers its attributable costs.” *Id.* at 131.

Similarly, the Public Representative asserts that the current ratemaking system does not allow the Postal Service pricing flexibility because it cannot use its pricing authority to eliminate massive losses generated by Periodicals. PR Comments at 18, 22, 56. He contends that applying the price cap to the Periodicals class has denied the Postal Service the pricing flexibility the PAEA was intended to achieve. *Id.* at 56.

Employee unions also contend that the current ratemaking system does not allow the Postal Service pricing flexibility. The APWU asserts that because of the Universal Service Obligation (USO), the Postal Service lacks the flexibility of a private firm to

¹⁷³ Pitney Bowes Comments at 18; GCA Comments at 17-18, 26.

¹⁷⁴ GCA Comments at 17-18; MMA, NAPM, and NPPC Comments at 3, 27.

adjust to adverse conditions.¹⁷⁵ It asserts that this issue is caused by the price cap, which limits the Postal Service's flexibility to respond to market forces and ensure fair rates for quality service. APWU Comments at 10. Similarly, NALC contends that the price cap lacks sufficient pricing flexibility because the CPI-U does not adequately capture relevant cost trends affecting delivery services. NALC Comments at 12.

Some commenters assert that the Postal Service has effectively used its pricing flexibility under the PAEA. For example, commenters submit that the Postal Service has effectively used its pricing flexibility to adjust rates for products within a class to align with or cover their attributable costs, to introduce innovations in rate design, and to offer promotions.¹⁷⁶ Other commenters contend that the Postal Service has not adequately used its pricing flexibility under the PAEA. MMA, NAPM, and NPPC assert that the Postal Service has not effectively used its pricing flexibility to maximize efficiency and profitability. MMA, NAPM, and NPPC Comments at 28. ANM *et al.* state that the Postal Service has largely ignored its pricing flexibility because it has implemented few market dominant NSAs and market tests.¹⁷⁷

¹⁷⁵ APWU Comments at 9. Eleven APWU local chapters filed almost identical comments asserting that "[W]ithout a flexible system that allows the Postal Service to respond to demand, the economy, and costs, the Postal Service will be unable to deliver stable postal services." See Comments of Carrie Bieberitz, President, APWU Local 1459, March 15, 2017; Comments of George Collins, President, Mississippi Coast Area, March 17, 2017; Comments of Nannette J. Corley, President, Montgomery County Area, March 20, 2017; Comments of Vito Fallacara, Acting Director, NJI-NDC, March 17, 2017; Comments of Todd Fawcett, President, APWU Greater Northland Area, March 16, 2017; Comments of Mike Landry, President, Central New York Area, March 16, 2017; Comments of Robert F. Oldt, President, March 20, 2017; Comments of Mark Sarcone, Des Moines Area, March 20, 2017; Comments of Philip D. Thomas, President, Omaha Area, March 20, 2017; Comments of VanScyoc, President, Wichita Area, March 20, 2017; Comments of William Whalen, General President, Wilmington Area, March 20, 2017.

¹⁷⁶ See DMA *et al.* Comments at 3; MMA, NAPM, and NPPC Comments at 27-28; NMA Comments at 4.

¹⁷⁷ ANM *et al.* Comments at 57-58. Similarly, ACMA and LSC contend that the Postal Service must take advantage of existing opportunities for growth by, for example, implementing more market dominant NSAs. ACMA Comments at 4; LSC Comments at 2.

(2) Application of Measurement

The Commission analyzes Objective 4 to determine whether the system has “allow[ed] the Postal Service pricing flexibility.” 39 U.S.C. § 3622(b)(4). As set forth in the ANPR, the Commission proposed that “[a] system achieving Objective 4 allows for the Postal Service to exercise its discretion to set prices, the price structure, and the price schedule for market dominant products, subject to other requirements under the law.” Order No. 3673 at 6. The key measureable concept for Objective 4 is pricing flexibility. *Id.*

With regard to the Commission’s definition, the Postal Service asserts that a critical part of its “discretion to set prices” is whether the Postal Service has the ability to set overall rate levels that enable financial stability. Postal Service Comments at 55. The Commission declines to interpret pricing flexibility to require that the Postal Service maintain financial stability, but instead finds that financial stability is appropriately addressed with respect to several other objectives.¹⁷⁸

The Commission adopts the definition and key measureable concept proposed in the ANPR with one minor clarification. The proposed definition used the term “price schedule” to describe one element of pricing flexibility. “Price schedule” in that context could mean either autonomy over the timing of price changes or autonomy over the prices (which combined make up the price schedule). Because the latter is already included in the proposed definition, the Commission replaces “the price schedule” with “the timing of price changes.” As a result, the definition now reads a system achieving Objective 4 allows for the Postal Service to exercise its discretion to set prices, the price structure, and the timing of price changes for market dominant products, subject to other requirements under the law. The actionable verb in Objective 4 is “allow,” which

¹⁷⁸ See section II.C., *infra*; 39 U.S.C. § 3622(b)(1), (5) (“to maximize incentivizes to reduce costs and increase efficiency” and “to assure adequate revenues, including retained earnings, to maintain financial stability”); see *also* GCA Comments at 17.

implies a floor or minimum level of pricing flexibility. As a result, the Commission finds that Objective 4 permits pricing flexibility to be limited as long as the Postal Service has some flexibility to set prices, the price structure, and the timing of price changes.

In the ANPR, the Commission proposed three potential methods for measuring pricing flexibility. The Commission suggested reviewing price adjustment proceedings and ACR dockets that discussed the pricing flexibility exercised by the Postal Service. Order No. 3673 at 6. The Commission also suggested an analysis of the time it takes for the approval of a price adjustment, the number of price categories approved without material alteration, and reviewing discussions of pricing flexibility in other Commission proceedings. *Id.* at 6-7. Additionally, the Commission suggested comparing the Postal Service's pricing flexibility to other systems, such as the pricing flexibility afforded to and/or exercised by foreign posts, utilities, the Postal Service pre-PAEA, and private carriers. *Id.* at 6.

The Commission adopts all but one of the proposed measurement methods outlined in the ANPR. After further consideration, the Commission has determined "comparisons to other systems, such as the pricing flexibility afforded to and/or exercised by foreign posts, utilities . . . and private carriers" are not appropriate because the unique nature of the Postal Service makes it difficult to compare to other entities. See Order No. 3673 at 6. For example, although private carriers may have no legal notice requirements to change rates, competition, operational realities, and customer preferences likely limit private carriers' ability to change rates without providing any notice to customers. Similarly, private carriers may not face a price cap, and instead have their pricing flexibility limited by customer elasticities and competition. As explained above, because Objective 4 requires only a floor or minimum level of pricing flexibility, an appropriate assessment under this objective looks only at pricing flexibility under the PAEA. The Commission notes, however, that a brief discussion of the differences in pricing flexibility between the PRA and PAEA is relevant background to

understanding why Objective 4 was included in the PAEA. See *id.* The Commission describes the differences between the two legal regimes with regard to pricing flexibility in section II.A., *supra*.

The Commission applies the remaining proposed measurement methods to assess whether the system has allowed for pricing flexibility as follows. First, the Commission provides an overview of the pricing flexibility afforded to the Postal Service during the PAEA era with regard to price setting and price structure. In that section, the Commission covers “a review of price adjustment proceedings and Annual Compliance Report (ACR) dockets,” “discussions of pricing flexibility in other Commission proceedings,” and a discussion of the limitations on pricing flexibility (including a summary of the large-scale rate cases that had planned prices that required material alteration).¹⁷⁹ Second, the Commission discusses the extent of the Postal Service’s pricing flexibility during the PAEA era with regard to timing (including an analysis of “the time it takes for the approval of a price adjustment.”). *Id.* at 6. Based on its analysis of price setting and timing, the Commission finds that the system has allowed for the Postal Service to have pricing flexibility during the PAEA era.

(a) Flexibility to Set Prices

The Commission has consistently stated that the PAEA gave the Postal Service broad discretion to set prices for market dominant products.¹⁸⁰ This discretion included the ability to set prices and the price structure, albeit subject to certain limitations including the class-level price cap (39 U.S.C. § 3622(d)). In the remainder of this

¹⁷⁹ Order No. 3673 at 6-7. The ANPR suggested “the number of price categories approved without material alternation” be measured. Because the vast majority of prices were approved in each rate proceeding, the Commission focuses its discussion on situations where prices needed to be amended in the context of the limitations on the Postal Service’s pricing flexibility during the PAEA era.

¹⁸⁰ See, e.g., FY 2015 ACD at 11; Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2014, January 5, 2015, at 22 (FY 2014 Annual Report).

section, the Commission reviews the various ways the system allowed the Postal Service to set prices and the price structure during the PAEA era. The Commission also reviews how that flexibility was qualified during the PAEA era and how that resulted in the Postal Service being required to make material changes to its proposed rates on several occasions.

The primary way the Postal Service exercised flexibility in price setting has been through market dominant rate cases. In the PAEA era, 39 U.S.C. § 3622(d) capped rate adjustments for each mail class at the annual CPI-U. 39 U.S.C. § 3622(d)(1)(A), (2)(A). However, beyond that class-based price cap, the Postal Service had broad discretion to set and adjust prices. As the Commission has previously explained, “[b]elow the class level, the Postal Service has considerable pricing flexibility to adjust or eliminate the prices of particular rate cells as long as such price changes are properly accounted for in the applicable class price cap calculation.”¹⁸¹ The Commission has consistently discussed examples of the Postal Service’s use of pricing flexibility in its ACDs.¹⁸² For example, in Docket No. R2015-4, the Postal Service proposed above-inflation price increases for Media Mail/Library Mail to improve cost coverage. FY 2015 ACD at 68. Similarly, in Docket No. R2011-2, the Postal Service effectively used its pricing flexibility to move Package Services and Standard Mail NFMs/Parcels toward improved cost coverage. FY 2010 ACD at 14, 107-108. During the PAEA era, the Commission ordered the Postal Service to use its intra-class pricing flexibility to reduce the cost coverage shortfall for Standard Mail Flats through above-average price

¹⁸¹ Docket No. R2015-4, Order on Price Adjustments for Special Services Products and Related Mail Classification Changes, March 10, 2015, at 10 (Order No. 2388).

¹⁸² FY 2015 ACD at 76; Docket No. ACR2014, Annual Compliance Determination, March 27, 2015, at 68 (FY 2014 ACD); Docket No. ACR2013, Annual Compliance Determination, March 27, 2014, at 70 (FY 2013 ACD); Docket No. ACR2012, Annual Compliance Determination, May 7, 2013, at 82 (Revised FY 2012 ACD).

increases after the Postal Service failed to do so on its own initiative and the Commission found a violation of 39 U.S.C. § 101(d). FY 2010 ACD at 105-107.

The Postal Service has also used its price setting flexibility to reduce prices and offer promotional pricing programs. For example, the Postal Service reduced select Periodicals prices in Docket No. R2017-1 to incentivize more efficient mail preparation.¹⁸³ With regard to promotional pricing programs, the Postal Service also exercised its pricing flexibility to set prices for market dominant products through incentive pricing programs. For example, during select months in FY 2015, the Postal Service offered an Earned Value Reply Mail Promotion, which provided a per piece rebate on Business Reply Mail and Courtesy Reply Mail returned to the mailer during the promotion period.¹⁸⁴ Depending on whether mailers previously participated in the same promotion, the rebates were either 2 or 3 cents per piece. Order No. 2461 at 3. As another example, during select months in FY 2015 and FY 2016, the Postal Service offered the Advanced and Emerging Technology Promotion. *Id.* at 5. This promotion provided a 2 percent discount on First-Class Mail Presort and Automation Letters, Cards, and Flats that incorporated advanced print technology or an advanced augmented reality experience that allowed the recipient to engage in an interactive experience. *Id.*

Because the Postal Service had the flexibility to set prices for each price cell, the Postal Service also had authority to set the price structure during the PAEA era. This allowed the Postal Service to establish new price categories¹⁸⁵ and remove price

¹⁸³ Docket No. R2017-1, United States Postal Service Notice of Market Dominant Price Adjustment, October 12, 2016, at 30; see also Order No. 3610 at 42-44.

¹⁸⁴ Docket No. R2015-4, Order on First-Class Mail Promotions and Related Mail Classification Changes, April 30, 2015, at 3 (Order No. 2461).

¹⁸⁵ See Docket No. R2014-1, Order No. 1917, Order Granting Classification and Price Changes for Alternate Postage Payment, December 20, 2013, at 6 (approving proposal to add Alternate Postage Payment as a new, permanent price category).

categories.¹⁸⁶ Authority to set the price structure has also allowed the Postal Service to establish and sever relationships between products and price categories through pricing differentials. For example, prior to FY 2013, the Postal Service charged the same price for a stamped First-Class Mail Single-Piece Letter and a metered First-Class Single-Piece Letter.¹⁸⁷ In FY 2013, the Postal Service proposed to set a 1-cent price difference between First-Class Mail stamped (47 cents at the time) and metered (46 cents at the time) letters. *Id.* The Postal Service asserted that the change to the price structure would encourage small businesses to switch from stamps to meters, which it noted would reduce risk of stamp theft and provide operational benefits. *Id.*

As previously acknowledged by the Commission, the Postal Service had additional pricing flexibility through its ability to offer market dominant NSAs during the PAEA era.¹⁸⁸ During the PAEA era, the Postal Service contracted with both domestic mailers and foreign postal operators to offer rates not of general applicability for market dominant products.¹⁸⁹ Market dominant NSAs did not have to comply with the price cap during the PAEA era. They are instead regulated under 39 U.S.C. § 3622(c)(10), which places several conditions on market dominant NSAs, including that they improve the net financial position of the Postal Service or enhance operational functions; that they do

¹⁸⁶ See Order No. 3670 at 13-14 (approving proposal to remove permitting and account maintenance fees).

¹⁸⁷ Metered mail includes letters with postage affixed by meter, information based indicia, permit imprint, or pre-cancelled stamps. Order No. 1890 at 46. Stamped mail includes letters with stamps that have not been cancelled and postal validation imprint indicia. *Id.*

¹⁸⁸ Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2011, December 21, 2011, at 21 (FY 2011 Annual Report).

¹⁸⁹ See, e.g., Docket No. R2016-4, Order No. 3017, Order Approving Additional Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement with Canada Post Corporation, January 12, 2016; Docket Nos. MC2014-21 and R2014-6, Order No. 2097, Order Adding PHI Acquisitions, Inc. Negotiated Service Agreement to the Market Dominant Product List, June 19, 2014.

not cause unreasonable harm to the marketplace; and that they are available on public and reasonable terms to similarly situated mailers. 39 U.S.C. § 3622(c)(10).

Although the Postal Service had broad authority to set prices and the price structure during the PAEA era, this authority was not without limitation. As mentioned above, the PAEA contains several specific provisions that limit the Postal Service's broad price setting authority. These provisions include the class-level price cap (39 U.S.C. § 3622(d)), workshare discount requirements (39 U.S.C. § 3622(e)), and revenue ceilings for certain preferred mail categories (39 U.S.C. § 3626). During PAEA era rate cases, the Commission reviewed the Postal Service's prices for consistency with the statutory and regulatory requirements that limited the Postal Service's pricing flexibility. When prices proposed by the Postal Service were inconsistent with statutory or regulatory requirements, or filings lacked the information necessary to make a determination on consistency, the Postal Service was required to file the information needed to show legal compliance and/or amend its proposed prices.

As described in section II.B.2.b.(a)(i), *supra*, there were eight non-exigent large-scale price adjustment proceedings during the PAEA era. For three of these proceedings, the Commission found that the proposed price adjustments were consistent with applicable laws and did not require the Postal Service to amend its planned prices or provide further information to demonstrate its planned prices were consistent with statutory requirements.¹⁹⁰ In the five other cases, the Commission found some prices inconsistent with statutory requirements or was unable to make a determination based on the information provided. In those cases, the Commission

¹⁹⁰ See Docket No. R2011-2, Order No. 675, Order Revising Postal Service Market Dominant Price Adjustments, February 16, 2011; Order No. 987; Order No. 3610; Order No. 3670. Although not requiring the prices to be altered, Docket No. R2017-1 presented unique issues, which are noted in section II.B.2.b.(2)(a)(i), *supra*.

approved the Postal Service's planned prices, except for those in question.¹⁹¹ In most cases, it was a single price or handful of prices that were found inconsistent with statutory or regulatory requirements. See *id.* For the prices in question, the Postal Service later demonstrated consistency with applicable law and/or amended its planned prices, which the Commission approved once it determined all planned prices were consistent with statutory and regulatory requirements.¹⁹²

As demonstrated by this section, the system afforded the Postal Service substantial discretion to set prices and the price structure during the PAEA era as prescribed by statutory and regulatory requirements.

(b) Flexibility with Timing

As clarified with regard to the definition above, the Commission determines that pricing flexibility also contains a timing component. During the PAEA era, the Postal Service had authority to make the majority of decisions with regard to the timing of price adjustments, albeit subject to several statutory conditions. The Commission identifies three elements of timing that relate to pricing flexibility and discusses each briefly below.

¹⁹¹ See Order No. 66 at 32-37 (workshare discount for applying a barcode to certain Standard Mail letters); Order No. 191 at 73 (confirm service annual fees for mailing agents); Order No. 1541 at 81 (Standard Mail Flats prices); Order No. 1890 at 83-84 (Standard Mail nonprofit discounts); see Docket No. R2013-10, Notice of Errata, November 21, 2013; Docket No. R2015-4, Order No. 2378, Order on Price Adjustments for Standard Mail, Periodicals, and Package Services Products, March 6, 2015, at 2-3 (Standard Mail, Periodicals, and Package Services); See Docket No. R2015-4, Order No. 2398, Order on Amended Price Adjustments for Standard Mail, Periodicals, and Package Services Products, March 18, 2015 (Standard Mail, Periodicals, and Package Services).

¹⁹² See Docket No. R2008-1, Order No. 69, Review of Postal Service Amended Notice of Market Dominant Price Adjustment, April 9, 2008; Docket No. R2009-2, Order No. 201, Order Approving Revisions in Amended Notice of Market Dominant Price Adjustment, April 9, 2009; Docket No. R2013-1, Order No. 1573, Order on Standard Mail Rate Adjustments and Related Mail Classification Changes, December 11, 2012; Docket No. R2013-10, Order No. 1902, Order Approving Amendments to Notice of Market Dominant Price Adjustment, December 11, 2013; Order No. 2472. In Docket No. R2013-10, the Commission also identified issues with the Postal Service's implementation of new Full Service Intelligent Mail barcode (IMb) requirements for First-Class Mail, Standard Mail, and Periodicals prices. Order No. 1890 at 29-37. The Postal Service deferred implementing new IMb requirements.

The first element of timing is the ability to decide when price adjustments would go into effect. During the PAEA era, the Postal Service had flexibility to decide when prices would go into effect. The PAEA did require the Postal Service to plan its price adjustments in advance thereby limiting (in a relatively minor way) this flexibility. As described in more detail in section II.B.2.a.(2)(a), *supra*, the PAEA required the Postal Service to establish a schedule of future rate changes. 39 U.S.C. § 3622(d)(1)(B). The PAEA also required that the Postal Service provide notice at least 45 days prior to the planned implementation of any price adjustment to allow for Commission review. 39 U.S.C. § 3622(d)(1)(C).

The second element of timing flexibility is the ability to decide the frequency of price adjustments. During the PAEA era, the Postal Service's ability to determine the frequency of price adjustments was not limited by the PAEA. The Commission's regulations supported the use of such flexibility by providing for the price cap to account for price adjustments both less than 1 year apart and more than 1 year apart (39 C.F.R. § 3010.26(b),(c)) and allowing for *de minimis* rate increases (39 C.F.R. § 3010.30), among other flexibilities. Although the Postal Service's ability to decide the frequency of price adjustments was not limited by the PAEA, it was limited by practical realities, including the availability of CPI-U price cap authority and the customers' tolerance and preferences.

The third element of timing flexibility is "the time it takes for the approval of a price adjustment." Order No. 3673 at 6. As discussed in section II.B.2.b.(2)(a)(i), *supra*, the duration of review during the PAEA era was varied. Large-scale price adjustments, excluding exigent cases, lasted an average of 62 days, while small-scale price adjustments lasted an average of 37 days. Longer review periods were due to deficiencies in the Postal Service's filings that required corrections to resolve the proceedings. Those deficiencies most frequently were due to inconsistencies with statutory requirements and are described with regard to material alterations to proposed

prices in the preceding discussion about the Postal Service's price setting flexibility, *supra*. The PAEA also required that the Postal Service provide notice at least 45 days prior to the planned implementation of any price adjustment to allow for Commission review. 39 U.S.C. § 3622 (d)(1)(C). As discussed in section II.B.2.a.(2)(b), *supra*, the Postal Service provided notice well in advance of the 45-day minimum.

As demonstrated by a review of the three elements of timing flexibility, although the time it took for approval of proposed prices varied, the PAEA generally provided the Postal Service flexibility with regard to the timing and frequency of price adjustments subject to statutory limitations.

b. Predictability and Stability (Magnitude)

As set forth in the ANPR and discussed in section II.B.2.a., *supra*, Objective 2 contains timing and magnitude components to determine whether the system has fostered rates "that are capable of being consistently forecast . . . and that do not include sudden or extreme fluctuations." Order No. 3673 at 5. In reviewing the system with respect to pricing, the Commission reviews the magnitude component of Objective 2 to determine whether the system resulted in price adjustments of a predictable and stable magnitude during the PAEA era.

(1) Comments

Most comments on Objective 2 conclude that the system has created predictable and stable rates. Several commenters note that the CPI-U price cap creates predictability and stability in rates.¹⁹³ Specifically, GCA states that because the current

¹⁹³ AF&PA Comments at 6; DMA *et al.* Comments at 2; GCA Comments at 12; MMA, NAPM, and NPPC Comments at 1-2; SMC *et al.* Comments at 6, 9; ANM *et al.* Comments at 16; NNA Comments at 11-12; SIIA Comments at 6; ABA Comments at 3; AA Comments; ACMA Comments at 3; ADRFCO *et al.* Comments at 4, 9; eBay Comments at 7; LSC Comments at 2; March 20, 2017 EMA Comments at 18; NMA Comments at 5; Marine Toys For Tots Comments; FFP Comments.

rate of inflation and the 12-month moving average are easily available to the mailing community, mailers are able to predict class-level price increases. GCA Comments at 12. In addition, MH and NAAD state that because calculation of the Postal Service's rate authority under the current rate-setting system is neither complicated nor mathematically difficult, it is easy to determine the maximum rate increase at any given time. MH and NAAD Comments at 4. However, MH and NAAD also state that because the Postal Service's pricing authority is linked to CPI-U, the predictability and stability of the current system is likewise linked to the predictability and stability of CPI-U. *Id.* Additionally, several commenters state that the CPI-U price cap protects against unaffordable price increases.¹⁹⁴

Some commenters address the application of the CPI-U price cap. Several commenters state that the current price cap regulations have created predictability and stability at the class-level.¹⁹⁵ Several commenters also note that rates within classes have been generally less predictable and less stable.¹⁹⁶

Several commenters discuss the effect the exigent surcharge had on pricing predictability and stability. MMA, NAPM, and NPPC, PSA, and NMA all state that the current ratemaking system, with the exception of the period during which the exigent surcharge was in effect, created predictability and stability in rates.¹⁹⁷ In addition, DMA *et al.* note that the Postal Service's request for an exigent price increase and the

¹⁹⁴ ALA Comments at 2 ("Above-inflation increases in the postal rates charged for market dominant products would hamper the Lung Association's ability to fight lung disease."); ADRFCO *et al.* Comments at 2-3 ("Knowing that postage rates are regulated using the Consumer Price Index (CPI) gives us peace of mind."); ANM *et al.* Comments at 20 ("The CPI cap directly advances most of the objectives of Section 3622(b). . . . It creates predictability and stability in rates (Objective 2) by limiting annual increases and tying the amount of those increases to a publicly available index. . . .").

¹⁹⁵ See, e.g., MMA, NAPM, and NPPC Comments at 22; SIIA Comments at 6; ANM *et al.* Comments at 77; GCA Comments at 12.

¹⁹⁶ See, e.g., MMA, NAPM, and NPPC Comments at 23; SIIA Comments at 6.

¹⁹⁷ MMA, NAPM, and NPPC Comments at 22-23; PSA Comments at 4; and NMA Comments at 5.

corresponding sunset of the exigent price increase resulted in the inability of some mailers to confidently predict what their postal rates would be. *DMA et al.* Comments at 2. However, *DMA et al.* state that the exigent price adjustments are a necessary safety valve under the CPI-U price cap system. *Id.*

(2) Application of Measurement

The Commission analyzes the magnitude component of Objective 2, which looks to whether the system has “creat[ed] predictability and stability in rates.” 39 U.S.C. § 3622(b)(2). As explained in section II.B.2.a.(2), *supra*, a system achieving Objective 2 fosters prices for all market dominant products that with regard to both timing and magnitude are capable of being consistently forecast and do not include sudden or extreme fluctuations.¹⁹⁸ In section II.B.2.a.(2), *supra*, the Commission finds the two key measurable concepts underlying Objective 2 are timing and magnitude. This section focuses solely on magnitude.

As explained in detail in section II.B.2.a.(2), *supra*, the Commission adopts the definition in the ANPR with minor modifications. This section focuses on whether the magnitude of price changes have been predictable and stable during the PAEA era and examines whether the magnitude of price changes have been “capable of being consistently forecast” or included “sudden or extreme fluctuations.” Order No. 3673 at 5.

In the ANPR, the Commission also proposed two potential methods for measuring the magnitude of price changes with respect to Objective 2. The

¹⁹⁸ See also Order No. 3673 at 5. The Postal Service is the only commenter that addresses the Commission’s preliminary definition for Objective 2. The Postal Service states that stable rates should not include “permanently or persistently below cost rates.” Postal Service Comments at 45-46 n.67. The Commission finds non-compensatory rates are more appropriately addressed with respect to pricing efficiency under Objective 1 and in the reasonable prong of its Objective 8 analysis. See sections II.B.3.d. and II.C.4., *infra*.

Commission suggested “measur[ing] average price increases over time and compar[ing] them to objective measures, such as [CPI-U].” *Id.* The Commission also suggested “evaluat[ing] the number of price categories that deviate significantly from percentage changes in objective measures, such as the CPI-U or the average price adjustment for the class or product.” *Id.*

The Commission adopts the proposed magnitude-related measurement methods from the ANPR with one modification. In the ANPR, the Commission suggested an evaluation of “the number of price categories that deviate significantly from percentage changes in objective measures.” *Id.* After further consideration, the Commission determines that for the purpose of this review a more general perspective provides a better review of the PAEA era, and as a result, declines to individually analyze the magnitude of each price change for each price category during the PAEA era. Although it does not look at price categories specifically, the Commission discusses deviations from the objective measure that occurred during the PAEA era in its analysis below.

The Commission applies the proposed measurement methods to assess whether the system created predictability and stability with regard to the magnitude of price changes as follows. First, the Commission discusses whether price changes are subject to a limitation in magnitude and ultimately concludes that a system must include a limitation that is widely understood due to available information in order for the magnitude of price changes to be considered predictable and stable. This is consistent with Commission precedent during the PAEA era, which regularly linked Objective 2 to the existence of an annual rate limitation.¹⁹⁹ Second, the Commission measures “average price increases over time and compare[s] them to objective measures, such

¹⁹⁹ 2011 701 Report at 28; Docket No. MC2015-8R, Order Resolving Issues on Remand, October 31, 2016, at 13 (Order No. 3597); Docket No. R2013-10R, Order Resolving Issues on Remand, January 22, 2016, at 14 (Order No. 3047); Order No. 1890 at 17.

as [CPI-U].” Order No. 3673 at 5. Third, the Commission discusses deviations from the objective measure that occurred during the PAEA era.

As explained in section II.B.2.a.(2), *supra*, the Commission also looks to qualitative commenter views to inform its assessment. These comments are particularly informative with regard to Objective 2 because Objective 2 focuses on mailers’ ability to “consistently forecast” the magnitude of price changes. *See id.* Based on its analysis, as further informed by comments, the Commission concludes that the system created predictability and stability with regard to the magnitude of price changes during the PAEA era.

(a) Limitations on Price Adjustments

As a measure of whether the system has achieved price adjustments of a predictable and stable magnitude, the Commission first reviews the limitations on price adjustments under the system. As a threshold matter, in order for a system to create predictable and stable rates, the ratemaking system must have a mechanism that limits the magnitude of price adjustments and is sufficiently transparent to allow for mailers to understand how the limitation mechanism works.

As described in section II.A.1.b., *supra*, it was difficult for mailers to predict the magnitude of price adjustments under the PRA. The PAEA included the CPI-U class-level price cap as a specific response to mailer concerns regarding the predictability and stability of price adjustments. During the PAEA era, generally speaking, the average price adjustment for each class of market dominant mail could not exceed the percent change in CPI-U over the most recent 12-month period. 39 U.S.C. §§ 3622(d)(1)(A) and (d)(2)(A). As a result, the Commission finds that the system had a mechanism that limited the magnitude of price adjustments during the PAEA era.

Although the PAEA limited the magnitude of price adjustments through the price cap, it did not require the Postal Service to use all of its available rate adjustment authority and permitted the Postal Service to “bank” unused price adjustment authority and use it in future price adjustments. 39 U.S.C. § 3622(d)(2)(C). The PAEA limited the amount of unused price adjustment authority that the Postal Service could use to 2 percentage points per year and provided that unused price adjustment authority lapsed 5 years after such authority accrued.²⁰⁰

The Commission’s regulations contain procedures for determining the Postal Service’s price adjustment authority.²⁰¹ During the PAEA era, the Commission posted monthly updates regarding the Postal Service’s available CPI-U price adjustment authority.²⁰² These monthly updates also provided the Postal Service’s unused price adjustment authority for each class of mail and continually informed the public and mailers of the magnitude of a potential price adjustment. *See id.*

As discussed in more detail in the Comment section above, commenters generally agree that the limitation itself and its ability to be understood were fundamental to predictability and stability in the magnitude of price adjustments during the PAEA era. For example, GCA states that because information related to the Postal

²⁰⁰ 39 U.S.C. § 3622(d)(2)(C)(ii),(iii)(IV). The Commission previously found that its rules, which require that the Postal Service choose whether it will generate unused rate adjustment authority when it files a request to decrease prices, provides predictability for mailers by informing them when unused rate adjustment authority will be generated and allows them to comment on the effects of the proposed price decrease. Docket No. RM2014-3, Order No. 2086, Order Adopting Final Rules on the Treatment of Rate Incentives and De Minimis Rate Increases for Price Cap Purposes, June 3, 2014, at 6.

²⁰¹ See 39 C.F.R. part 3010, subpart C. The Commission has repeatedly stated that the rules for determining the maximum rate adjustments carry out the intent of Congress with respect to the price cap: “to protect mailers by providing predictable and stable rates that at the class level do not rise above the annual rate of inflation.” Order No. 3597 at 10; see e.g., Order No. 3047 at 14; Docket No. R2013-10R, Order No. 3441, Order Resolving Motion for Reconsideration of Commission Order No. 3047, July 20, 2016, at 17; Order No. 547 at 11.

²⁰² See 12-Month Average Change in CPI-U, (last accessed November 21, 2017), available at <https://www.prc.gov/sites/default/files/CPI%20091417.pdf>.

Service's price adjustment authority is easily available to the mailing community, mailers are able to predict class-level price increases. GCA Comments at 12. Similarly, MH and NAAD state that because calculation of the Postal Service's rate authority under the current system is neither complicated nor mathematically difficult, it is easy to determine the maximum rate increase at any given time. MH and NAAD Comments at 4.

In summary, the ratemaking system limited the magnitude of price adjustments through the application of the price cap during the PAEA era. The Commission's regulations contained detailed procedures concerning the operation of the price cap, and the Commission posted detailed information about the Postal Service's maximum available price adjustment authority on its website on a monthly basis. In addition, as summarized above, several commenters note that the CPI-U price cap created pricing predictability and stability during the PAEA era. Therefore, the Commission finds that the ratemaking system had a mechanism that limited the magnitude of price adjustments and allowed for mailers to understand the maximum rate adjustment authority available to the Postal Service during the PAEA era.

(b) Review of Price Adjustments Compared to Objective Measures

Next, as a measure of whether the system has achieved price adjustments of a predictable and stable magnitude, the Commission reviews "average price increases over time and compare[s] them to objective measures." Order No. 3673 at 5. The Commission determines that the ratemaking system creates pricing predictability and stability when price adjustments fall near the rate of change expected by objective measures. The Commission finds that the appropriate objective measure is the system's applicable mechanism that limits the magnitude of price adjustments. This is the appropriate objective measure because the mechanism sets the expectation of the magnitude of price increases. For purposes of this review, that objective measure is CPI-U.

Table II-3 shows the percent price increase for each class of market dominant mail for each large-scale price adjustment under the PAEA as compared to the annual change in CPI-U. The Commission makes the comparison at the class-level because the price cap was applied at the class-level during the PAEA era.

**Table II-3
Average Class-Level Price Adjustments**

Docket No.	R2008-1	R2009-2	R2011-2	R2012-3	R2013-1	R2013-10	R2015-4	R2017-1	Total Adjustment under PAEA
First-Class Mail	2.886%	3.770%	1.741%	2.133%	2.570%	1.587%	1.956%	0.778%	17.421%
Standard Mail	2.875%	3.759%	1.739%	2.041%	2.569%	1.642%	1.926%	0.900%	17.451%
Periodicals	2.724%	3.961%	1.741%	2.133%	2.549%	1.664%	1.966%	0.832%	17.570%
Package Services	2.875%	3.800%	1.740%	2.115%	2.567%	1.453%	1.787%	0.973%	17.310%
Special Services	2.848%	3.825%	1.739%	-0.699%	2.850%	2.500%	0.255%	2.514%	15.832%
Annual CPI-U Limitation at Filing	2.900%	3.800%	1.741%	2.426%	2.570%	1.696%	1.685%	0.804%	17.622%

Source: Library Reference PRC-LR-RM2017-3/1

As Table II-3 shows, in each docket during the PAEA era, most classes received average total price increases relatively close to the annual CPI-U limitation.²⁰³ For example in Docket No. R2008-1, the annual CPI-U limitation was 2.900 percent, and the average class-level increases in that docket ranged from 2.724 percent to 2.886 percent. In general, in every rate docket during the PAEA era, the price adjustments for the First-Class Mail, Standard Mail, Periodicals, and Package Services classes were very close to the annual change in CPI-U. Only the Special Services class showed substantial variation in some dockets during the PAEA era. Because such variation was

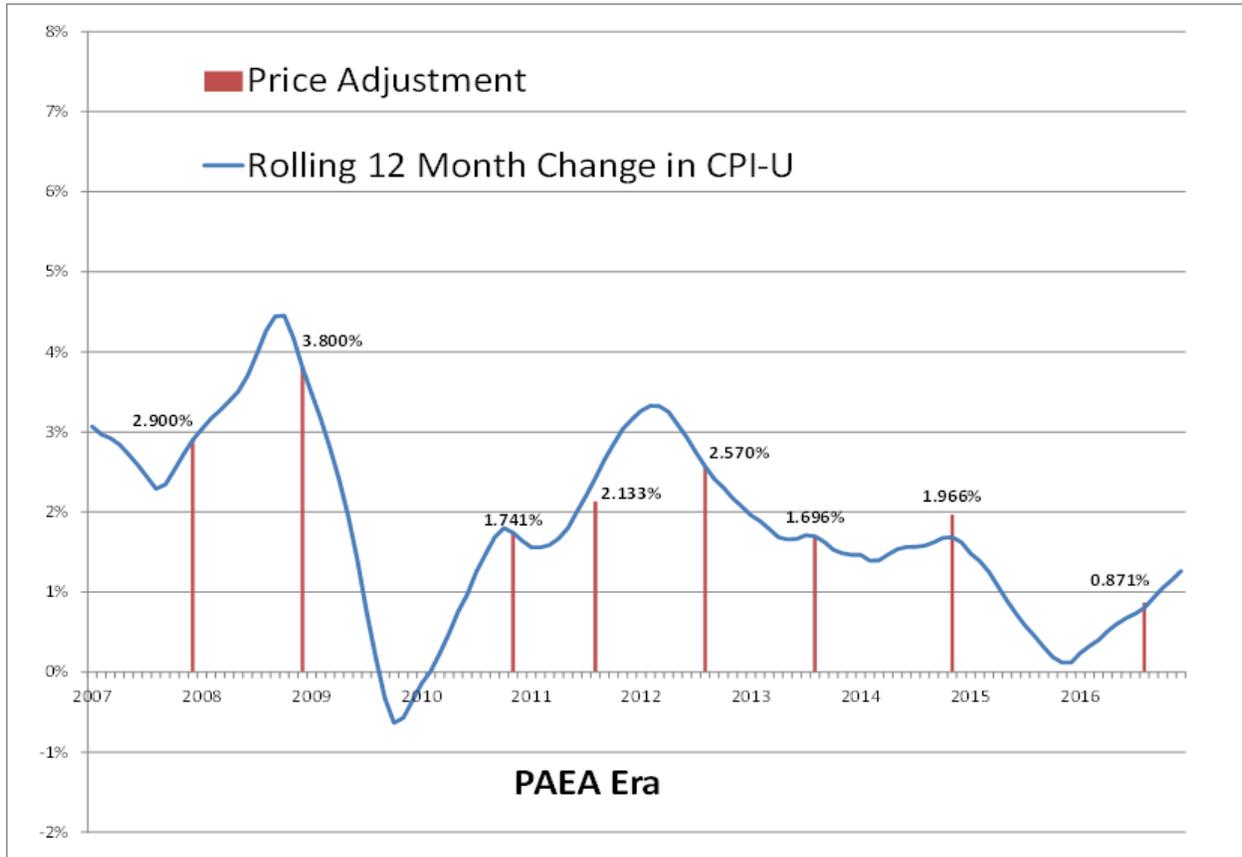
²⁰³ This reflects the schedule the Postal Service filed with the Commission which states “[t]he Postal Service expects that . . . it will implement price changes for all of the market-dominant classes in January of such year, with the price increase for each market-dominant class equal, on average, to the applicable price cap limitation in that year.” United States Postal Service Filing of Updated Schedule of Regular and Predictable Price Changes, October 18, 2011, at 3.

primarily due to the unique nature of the Special Services class,²⁰⁴ the Commission finds that a comparison of the annual change in CPI-U and the average price adjustment at the class-level indicates that the magnitude of rate adjustments were predictable and stable during the PAEA era. In addition, no commenters express concern about the Special Service variations.

Figure II-3 below compares the Postal Service's total CPI-U price adjustment authority in each large-scale market dominant rate case with the average price adjustment for all mail classes. As Figure II-3 indicates, as a whole, the Postal Service has adjusted prices that closely tracked its total CPI-U price adjustment authority.

²⁰⁴ The variation in Special Services was due in part of the unique nature of the products in that class, which are not traditional mail products. For example, the Special Services class includes Address List Services, Change-of-Address Credit Card Authentication, International Business Reply Mail Service, Money Orders, and Post Office Box Service. In Docket No. R2012-3, the Postal Service proposed an average price decrease of 0.699 percent, citing that the primary reasons for the decrease were the elimination of Confirm service and the removal of charges for electronic Delivery Confirmation for First-Class Mail Parcels and Package Services. Order No. 987 at 47. In Docket No. R2015-4, the Postal Service's planned price increase for Special Services was 0.255 percent because the Postal Service did not change rates for five Special Services products and consolidated or eliminated some Special Services offerings. Order No. 2388 at 6-7. These below average price adjustments resulted in unused price adjustment authority for Special Services, which the Postal Service applied in later price adjustments by proposing above-average price increases. Order No. 1890 at 100; Order No. 3670 at 8. As discussed with regard to the limitations on price adjustments, *supra*, the use of unused price adjustment authority did not undermine predictability and stability because the maximum price adjustment authority was reported, widely available, and updated on a monthly basis during the PAEA era.

**Figure II-3
Total CPI-U Authority and Price Adjustments under the Current
Ratemaking System²⁰⁵**



Source: Library Reference PRC-LR-RM2017-3/1

²⁰⁵ In Figure II-3, the red lines represent the filing of a “Price Adjustment” with the percentage increase indicated by the height of the line and denoted by the text. Pursuant to the Commission’s regulations, the Postal Service’s pricing authority is capped by an annual limitation calculated using the CPI-U inflation index. The Postal Service’s pricing authority is limited by the “annual limitation” as calculated when the Postal Service files a Notice of Market Dominant Price Adjustment. In addition to its annual limitation pricing authority, the Postal Service generates interim pricing authority when it files price adjustments more than 12 months apart. In Table II-3 above, the row “CPI-U Annual Limitation at Filing” contains this annual limitation for each of these “Price Adjustment” filings. The numbers associated with each “Price Adjustment” in Figure II-3 represent the combination of the annual limitation and the interim pricing authority that the Postal Service elected to use for each “Price Adjustment” and these results differ from Table II-3 for Docket Nos. R2017-1, R2015-4, and R2012-3. For example, in Docket No. R2015-4, the annual limitation was 1.685 percent, which is shown in Table II-3. The interim authority was 0.281 percent for a total authority of 1.966 percent, which is shown in Figure II-3.

In summary, the Commission finds that during the PAEA era, CPI-U was an accurate predictor of the magnitude of price adjustments at the class-level and as a whole. Therefore, the Commission concludes that price adjustments fell near the rate of change predicted by the comparable objective measure of CPI-U during the PAEA era.

(c) Deviations of Price Adjustments

The Commission now turns to whether deviations that occurred during the PAEA era prevented the system from achieving a predictable and stable magnitude of price adjustments. Deviations occurred when the price adjustment differed from the objective measure of the annual change in CPI-U. In the prior sections, the Commission identified two types of deviations: (1) when the Postal Service had unused rate authority available; and (2) when the annual change in CPI-U differed substantially from the average change in prices for a class in a large-scale rate case. In cases where the Postal Service applied its unused rate adjustment authority, the price adjustment remained predictable and stable because the Postal Service's total available pricing authority was updated monthly and available on the Commission's website. See section II.B.3.b.(2)(a), *supra*. The Commission also explained that the few occasions where the annual change in CPI-U differed substantially from the average change in prices for Special Services were due to unique features of the Special Services class and the use of unused price adjustment authority. See section II.B.3.b.(2)(b), *supra*.

The Commission now discusses two other deviations that occurred during the PAEA era. First, the Commission addresses deviations that occurred below the class-level when individual price categories fell above or below the class average. Second, the Commission discusses the exigent surcharge that was applied to all market dominant rates pursuant to 39 U.S.C. § 3622(d)(1)(E) for just over 2 years. As the Commission explains in more detail below, even when a price adjustment differs

substantially from the expected objective measure, the changes may still be predictable and stable.

Several commenters note that because the price cap is applied at the class-level, rates are less predictable and stable below the class-level.²⁰⁶ However, the system of ratemaking allows deviations from the annual change in CPI-U below the class-level (Objective 4) and also explicitly permits the Postal Service to “mak[e] changes of unequal magnitude within, between, or among classes of mail” (Objective 8).²⁰⁷

There are many reasons why a price change may differ from the annual change in CPI-U at the class-level and remain predictable and stable. For example, the Commission has directed the Postal Service to implement above-average price adjustments for some products that have low cost coverage. In the FY 2010 ACD, the Commission found that the Standard Flats prices did not comply with 39 U.S.C. § 101(d) and directed the Postal Service to implement above-average price increases for the product. FY 2010 ACD at 81. In addition, in the FY 2015 ACD, the Commission concluded that the Media Mail/Library Mail product failed to cover its costs for several consecutive years and directed the Postal Service to “improve cost coverage through above-average price increases in future Market Dominant price adjustments. . . .” See FY 2015 ACD at 67-68.

Ultimately, because Objective 2 must be applied in conjunction with the other objectives, the Commission declines to undertake the highly fact and situation specific inquiry that would be required to analyze the predictability and stability of the magnitude of each price change for each price category below the class-level during the PAEA era for purposes of its review. As discussed in detail in section II.B.3.c.(2), *infra*, the PAEA provided several avenues for mailers to seek recourse on a case-by-case basis for

²⁰⁶ See, e.g., MMA, NAPM, and NPPC Comments at 23; SIIA Comments at 6.

²⁰⁷ 39 U.S.C. § 3622(b)(4), (8). See also sections II.B.3.a., *supra* and II.B.3.c., *infra*.

rates inconsistent with statutory requirements both before and after implementation of those rates.

As several commenters mention,²⁰⁸ the PAEA contains an exception to the price cap. Under 39 U.S.C. § 3622(d)(1)(E), rates may be increased by an amount greater than what is allowable under the price cap if the Commission determines that such an increase is “due to either extraordinary or exceptional circumstances” and such adjustment is “reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” In Docket No. R2013-11, the Postal Service requested an exigent rate increase due to contribution losses associated with volume declines as a result of the Great Recession. For over 2 years, the Commission allowed the Postal Service to add a temporary exigent surcharge on all market dominant products pursuant to 39 U.S.C. § 3622(d)(1)(E). Order No. 1926 at 1.

Although the exigent surcharge affected pricing predictability and stability, its effects were mitigated by safeguards put in place by the PAEA. Further, the specific facts surrounding the sole exigent rate increase of the PAEA era show that the change was more predictable and stable than the PAEA required. 39 U.S.C. § 3622(d)(1)(E) requires that the Postal Service provide at least 90 days advanced notice when requesting an exigent price adjustment. In the case of the exigent price increase that was implemented during the PAEA era, the Postal Service provided 4 months’ notice. Docket No. R2013-11 Exigent Request at 2. Further, the Postal Service’s request in that docket directly resulted from several years of litigation resulting from a prior exigent

²⁰⁸ See, e.g., MMA, NAPM, and NPPC Comments at 22-23; PSA Comments at 4; NMA Comments at 5; DMA *et al.* Comments at 2.

request in FY 2010.²⁰⁹ Both the FY 2010 and FY 2013 requests for an exigent price increase provided detailed information regarding the amount requested.²¹⁰ Given the long history of the case generally and the finding by the Commission in FY 2010 that the Great Recession constituted an extraordinary or exceptional circumstance, the magnitude of exigent surcharge was predictable and not a sudden fluctuation.

Further, although the exigent surcharge did increase market dominant rates above the CPI-U price cap for over 2 years, the Commission finds the increase did not constitute an extreme fluctuation in rates. Additional contribution from an exigent rate increase is limited to the amount the Postal Service is able to show is due to the exigent circumstance and the amount “reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.” 39 U.S.C. § 3622(d)(1)(E). In the case of the exigent price increase during the PAEA era, the Commission granted the Postal Service’s request only in part, did not allow rates to increase permanently, and required removal of the exigent surcharge when the Postal Service had collected the allowable amount of contribution.²¹¹

²⁰⁹ On July 6, 2010, the Postal Service filed its first exigent request, which was also premised on volume loss due to the Great Recession. See Docket No. R2010-4, Exigent Request of the United States Postal Service, July 6, 2010 (Docket No. R2010-4 Exigent Request). The Commission found that although the Great Recession and its impact on postal volumes constituted an “extraordinary or exceptional circumstance,” the Postal Service failed to show that the proposed rate adjustments were “due to” that circumstance and denied the request. Order No. 547 at 50, 64. The case was then litigated before the D.C. Circuit. *United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263 (D.C. Cir. 2011). The court upheld the Commission’s denial of the Postal Service’s request, remanding the case for the Commission to explain “how closely the amount of the adjustments must match the amount of the revenue loss. . . .” *Id.* at 1268.

²¹⁰ See Docket No. R2013-11 Exigent Request; Docket No. R2010-4 Exigent Request.

²¹¹ See Order No. 1926 at 180-85; Docket No. R2013-11, Notice of the United States Postal Service of Removal of the Exigent Surcharge, February 25, 2016.

In summary, deviations from the objective measure may occur for a variety of reasons and as a result are most appropriately analyzed on a case-by-case basis. The Commission finds that during the PAEA era there has not been evidence of deviations that would rise to the level of being unpredictable or unstable.

c. Just Schedule for Rates and Classifications

Next, the Commission reviews Objective 8 and whether the system has established and maintained “a just and reasonable schedule for rates and classifications.”²¹² Objective 8 has two separate prongs (*i.e.*, just and reasonable); both of which must be achieved. In this section, the Commission reviews whether the system maintained just rates by reviewing whether “the amount charged for each service is [not] excessive to the mailer” Order No. 3673 at 9. In section II.C.4., *infra*, the Commission reviews whether the system maintained reasonable rates.²¹³

(1) Comments

Most commenters addressing Objective 8 focus on whether rates have been reasonable during the PAEA era. Those comments are addressed in section II.C.4., *infra*.

²¹² 39 U.S.C. § 3622(b)(8). Objective 8 in its entirety reads: “To establish and maintain a just and reasonable schedule for rates and classifications, however, the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.” *Id.*

²¹³ In this Order, the Commission finds that for rates to be “just and reasonable” they must be neither excessive to the mailer nor threaten the financial integrity of the Postal Service. This definition is consistent with the interpretation of this phrase in other regulatory contexts, which have relied on a “basic principle, well established by decades of judicial review of agency determinations of ‘just and reasonable’ rates: an agency may issue, and courts are without authority to invalidate, rate orders that fall within a ‘zone of reasonableness,’ where rates are neither ‘less than compensatory’ nor ‘excessive.’” *Farmers Union Central Exchange Inc. v. Federal Energy Regulatory Commission*, 734 F.2d 1486, 1502 (D.C. Cir. 1984).

MH and NAAD conclude that the system has achieved the goal of establishing and maintaining a just and reasonable schedule for rate and classifications. MH and NAAD Comments at 9. ANM *et al.* also state that the CPI-U based price cap furthers the goal of establishing and maintaining just and reasonable rates. ANM *et al.* Comments at 21. They explain that the price cap system protects mailers from excessive cost increases. *Id.* at 72-73.

ANM *et al.* also assert the current system for regulating workshare discounts does not fully satisfy the goal of establishing and maintaining a just and reasonable schedule for rate classifications. *Id.* at 80. Similarly, Pitney Bowes explains that workshare discounts that fail to pass through the full value of the work performed by mailers and mail service providers are unjust and unreasonable because they are a form of unfair competition. Pitney Bowes Comments at 3.

Using the Commission's suggested metric to review excessive price increases for the just prong, MMA, NAPM, and NPPC state that the Postal Service has not charged just rates for several products, citing high cost coverages for these products relative to other products. MMA, NAPM, and NPPC Comments at 54, 55. MMA, NAPM, and NPPC also state that the Commission has promoted pricing flexibility at the expense of justness. *Id.* at 57.

(2) Application of Measurement

The Commission analyzes Objective 8, which looks to whether the system has allowed the Postal Service to “establish and maintain a just and reasonable schedule for rates and classifications.” 39 U.S.C. § 3622(b)(8). Objective 8 clarifies that it “shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.” *Id.*

The Commission separates the analysis of the two prongs of Objective 8 under separate topics. In this section, the Commission analyzes the just prong of Objective 8.

In section II.C.4., *infra*, the Commission analyzes the reasonable prong. In the Commission's analysis the just prong is relevant to the mailers while the reasonable prong relates to the Postal Service. Although the analysis of each prong appears in different parts of this Order, the Commission finds that a system achieving Objective 8 requires rates and classifications to be both just and reasonable under Objective 8. As a result, the Commission discusses its findings in relation to the just prong in this section, but reserves its conclusion on Objective 8 in its entirety for section II.C.4., *infra*.

As set forth in the ANPR, "[a] system achieving Objective 8 requires that rates and classifications are linked to distinct cost or market characteristics, and the amount charged for each service is neither excessive to the mailer nor threatens the financial integrity of the Postal Service." Order No. 3673 at 9. In the ANPR, the Commission identified two key measurable concepts for this objective—just and reasonable—and stated that these two concepts are associated with both the schedule of rates and the schedule of classifications. *Id.* The Commission suggested three ways to determine whether the schedule of rates and classifications was just: (1) review instances of excessive price increases, including a review of classification changes; (2) review price and cost relationships to ensure that customers are protected from misuse of the Postal Service's market power; and (3) review the cost or market characteristics that define a price category, product, or service. *Id.*

The Postal Service was the only commenter to address the proposed definition with regard to the just prong. The Postal Service states that the Commission correctly defines just.²¹⁴

²¹⁴ Postal Service Comments at 46. Several commenters assert workshare discounts should be considered under this objective. See Pitney Bowes Comments at 3; ANM *et al.* Comments at 80. The Commission considers workshare discounts to be more appropriately addressed with regard to Objective 1. See sections II.B.3.d.(2)(a) and II.C.3.b.(2), *infra*.

The Commission adopts the definition as proposed in the ANPR with several clarifications and modifications. First, the Commission clarifies which part of the definition applies to each prong. For the just prong, as further explained below, the Commission looks at the link between rates and distinct cost characteristics and whether the price charged for each product or service is excessive to the mailer. For the reasonable prong, the Commission looks to whether rates threaten the financial integrity of the Postal Service. See also section II.C.4., *infra*.

Second, after further consideration, the Commission finds it is more appropriate to limit the definition of just rates to whether rates are excessive to the mailer. The Commission finds the link between rates and distinct cost characteristics provides additional insight into whether rates may have been excessive to mailers and, therefore, undertakes this analysis to support its overall finding in this section.

Third, the Commission clarifies that analysis of the schedule of classifications applies solely to the just prong for purposes of this review and is subsumed within its analysis of rates. As the Commission's regulations require, the Postal Service complies with the price cap and accounts for the rate effects of any classification changes that result in the "introduction, deletion, or redefinition of rate cells."²¹⁵ As a result, the Commission's analysis reviewing whether rates have been excessive to mailers accounts for the rate effects of classification changes. Therefore, in the remainder of the analysis, the Commission uses rates or prices as shorthand for both rates and classification changes that have rate effects. The Commission does not discuss classifications with regard to the reasonable prong in this review because the Postal Service did not add any products to the market dominant product list during the PAEA

²¹⁵ See 39 C.F.R. § 3010.23(d)(2). In addition, the Commission enforces the price cap rules with respect to certain mail preparation requirement changes that result in the introduction, deletion, or redefinition of rates cells under 39 C.F.R. § 3010.23(d)(2). See Order No. 3047.

era that were non-compensatory and thus a threat to the financial integrity of the Postal Service.²¹⁶

Fourth, after further consideration, the Commission does not consider market characteristics in this review. Market characteristics are one determinant of products and are reviewed on an individual basis when products are added to the product list or moved between product lists. See 39 U.S.C. § 102(6). Throughout the PAEA era, the Postal Service generally maintained the price categories within the market dominant products established at the time PAEA was implemented. Products that were added or moved between product lists were approved by the Commission after reviews that included analysis of market characteristics.²¹⁷ As a result, market dominant price categories generally remained linked to underlying market characteristics during the PAEA era. For purposes of this review, the Commission focuses only on the relationship between prices and costs.

Taking these modifications and clarifications together, a system achieving just rates requires that the amount charged for each service is not excessive to the mailer. See Order No. 3673 at 9.

The Commission adopts all but one of the proposed measurement methods outlined in the ANPR. After further consideration, the Commission determines that a

²¹⁶ Attributable costs are generated at the product-level, and, with revenue, are used to determine cost coverage and whether a product is non-compensatory. The Commission considered only the effect of added products for this reason.

²¹⁷ The Postal Service moved several parcel products that were part of the market dominant product list when the PAEA was implemented to the competitive product list. See, e.g., Docket No. MC2010-36, Order No. 689, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011; Docket No. MC2011-22, Order No. 710, Order Adding Lightweight Commercial Parcels to the Competitive Product List, April 6, 2011. The Postal Service created a new Standard Mail product and added it to the market dominant product list during the PAEA era. Every Door Direct Mail—Retail was a market test before it was added to the market dominant product list. See Docket No. MC2012-31, Order No. 1460, Order Approving Addition of Postal Services to the Mail Classification Schedule Product Lists, September 7, 2012.

“review of the cost . . . characteristics that define a price category, product, or service” would be duplicative. See Order No. 3673 at 9. As explained above, the just prong of Objective 8 requires that the amount charged for each service is not “excessive to the mailer.” *Id.* As outlined in the paragraph that follows, the other proposed measurement methods encompass the analysis necessary to determine whether there were just rates during the PAEA era.

The Commission applies the remaining proposed measurement methods to assess whether the system has allowed for maintenance of just rates as follows. To determine whether rates were excessive to mailers during the PAEA era, the Commission provides an analysis of whether the system has maintained just rates by reviewing price increases during the PAEA era to assess whether those price increases have been excessive to mailers. This includes “a review of instances of excessive price increases.” *Id.* Because the system is required to maintain just rates, the Commission also discusses how processes within the system itself have maintained just rates during the PAEA era.²¹⁸ Based on this analysis, the Commission concludes that the system has maintained just rates during the PAEA era.

To supplement the Commission’s determinative analysis, the Commission provides “[a] review of price and cost relationships,” including an analysis of whether “rates . . . are linked to distinct cost . . . characteristics” and a discussion of how the data show that customers were “protected from misuse of the Postal Service’s monopoly power” during the PAEA era. Order No. 3673 at 9. The Commission finds that this analysis supports the Commission’s overall finding that the system maintained just rates during the PAEA era.

²¹⁸ See 39 U.S.C. § 3622(b)(8). See also section II.D., *supra*, for a similar assessment, focusing on whether the system maintained high quality service standards.

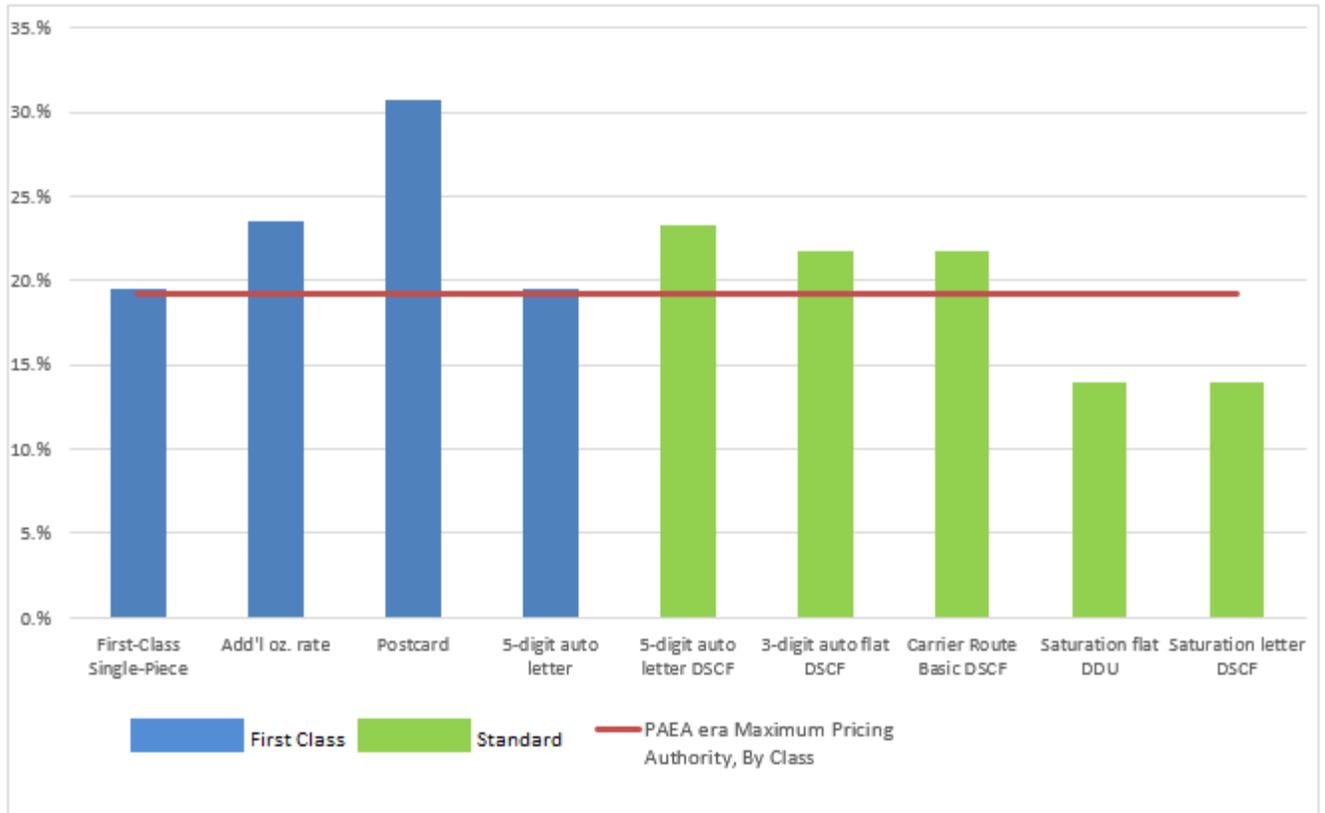
Objective 8 specifically concerns the schedule for rates which takes all rates together. Therefore, this review assesses whether rates were generally excessive to mailers during the PAEA era. As a result, the Commission's determinative and supplementary analyses provide various snapshots of rates and rate relationships during the PAEA era. Based on this analysis, the Commission finds that the system has maintained just rates during the PAEA era.

(a) Evaluation of Price Increases

As a measure of whether the system has created just prices, the Commission assesses price increases over the PAEA era to determine whether such price increases have been excessive to mailers. The Commission first quantitatively analyzes the price increases related to the categories of mail with the highest volume during the PAEA era. The Commission compares the aggregated price increases for each selected price category with the aggregated increase in CPI-U during the same period. Second, the Commission qualitatively discusses how the system has encouraged the maintenance of just rates during the PAEA era.

The Commission aggregates the generally applicable price increases that were approved during the PAEA era for a selection of price categories in Figure II-4 below. The Commission reviewed price increases for all products and price categories, and selected these price categories because they illustrate the price changes for the majority of mail during the PAEA era. These price categories represent approximately 60 percent of the volume for all market dominant mail. In Figure II-4, the cumulative price increases are compared to the cumulative change in maximum class-level pricing authority (CPI-U) over the same period.

Figure II-4
Price Changes During the PAEA Era²¹⁹ for Selected Rate Categories



Source: Library Reference PRC-LR-RM2017-3/1

The Commission compares the price categories to CPI-U because prices were capped at the annual percentage change in CPI-U during the PAEA era. As a result, CPI-U is an appropriate benchmark for comparison because it represents the maximum amount of pricing authority that was available for each class of mail. As discussed with regard to pricing flexibility, *supra*, the Postal Service had considerable discretion to set prices within classes during the PAEA era so long as it did not exceed the price cap for the class.

²¹⁹ This table is derived from the various price adjustments for these rate categories during the PAEA era and as a result includes Docket No. R2017-1. See n.125, *supra*.

Figure II-4 shows that for the categories listed, the price changes over time were relatively consistent with the overall change in CPI-U. Some price categories, such as First-Class Mail Postcards, show increases substantially greater than the change in CPI-U. However, Objective 8 specifically allows for such variation in stating “the objective . . . shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.” 39 U.S.C. § 3622(b)(8). The Commission discusses in more detail below reasons why price increases may differ. When considered with the pricing flexibility analysis discussed *supra*, the Commission finds that the PAEA plainly intended for individual rates to vary, even considerably, from the change in CPI-U baseline.

Next, the Commission turns to the mechanisms in place to ensure the ratemaking system maintained just prices during the PAEA era. As previously mentioned, the inquiry into whether a rate is unjust is a highly fact and situation specific inquiry intended to be undertaken on a case-by-case basis. The PAEA provided several distinct avenues for mailers to raise concerns and request recourse for excessive rates (among other issues). Based on this analysis, the Commission finds that the system provided for the maintenance of just rates during the PAEA era.

The Commission’s review of rates prior to implementation was one mechanism that supported the maintenance of just rates. The PAEA required the Postal Service to provide the public and the Commission notice before it implemented a change in prices. 39 U.S.C. § 3622(d)(1)(C)(ii, iii). During the PAEA era, the Commission reviewed the proposed prices for market dominant mail before they were implemented. *Id.* In one such case, the Postal Service proposed to increase the price for certain rate cells within the Special Services class by 963.8 percent.²²⁰ The Commission received comments

²²⁰ Order No. 191 at 70. Specifically, the prices affected were the Platinum tier of Confirm service. *Id.* at 69.

asserting “that the proposed price is contrary to both the ‘reasonable and equitable’ rate requirement of 39 U.S.C. § 404(b) and the ‘just and reasonable’ rate and classification objective of 39 U.S.C. § 3622(b)(8).” *Id.* at 67. The Commission observed that the commenters’ “allegations raise[d] troubling issues of discrimination and compliance with the objectives and factors of 39 U.S.C. § 3622.” *Id.* at 69. Ultimately, the Commission concluded that the proposed price increases could not go into effect because they were “inconsistent with applicable law.” *Id.* at 73.

The increase above demonstrates why the inquiry into whether a rate is unjust must be highly fact and situation specific and how the procedures in place for reviewing rates prior to implementation work to maintain just rates. Before the Commission completed its review of proposed rate adjustments, it provided any interested person the opportunity to comment on the proposed rates. 39 C.F.R. § 3010.11(a)(5),(b). It was through this process that Special Services mailers raised their concerns about the 963.8 percent increase, and the Commission, after considering the views of mailers and the Postal Service, determined that the price increase could not go into effect.

In addition to the Commission’s review of prices prior to implementation, the PAEA also established an ex-post review of market dominant prices (the Commission’s ACD), which was another mechanism supporting the maintenance of just prices during the PAEA era. During each year of the PAEA era, the Commission did an in-depth review of the rates and fees in effect for that year and assessed each’s compliance with statutory standards. 39 U.S.C. § 3653(b)(1). Parties had the opportunity to comment on the rates and fees under review, and the Commission had the authority to take necessary corrective action. 39 U.S.C. § 3653(c). In addition, pursuant to 39 U.S.C. § 3662, any interested person who believed that the Postal Service was not operating in conformance with various provisions of title 39, was able to file a complaint with the Commission during the PAEA era. Through these three separate mechanisms, the system provided for the maintenance of just rates during the PAEA era.

(b) Supplementary Analysis

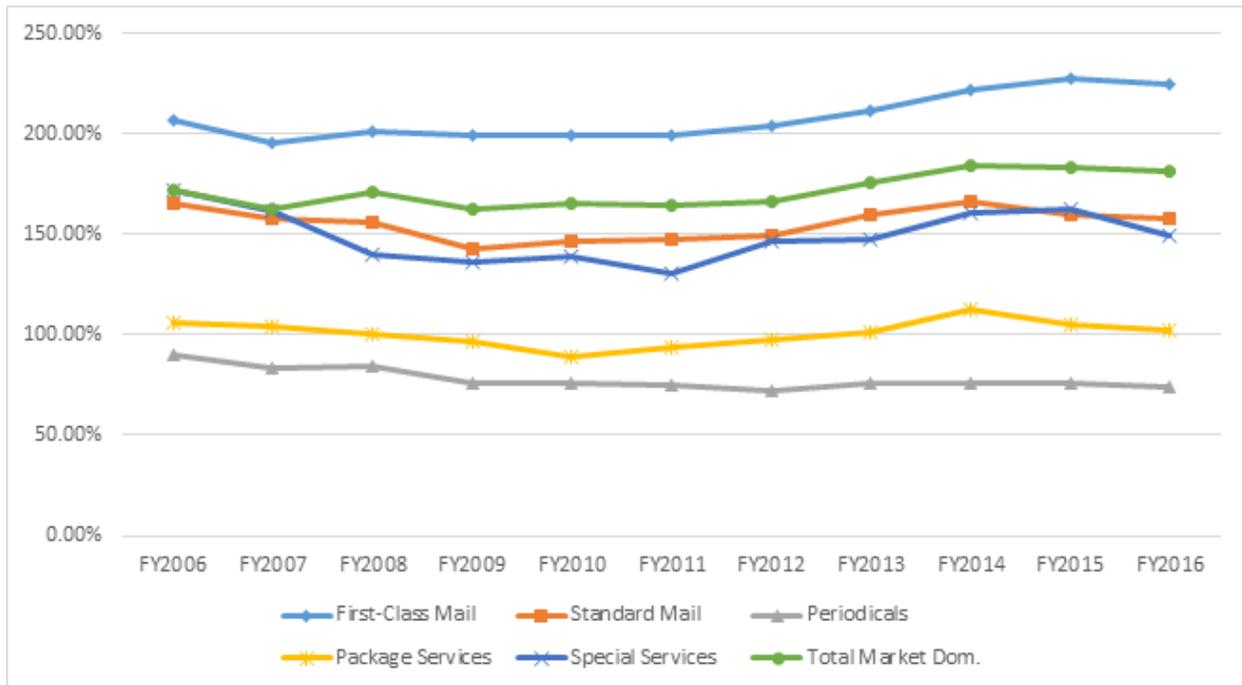
In this section, the Commission provides a supplementary analysis of the relationship between costs and prices to support its determinative analysis above. First, the Commission reviews cost coverage (by class) during the PAEA era. Second, the Commission calculates the coverage index (by class and selected products). Third, the Commission performs an elasticity analysis using cost coverage to assess whether customers were protected from misuse of the Postal Service's market power during the PAEA era.

The Commission starts its evaluation of the relationship between cost and price at the class-level. Although prices during the PAEA era were no longer as directly linked to costs as they were under the PRA's cost-of-service model, Congress retained 39 U.S.C. § 101(d).²²¹ In retaining 39 U.S.C. § 101(d) in the PAEA, Congress appeared to envision that prices would continue to bear some relationship to costs albeit in a less direct way than contemplated under the PRA. As a result, if price changes were related to changes in cost over time that supports a conclusion that rates were not excessive to the mailer.

Cost coverage is calculated by dividing revenue by attributable cost. Figure II-5 below displays cost coverage over time, by class. This figure begins with the cost coverages from FY 2006, the final year of the PRA era. As discussed earlier in this section, rates in the PRA era were designed to apportion the costs to users on a "fair and equitable basis." As a result, FY 2006 cost coverages are a logical starting point. Figure II-5 illustrates that the relationship between costs and prices for each class of mail was relatively stable during the PAEA era.

²²¹ See 39 U.S.C. § 101(d), which states that rates should apportion the costs to users on a "fair and equitable basis."

**Figure II-5
Cost Coverages by Class**



Source: Library Reference PRC-LR-RM2017-3/1

Although the relationship between prices and costs was relatively stable, there was some variation. During the PAEA era, the price cap operated at the class-level. Thus, as the attributable cost of a given class changed, the Postal Service may not have had the available pricing authority to change prices to sufficiently cover all the attributable cost changes. The Commission notes that other factors can also affect cost coverages. For example, the reclassification of some products from the market dominant product list to the competitive product list also has impacted the resulting cost coverages.

However, Figure II-5 shows that costs and revenues at the class-level maintained a similar relationship during the PAEA era.

Next, the Commission converts the cost coverages into coverage indices for all market dominant classes and selected products starting in FY 2008.²²² In the Commission's coverage indices analysis, the cost coverage is converted to an index relative to the overall cost coverage for market dominant products as a whole.²²³ If a product has a coverage index greater than 1.0, then its cost coverage is greater than the cost coverage for market dominant products as a whole. A benefit of converting cost coverages to indices is that it helps to control for exogenous factors that cause all cost coverages to change simultaneously.²²⁴ As explained above, the Postal Service had significant pricing flexibility below the class-level during the PAEA era. Analyzing the relationships between costs and prices at a level below the class-level illustrates how the Postal Service used its flexibility to maintain these relationships.

²²² The product list and the number of products were adjusted with the implementation of the PAEA, and FY 2008 is the first year where cost coverages were available for the entire product list.

²²³ To calculate each index, cost coverage for a class or product is divided by the cost coverage for all market dominant classes or products. For example, the coverage index for First-Class Mail Single-Piece Letters and Cards is the cost coverage for First-Class Mail Single-Piece Letters and Cards divided by the cost coverage for all market dominant products.

²²⁴ A significant change in economic activity, such as a recession, is an example of an exogenous factor. However, reclassifications of products are not exogenous factors and, therefore, can affect coverage indices.

**Table II-4
Coverage Indices (By Class and Selected Products) FY 2008 – FY 2016**

	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
First Class Mail	1.19	1.23	1.21	1.21	1.26	1.20	1.20	1.24	1.24
Single-Piece Letters and Cards	0.67	0.64	0.64	0.69	0.78	0.70	0.67	0.78	0.68
Presort Letters and Cards	1.77	1.79	1.80	1.83	1.82	1.78	1.75	1.75	1.88
Flats	0.94	1.01	0.88	0.88	0.93	0.85	0.87	0.83	0.80
Parcels	0.62	0.63	0.61	0.67	0.61	0.57	0.60	0.61	0.67
Standard Mail	0.93	0.88	0.89	0.90	0.93	0.91	0.91	0.88	0.88
High Density and Saturation Letters	1.36	1.33	1.29	1.35	1.38	1.35	1.31	1.20	1.22
High Density and Saturation Flats and Parcels	1.52	1.47	1.36	1.30	1.35	1.31	1.24	0.95	0.94
Carrier Route	0.89	0.89	0.87	0.83	0.81	0.76	0.75	0.72	0.76
Letters	1.14	1.07	1.10	1.13	1.11	1.08	1.10	1.12	1.12
Flats	0.56	0.51	0.50	0.49	0.50	0.49	0.46	0.44	0.44
Periodicals	0.50	0.47	0.46	0.46	0.45	0.43	0.42	0.41	0.41
In County	0.57	0.54	0.46	0.48	0.44	0.43	0.43	0.41	0.39
Outside County	0.50	0.46	0.46	0.46	0.45	0.43	0.42	0.41	0.41
Packages	0.60	0.59	0.54	0.58	0.61	0.58	0.62	0.57	0.57
Bound Printed Matter Flats	0.99	1.07	0.90	1.00	0.84	0.82	0.83	0.77	0.89
Bound Printed Matter Parcels	0.64	0.60	0.56	0.60	0.68	0.60	0.60	0.65	0.58
Media and Library Mail	0.52	0.52	0.49	0.47	0.53	0.49	0.51	0.42	0.42
Special Services	0.76	0.78	0.81	0.80	0.79	0.87	0.69	0.69	0.70
Total Market Dominant	1.00								
Standard Deviation	0.274	0.292	0.298	0.295	0.312	0.298	0.298	0.314	0.317

Source: Library Reference PRC-LR-RM2017-3/1

The indices analysis illustrates the relative changes between cost coverages. For example, the Standard Mail Carrier Route product covered its cost each year, but had lower cost coverage than market dominant mail as a whole; therefore, its index values were also below 1.0 every year. Standard Mail High Density and Saturation Letters is a product that has covered its cost throughout the PAEA era, with above-average cost coverages. As expected, its index values were above 1.0 every year. With the exception of First-Class Mail, each class had an average cost coverage less than the average cost coverage of all market dominant products.

In order to assess how closely prices remained linked to costs for market dominant products as a whole, the Commission analyzes how far the product-level index values were from the mean of 1.0 throughout the PAEA era as measured by the standard deviation. If the changes in cost for a product were not reflected in changes in price, then the index values for that product would not be consistent over time. All other things being equal, changes in a product's coverage index would cause the standard deviation for market dominant products as a whole to change over time. The final row in Table II-4 above shows that the standard deviation rose from 0.274 in FY 2008 to 0.317 in FY 2016. The table also shows that each year it was between 0.274 and 0.317. The limited variation illustrates that the changes in prices throughout the PAEA era generally reflected changes in cost at the product-level.

Because cost coverages have remained relatively stable at the class-level and the coverage index has been relatively stable at the product-level, the Commission finds that costs were linked to prices during the PAEA era. This further supports a determination that prices have been just.

Next, the Commission compares changes in cost coverage to demand elasticity to analyze how the Postal Service has leveraged its market power during the PAEA era. Each market dominant product has an own-price demand elasticity, which measures the sensitivity of mailers to changes in the price of the product, and, therefore, reflects the extent of the Postal Service's market power.²²⁵ The closer an elasticity is to zero, the less elastic the product is and the less volume is lost when the Postal Service increases the price of it. In other words, the less elastic the product is, the more captive its

²²⁵ Elasticity is a unit-free measure of the responsiveness of a given variable (for example, the quantity demanded or supplied) to a change in another variable (for example, the price). Using the examples given, elasticity, or price elasticity of demand, is defined as the ratio of the percentage change in quantity to the associated percentage change in price.

customers are to the Postal Service and the more vulnerable those customers are to the Postal Service's market power.

The following table contains cost coverages from FY 2008 to FY 2016 and the Postal Service's estimates for FY 2016 demand elasticity for selected products.²²⁶

²²⁶ In FY 2016, the Postal Service's estimates of demand elasticity did not perfectly align with the market dominant product list. For example, the Postal Service's demand model produced an elasticity for First-Class Mail Presort Letters and an elasticity for First-Class Mail Presort Cards. For Table II-5, the Commission uses volume distribution to align the demand elasticities with the market dominant product list. The Commission also notes that it excludes the Special Services class from Table II-5. It would not be informative to analyze the relationship between the cost coverage for Special Services products and demand elasticities because of the unique nature of the Special Services class. For example, the Special Services product Ancillary Services is composed of 22 different offerings, many of which can only be purchased with other postal products, such as Insurance. As a result, aggregating the demand elasticities to the product-level for these offerings would not provide meaningful insight into whether the Postal Service is misusing its market power.

**Table II-5
Cost Coverage and Price Elasticity (By Class and Selected Products)²²⁷**

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015	FY 2016	FY 2016 Elasticity
First-Class Mail	200%	200%	199%	199%	203%	210%	220%	226%	223%	(0.169)
Single-Piece Letters and Cards	167%	166%	165%	162%	167%	171%	177%	187%	177%	(0.116)
Presort Letters and Cards	298%	292%	297%	300%	293%	311%	321%	320%	338%	(0.193)
Flats	158%	164%	145%	145%	149%	149%	160%	152%	144%	(0.216)
Parcels	104%	102%	100%	110%	99%	99%	109%	112%	121%	(0.648)
Standard Mail	156%	143%	147%	148%	149%	160%	166%	160%	158%	(0.538)
High Density and Saturation Letters	229%	216%	213%	221%	222%	237%	239%	219%	219%	(0.802)
High Density and Saturation Flats and Parcels	256%	240%	224%	214%	217%	229%	227%	173%	169%	(0.823)
Carrier Route	151%	145%	143%	136%	131%	134%	137%	131%	138%	(0.816)
Letters	193%	174%	181%	185%	179%	190%	201%	204%	202%	(0.403)
Flats	94%	82%	82%	80%	81%	85%	83%	80%	80%	(0.450)
Periodicals	84%	76%	75%	75%	72%	76%	76%	76%	74%	(0.202)
In County	96%	88%	75%	78%	71%	76%	78%	75%	71%	(0.040)
Outside County	84%	76%	75%	75%	72%	76%	76%	76%	74%	(0.219)
Package Services	101%	97%	89%	94%	98%	102%	113%	105%	102%	(0.467)
Bound Printed Matter Flats	166%	175%	148%	164%	135%	143%	151%	141%	161%	(0.444)
Bound Printed Matter Parcels	108%	98%	92%	99%	109%	105%	109%	119%	105%	(0.499)
Media and Library Mail	87%	84%	81%	77%	85%	85%	94%	76%	75%	(0.443)

Source: Library Reference PRC-LR-RM2017-3/1

Table II-5 shows that the cost coverages fluctuated during the PAEA era.²²⁸

Table II-5 also shows that extreme cost coverage increases were not imposed on products with the lowest elasticities²²⁹ as would be expected if the Postal Service had

²²⁷ The Postal Service's estimates of own-price demand elasticity are not always statistically significant. For example, none of the Package Services demand elasticity estimates in FY 2016 were statistically significant. While not statistically significant, these estimates are still informative for the purposes of the Commission's review because the demand elasticities were the best information available to the Postal Service when it developed its prices.

²²⁸ The Commission notes that the cost coverage for most products increased during FY 2014 and FY 2015, followed by declines in cost coverage in FY 2016. The exigent surcharge (approved in Docket No. R2013-11) was in effect during the higher cost coverage periods of FY 2014 and FY 2015. For additional information, see section II.B.3.b.(c), *supra*.

²²⁹ Elasticities are normally negative. When considering whether an elasticity is high or low, the Commission uses the absolute value of the elasticity. Thus, a product with an elasticity of -0.1 is considered a low-elasticity product, and a product with an elasticity of -0.8 is considered a high-elasticity product.

misused its market power. For example, the cost coverage of the First-Class Mail product with the lowest elasticity, Single-Piece Letters and Cards, increased similarly during the PAEA era to the cost coverage of products with higher elasticities, for example Standard Mail Letters. Although there was a variation in the change in cost coverage within classes, Table II-5 does not indicate that the Postal Service misused its market power during the PAEA era. As previously explained, variations in cost coverage have generally been due to multiple factors. The Commission determines that price increases during the PAEA era have not been focused on inelastic mailers. This further supports a determination that prices were just.

d. Pricing Efficiency

Next, the Commission reviews Objective 1 with regard to whether the system has increased pricing efficiency. Objective 1 looks to whether the system has “maximize[d] incentives to reduce costs and increase efficiency.” 39 U.S.C. § 3622(b)(1). Under Objective 1, the Commission looks at two forms of efficiency: (1) operational efficiency; and (2) pricing efficiency. In this section, the Commission reviews whether the system has increased pricing efficiency by measuring whether prices during the PAEA era adhered to Efficient Component Pricing (ECP) and allocative efficiency principles. In section II.C.3., *infra*, the Commission reviews whether the system maximized incentives to reduce costs and increase operational efficiency.

The Commission analyzes ECP in the price and cost relationships in workshared mail. Worksharing provides mailers discounted rates in exchange for mailers performing certain processing, handling, sortation, or barcoding activities (thus relieving the Postal Service of the costs of performing those activities).²³⁰ The central tenet of

²³⁰ Cohen, R. *et al.*, The Impact of Using Worksharing to Liberalize a Postal Market, Proceedings of the Wissenschaftliches Institut für Kommunikationsdienste GmbH 6th Königswinter Seminar on Postal Economics “Liberalization of Postal Markets,” February 19-21, 2001, at 3-6, available at <https://www.prc.gov/sites/default/files/papers/Wik.pdf>.

ECP is that it is most efficient to set the price difference (*i.e.*, the discount) between a piece of workshared mail and the related non-workshared or less-workshared piece equal to the cost difference between the workshared and non- or less-workshared piece. *Id.* at 19-20. This cost difference is referred to as the avoided cost. The non-workshared or less-workshared piece is referred to as the benchmark.

As a result, workshare discounts reflect ECP and result in the most efficient outcome when they are set equal to their corresponding avoided costs.²³¹ When a discount equals its avoided cost, the Postal Service neither gives too great a discount (*i.e.*, the discount exceeds what it costs the Postal Service to perform the work) nor too little a discount (*i.e.*, the discount is less than what it costs the Postal Service to perform the work, and although a mailer could perform the work at a lower cost than the Postal Service, it may not if the cost to the mailer for performing the work exceeds the amount of the discount). This type of pricing efficiency also promotes fair competition, because it allows mailers to determine if they can prepare the mail at a lower cost than paying the Postal Service to do the work. *Id.*

The relationship between workshare discounts and avoided costs is usually expressed as a percentage called a passthrough, which is calculated by dividing the discount by the avoided cost. A workshare discount that fully reflects ECP has a passthrough equal to 100 percent.

Allocative efficiency is another economic principle in setting efficient prices. Allocative efficiency is the concept that prices should cover at least marginal costs. Prices that adhere to the principles of allocative efficiency have been set to at least their

²³¹ The Commission previously explained that the “ECP rule asserts that an integrated mail service will be produced most efficiently if its various components are provided by the least-cost producer.” Docket No. RM2010-13, Order No. 1320, Order Resolving Technical Issues Concerning the Calculation of Workshare Discounts, April 20, 2012, at 3.

marginal or attributable costs, meaning they would have a cost coverage of 100 percent.

(1) Comments

Several comments support the application of ECP to worksharing. Pitney Bowes states that ECP promotes efficiency and fairness in postal pricing. See Pitney Bowes Comments at 6, 8. Pitney Bowes promotes a “soft floor” on workshare discounts, which it asserts would not limit pricing flexibility in a meaningful way and would also promote operational efficiency by incentivizing the least cost provider to perform the work. *Id.* at 2-3, 10, 13, 16, 18-21.

ANM *et al.* advocate that the current system for workshare discounts does not achieve efficient pricing. See ANM *et al.* Comments at 82. ANM *et al.* assert that without a floor, the Postal Service is performing functions that mailers could perform at lower cost. *Id.* Similarly, MMA, NAPM, and NPPC contend that workshare discounts are currently inefficient and should be set using ECP. See MMA, NAPM, and NPPC Comments at 19.

In contrast, the Postal Service states that although ECP may work to achieve pricing efficiency for workshare discounts, application of ECP as both a floor and ceiling for workshare discounts must be balanced against other objectives (*e.g.*, limiting the Postal Service to ECP for workshare discounts would reduce pricing flexibility). Postal Service Comments at 230-233.

Although it does not weigh in on ECP specifically, GCA asserts that the workshare discount system promotes efficiency of the Postal Service and states that “[t]o maximize incentives to reduce costs and increase efficiency’ does not mean ‘to make workshare discounts as large as possible.’” GCA Comments at 11. GCA states that “a properly-designed workshare discount is an incentive to reduce costs” that may also maximize efficiency. *Id.*

Regarding pricing efficiency generally, the Postal Service asserts that the price cap inhibits pricing efficiency, and contends that although there have been some improvements over the PRA system, the current system has constrained pricing flexibility and pricing efficiency. Postal Service Comments at 131. The Postal Service further contends that the class-level price cap inhibits its ability to make rational and efficient pricing decisions and to ensure that each class or type of mail covers its attributable costs. *Id.* By way of an example, the Postal Service states that the price cap does not allow for the correction of a non-compensatory class like Periodicals. *Id.* at 132. The Public Representative echoes this concern, stating that small increases in the price cap do not allow for price increases that could provide improvement in overall cost coverage. PR Comments at 23.

ANM *et al.*, on the other hand, assert that non-compensatory products are due to excessive costs, not constrained prices. See ANM *et al.* Comments at 76. NNA contends that the system has failed to produce a pricing proposal that permits smaller mailers to contribute to cost reductions. See NNA Comments at 22, 25. MMA, NAPM, NPPC state that the system fails to properly maximize incentives for pricing efficiency and points to the Postal Service's use of IMb, which it states is an example of the Postal Service not using its pricing flexibility to maximize participation in the program. MMA, NAPM, and NPPC Comments at 19, 20-21.

(2) Application of Measurement

In reviewing the pricing subpart of the ratemaking process, the Commission analyzes pricing efficiency pursuant to Objective 1. Objective 1 looks at whether the system “maximize[d] incentives to reduce costs and increase efficiency.” 39 U.S.C. § 3622(b)(1).

As set forth in the ANPR, “[a] system achieving Objective 1 uses available mechanisms, such as flexibility under the price cap, pricing differentials, and workshare

discounts to the fullest extent possible to incentivize the reduction of costs and increases in operational and pricing efficiency.” Order No. 3673 at 4. Most commenters support the Commission’s proposed definition of Objective 1. The Public Representative states that it is reasonable to include both pricing and operational efficiency in the definition. PR Comments at 26. MMA, NAPM, and NPPC agree that the definition is reasonable, while Pitney Bowes states that the definition as applied to worksharing is reasonable.²³² The Commission adopts the definition for Objective 1 proposed in the ANPR.

The ANPR identified three key measurable concepts within Objective 1: (1) maximize incentives, (2) reduce costs, and (3) increase efficiency. Order No. 3673 at 4. As contemplated by the definition for Objective 1, the Commission further separates its analysis of efficiency into operational efficiency and pricing efficiency. In its review under Objective 1, the Commission’s first step is to analyze whether efficiency (pricing or operational) increased and costs were reduced during the PAEA era. If the Commission determines the applicable form of efficiency increased or costs were reduced under the first step, the Commission’s second step is to review whether the system maximized incentives. If the Commission finds that the first step is not achieved for any component, it does not continue to the second step for that component. This approach differs from the approach laid out in the ANPR, which contemplated a review of incentives separate from the analyses of cost reduction and increases in operational and pricing efficiency. After further consideration, the Commission finds that Objective 1 intended for the maximize incentives analysis to relate directly to cost reduction and efficiency increases, and, therefore, shifts its approach to better reflect the intent of Objective 1. See 39 U.S.C. § 3622(b)(1).

²³² MMA, NAPM, and NPPC Comments at 19; Pitney Bowes Comments at 11.

This section focuses solely on pricing efficiency.²³³ In the ANPR, the Commission suggested measuring pricing efficiency by comparing actual prices and prices that adhere to allocative efficiency, Ramsey pricing,²³⁴ and ECP. See Order No. 3673 at 4 n.14. GCA suggests that efficiency should include constructing a set of prices which improve both consumer and producer surplus. GCA Comments at 8. GCA, however, provides no practical solution for incorporating its suggestion into the Commission's definition or measurement approach.

The Commission has determined that to measure pricing efficiency, it will evaluate whether prices were set using ECP and allocative efficiency. Order No. 3673 at 4 n.14. The Commission does not perform an analysis of Ramsey pricing because Ramsey pricing requires that each product covers its attributable costs and, as shown below, several products did not cover their attributable costs during the PAEA era.

The Commission applies the remaining proposed measurement methods to assess whether the system has achieved increased pricing efficiency as follows. First, the Commission looks at whether workshare discounts adhered as close as practicable to ECP during the PAEA era. Second, the Commission reviews whether prices were set in accordance with allocative efficiency.

(a) Efficient Component Pricing

The Commission first measures whether pricing efficiency was increased during the PAEA era by analyzing how closely workshare discounts adhered to ECP. As explained above, in accordance with ECP, prices are most efficient when workshare

²³³ For its analyses of whether operational efficiency increased and costs were reduced during the PAEA, see section II.C.3., *infra*.

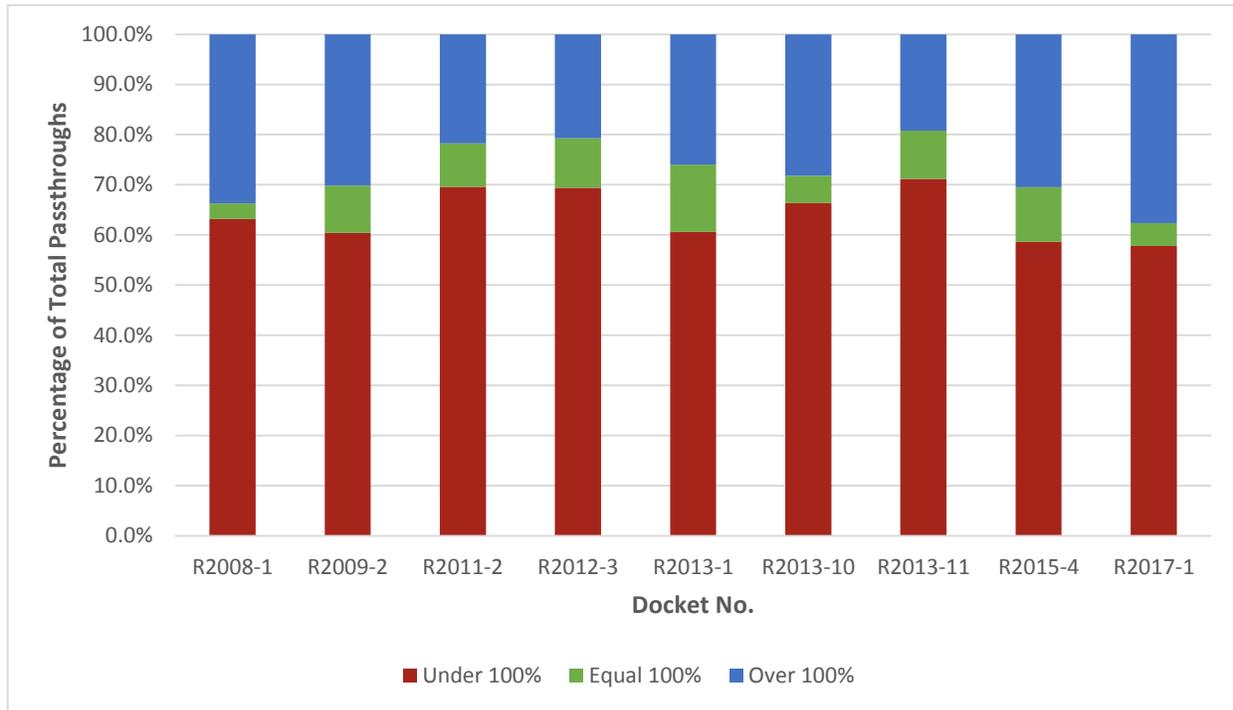
²³⁴ The ANPR uses the term "second best pricing" rather than "Ramsey pricing." The two terms are interchangeable. The Commission uses the more common term, Ramsey pricing, for purposes of this review.

discounts are set equal to avoided costs. Thus, the Commission determines that the system achieves efficient prices if prices adhere as closely as practicable to ECP.

As explained above, the relationship between workshare discounts and avoided costs is usually expressed as a percentage called a passthrough, which is calculated by dividing the discount by the avoided cost. A workshare discount that fully reflects ECP has a passthrough equal to 100 percent, and as a result, passthroughs provide information about the extent of pricing inefficiency. The further from 100 percent a passthrough is, the less efficient the pricing.

Figure II-6 below shows that in each generally applicable market dominant price adjustment since the passage of PAEA, the Postal Service has chosen to set very few discounts with passthroughs equal to 100 percent. Although the number of passthroughs equal to 100 percent fluctuated slightly over the PAEA era, and ended the 10-year period with slightly more discounts equal to 100 percent, the data show that the Postal Service generally did not adhere to ECP when setting prices. For example, in Docket No. R2017-1, 5 discounts were set at 100 percent, compared to 3 in Docket No. R2008-1, and 10 in Docket No. R2009-2.

**Figure II-6
Percentage of Passthroughs Under 100 percent, Equal to 100 percent,
and Over 100 percent**



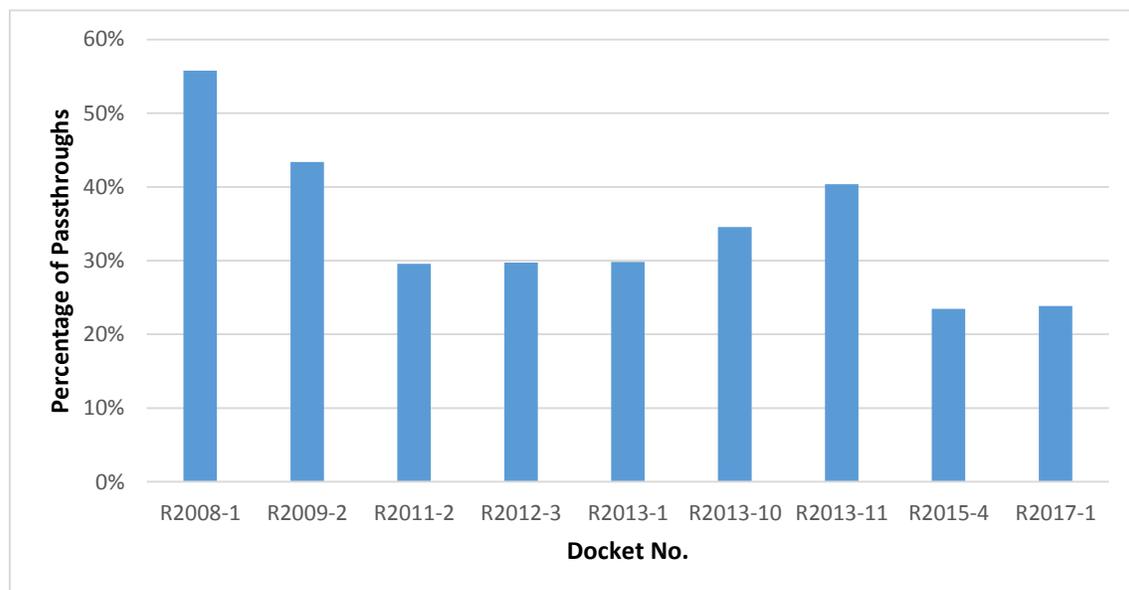
Source: Library Reference PRC-LR-RM2017-3/1

The PAEA provided the Postal Service with the flexibility to adhere to ECP within the price cap regime. The worksharing constraints contained in 39 U.S.C. § 3622(e)(2) limited the Postal Service’s flexibility to set worksharing discounts above 100 percent passthroughs, but did not provide any constraint for the Postal Service setting discounts below 100 percent passthroughs. Although the PAEA constrained workshare discount passthroughs from being set over 100 percent, it provided for exceptions in specific circumstances. 39 U.S.C. § 3622(e)(2)(A-D). The exceptions of 39 U.S.C. § 3622(e)(2)(A-D) allowed the Postal Service to consistently set certain workshare discount passthroughs above 100 percent during the PAEA era. For example, the Postal Service routinely applied the exception for workshare discounts “provided in connection with subclasses of mail consisting exclusively of mail matter of educational,

cultural, scientific, or informational value” to set Periodicals prices without consideration of ECP. See 39 U.S.C. § 3622(e)(2)(C).

Figure II-7 shows the percentage of discounts that deviated from a 100 percent passthrough by less than 15 percentage points (*i.e.*, those with a passthrough between 85 percent and 115 percent) during the PAEA era. This analysis illustrates that as a result of the Postal Service’s pricing decisions, the number of discounts with passthroughs that were close to 100 percent gradually declined since the passage of PAEA, and that the system did not result in workshare discounts as close as practicable to avoided costs. In the first rate case after the PAEA’s enactment (Docket No. R2008-1), 56 percent of workshare discounts had passthroughs between 85 and 115 percent. In the most recent rate case (Docket No. R2017-1), this percentage had fallen to 24 percent. During the PAEA era, the Postal Service used its flexibility to set workshare discounts further from ECP.

Figure II-7
Percentage of Workshare Discounts with Passthroughs between 85 and 115 Percent



Source: Library Reference PRC-LR-RM2017-3/1

As discussed in section II.B.3.a., *supra*, the Postal Service had flexibility to set prices for individual rate cells during the PAEA era. This included both the benchmark prices and the discounted prices. This flexibility allowed the Postal Service to adjust the discounts to reflect cost differences consistent with ECP. Although the Postal Service's pricing flexibility was generally limited by the price cap during the PAEA era, the price cap did not affect the Postal Service's ability to price discounts in accordance with ECP because the Postal Service could have manipulated both the workshare discount and the benchmark price. For example, if a discount is \$0.10 and the avoided cost is \$0.08, the passthrough is 125 percent. During the PAEA era, the Postal Service could have reduced the passthrough to 100 percent by increasing the discounted price \$0.02, or by reducing the benchmark price \$0.02, or some combination of the two. The Commission finds that the Postal Service was able to adjust prices to achieve ECP and did not do so during the PAEA era. Thus, the Commission concludes that the system did not increase pricing efficiency, as measured by adhering as closely as practicable to ECP, during the PAEA era.

(b) Allocative Efficiency

Next, the Commission measures whether pricing efficiency increased by reviewing allocative efficiency during the PAEA era. Prices that adhere to the principles of allocative efficiency are set at or above marginal (or in the Postal Service's case,

attributable)²³⁵ costs, meaning they would have a cost coverage of 100 percent or greater.²³⁶

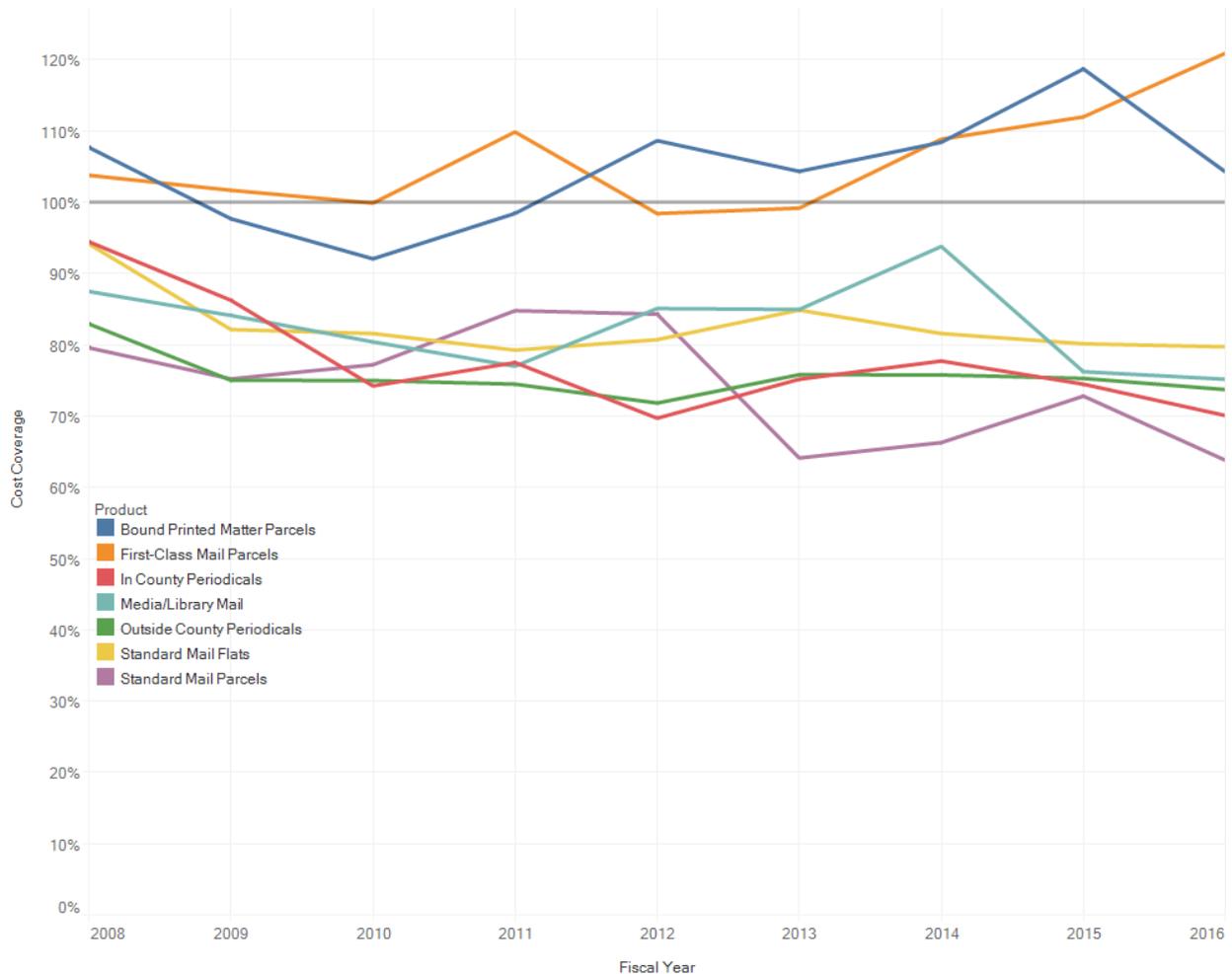
To evaluate whether prices were set according to allocative efficiency during the PAEA era, the Commission analyzes whether cost coverages for any product were less than 100 percent.²³⁷ Figure II-8 details the products that had cost coverages below 100 percent during the PAEA era (*i.e.*, First-Class Mail Parcels, Standard Mail Flats, Standard Mail Parcels, In County Periodicals, Outside County Periodicals, Bound Printed Matter Parcels, and Media Mail/Library Mail).

²³⁵ In a white paper for the Commission, Dr. Panzar detailed the usefulness of the attributable cost calculation, stating that “volume variable costs at the component level is a very useful step toward obtaining estimates of marginal cost from cost accounting data.” John C. Panzar, *The Role of Costs for Postal Regulation*, at 11, available at <https://www.prc.gov/sites/default/files/reports/J%20Panzar%20Final%20093014.pdf>. Dr. Panzar further states that the “[t]he CRA methodology defines attributable costs in a way that only partially aligns with the economic definition of incremental costs. In general, CRA attributable costs understate economic incremental costs.” *Id.* at 2. For this analysis, the Commission uses incremental cost as calculated without infra-marginal costs, as such information was not available until FY 2016. Because infra-marginal costs increase the cost attributable to the product, excluding them from this analysis does not change the non-compensatory status of the products discussed below.

²³⁶ See Docket No. RM2016-2, Order No. 3506, Appendix A. See also Jeffrey R. Church and Robert Ware, *Industrial Organization: A Strategic Approach (Management and Organizations)*, at 786-793 (2000).

²³⁷ Cost coverage is equal to unit revenue/unit attributable cost. Unit attributable cost is used for this analysis as a reasonable approximation of marginal cost.

Figure II-8
Products that did not Exhibit Allocative Efficiency During the PAEA Era



Source: Library Reference PRC-LR-RM2017-3/1

Figure II-8 shows that product-level prices during the PAEA era did not cover costs and as a result were not priced in accordance with allocative efficiency. First-Class Mail Parcels and Bound Printed Matter Parcels did not cover their attributable costs during some years, while the other five products failed to cover their attributable costs throughout the PAEA era.

As discussed in section II.B.3.a., *supra*, the Postal Service had flexibility to set prices for individual rate cells during the PAEA era subject to certain limitations. In

some cases, the Postal Service could have used its pricing discretion to set allocative efficient prices and elected not to do so. See Postal Service Comments at 134-35 (discussing Standard Mail Flats). In other cases, the price cap limited the Postal Service's ability to set allocative efficient prices.²³⁸ For example, In County and Outside County Periodicals are the only products in the Periodicals class, and neither covered their attributable costs during the PAEA era. The price cap was applied at the class-level, which limited the Postal Service's ability to set allocative efficient prices for Periodicals.

The Commission concludes that the system did not increase pricing efficiency, as measured by allocative efficiency, during the PAEA era.

4. Objectives Relevant to the Structure of the Ratemaking System Reviewed in Conjunction with Each Other

The Commission's adoption of a topical approach allows application of the objectives together as they relate to the structure of the ratemaking system to determine whether the objectives have been achieved for the ratemaking system as a whole. In reviewing the structure of the ratemaking system, the Commission analyzes predictability and stability in rates (Objective 2), administrative burden and transparency (Objective 6), pricing flexibility (Objective 4), just rates (Objective 8), and pricing efficiency (Objective 1). The Commission's analysis and conclusions are organized into two broad subtopics. The analysis of the ratemaking process includes predictability and stability in the timing of rate adjustments, and administrative burden and transparency; the analysis of pricing includes pricing flexibility, predictability and stability in the magnitude of rate adjustments, a just schedule for rates and classifications, and pricing efficiency.

²³⁸ As discussed in section II.C.3.b.(1), *infra*, while the Postal Service was limited in its ability to raise prices above the class-level price, it could improve cost coverage by reducing costs.

First, the Commission evaluates the objectives related to the ratemaking process. The Commission finds that the ratemaking system resulted in predictable and stable rates. In analyzing predictability and stability the Commission looked at both the timing and magnitude of rate changes. With respect to the timing of market dominant price adjustments, the system of ratemaking during the PAEA era has resulted in predictable and stable rates. The Postal Service has, for the most part, filed notices of price adjustments on predictable and consistent schedules. Where it has deviated from those schedules, such deviations have been based on external factors from which a mailer or postal customer could reasonably forecast the potential effect on the timing of adjusting prices. The Commission also finds that the Postal Service has consistently provided significantly more advance notice of market dominant price adjustments than the benchmark of the 45-day requirement. The Commission notes that this additional notice has been necessary to adjudicate several adjustment proposals that were not fully developed. Mailers and the Postal Service, nearly universally, view the system as providing predictable and stable rates.

With respect to reduced administrative burden and increased transparency, the Commission reviews whether the system balanced the concepts of reducing the complexity of rate proceedings and increasing the availability of understandable material relating to each rate proceeding. Based on the duration of Commission review as compared to the 90-day benchmark and taking into account participants' views, the Commission finds that the complexity of rate proceedings decreased during the PAEA era, resulting in reduced administrative burden. The Commission takes into account the participants' views, the number of motions for additional information, and the number and frequency of Postal Service and Commission reports to determine that the availability of comprehensive understandable material relating to each rate proceeding increased during the PAEA, resulting in increased transparency. Accordingly, the Commission finds that the system reduced administrative burden and increased transparency.

Next, the Commission evaluates the objectives relating to pricing and finds that the ratemaking system allowed for the Postal Service to exercise its discretion to set prices, the price structure, and the timing of price changes for market dominant products, subject to other requirements under the law. This finding is supported by analysis of the Postal Service's discretion over price setting and the price structure as well as over the speed and frequency with which the Postal Service was able to implement price adjustments. This discretion was limited by statutory requirements constraining the Postal Service's pricing flexibility, which at times necessitated alterations to proposed prices and price adjustment proceedings of longer durations. On balance, the Commission finds that the Postal Service had broad discretion over prices, the price structure, and the timing of price changes during the PAEA era. For these reasons, the Commission finds that the ratemaking system has achieved the goal of providing the Postal Service pricing flexibility.

The Commission finds that the system achieved price adjustments of a predictable and stable magnitude because price adjustments were "capable of being consistently forecast" and did "not include sudden or extreme fluctuations" during the PAEA era. This conclusion is based on the fact that a limitation on price adjustments was in effect and that there was substantial information available about its calculation and the maximum rate authority available to the Postal Service. It is also based on the Commission's analysis, which shows most price adjustments were, on average, near the rate of change expected by the objective measure of CPI-U. The Commission finds that while deviations did occur during the PAEA era, a deviation from the objective measure does not by itself mean a price adjustment has been unpredictable or unstable.

The Commission finds that, on balance, the ratemaking system maintained just prices. The Commission concludes that the inquiry into whether a rate is unjust is highly fact and situation specific and intended to be undertaken on a case-by-case

basis. The Commission finds that several avenues were in place during the PAEA era that allowed mailers to allege rates were unjust and permitted the Commission to evaluate such rates, both before and after rates went into effect.

The Commission also concludes that rates were not excessive to mailers during the PAEA era. In the determinative and supplementary analyses above, the Commission looks at several aspects of rates and rate relationships during the PAEA era. Although each shows some variation, overall the data show that price increases were not excessive, that a link between price and cost remained, and that the Postal Service did not misuse its market power to impose the largest rate increases on the most captive mailers during the PAEA era. Based on its determinative analysis, as supported by the supplementary analysis, the Commission finds that the system has maintained just rates during the PAEA era.

The Commission finds that the system has not resulted in the use of “available mechanisms, such as flexibility under the price cap, pricing differentials, and workshare discounts, to the fullest extent possible to incentivize . . . increases in . . . pricing efficiency.” Order No. 3673 at 4. This conclusion is based on the Commission’s analysis of whether prices during the PAEA era reflected ECP and allocative efficiency. As discussed in the ECP analysis above, workshare discounts were not set as close as practicable to their avoided costs despite the Postal Service’s ability to do so under the price cap. As discussed in the allocative efficiency analysis above, seven products did not cover their attributable costs during the PAEA era. As a result of both its ECP and allocative efficiency analyses, the Commission concludes that the ratemaking system has not increased pricing efficiency during the PAEA era.

Applying the objectives in conjunction with the others demonstrates that the system was largely successful in achieving the goals related to the structure of the ratemaking system. During the PAEA era, the system achieved a streamlined ratemaking process that reduced administrative burden and increased transparency,

allowed the Postal Service pricing flexibility, and achieved rates that were predictable, stable (with regard to timing and magnitude), and just. However, the Commission finds that the market dominant ratemaking system established under section 3622 has not increased pricing efficiency during the PAEA era.

C. Financial Health of the Postal Service

The second principal area of the PAEA system is the financial health of the Postal Service. The market dominant ratemaking system established by section 3622 of the PAEA was intended to enable the Postal Service to maintain its financial health by generating sufficient revenue, including retained earnings and funds for mail security and terrorism deterrence measures, while charging reasonable rates, maximizing cost reductions and efficiency increases, and properly allocating costs. See 39 U.S.C. §§ 3622(b)(1), (5), (7), (8), (9).

The Commission's adoption of a topical approach allows application of the objectives in conjunction with each other to determine whether the relevant objectives have been achieved for the Postal Service's finances as a whole. The Commission determines that Objectives 1, 5, 7, 8, and 9 as set forth in section 3622(b) are applicable to the Postal Service's overall financial health. These objectives include goals relating to financial stability (Objective 5), cost reduction and operational efficiency gains (Objective 1), reasonable rates (Objective 8), mail security and terrorism deterrence (Objective 7), and institutional cost allocation (Objective 9).²³⁹ The Commission also takes into account the factors relevant to the Postal Service's financial health.

²³⁹ As the Commission has explained earlier, it considers the objectives together as they apply to the system as a whole and it does not elevate any individual objective above another. See section I.B., *supra*. The order in which these objectives are discussed facilitates the Commission's topical structured review.

The Commission first reviews the financial stability of the Postal Service. Objective 5 provides that the ratemaking system should “assure adequate revenues, including retained earnings, to maintain financial stability.” 39 U.S.C. § 3622(b)(5). As presented in the ANPR, the key measurable concept of “financial stability” involves analyzing measures of the short, medium, and long-term financial stability of the Postal Service during the PAEA era. See Order No. 3673 at 7.

The Commission continues its review of the overall financial health of the Postal Service by determining whether the system has “maximize[d] incentives to reduce costs and increase efficiency.”²⁴⁰ The Commission first evaluates whether costs have been reduced and operational efficiency has increased and then analyzes whether incentives to reduce costs and increase operational efficiency have been maximized.

The Commission then looks to whether the system has established and maintained reasonable rates as provided by Objective 8 and related to the financial health of the Postal Service. 39 U.S.C. § 3622(b)(8). In this analysis, the Commission reviews the reasonable prong of Objective 8²⁴¹ to ensure “the amount charged for each service . . . [does not threaten] . . . the financial integrity of the Postal Service.” Order No. 3673 at 9.

The Commission analyzes Objective 7, which relates to the financial health of the Postal Service because it requires the Commission to determine whether the system has enabled the Postal Service to fund safeguards “to enhance mail security and deter terrorism.”²⁴²

²⁴⁰ 39 U.S.C. § 3622(b)(1). Throughout this section, unless otherwise specified, efficiency refers to operational efficiency. The Commission analyzed pricing efficiency as related to Objective 1 in section II.B.3.d., *supra*.

²⁴¹ The Commission analyzed the just prong of Objective 8 in section II.B.3.c., *supra*.

²⁴² See *id.*; 39 U.S.C. § 3622(b)(7).

The Commission also reviews Objective 9 as it relates to the financial health of the Postal Service. Objective 9 is concerned with the allocation of institutional costs between market dominant and competitive products. 39 U.S.C. § 3622(b)(9). The Commission considers whether the system “has a mechanism to appropriately divide total institutional costs between market dominant and competitive products in a manner reflecting the relevant statutory considerations.” Order No. 3673 at 10.

Finally, applying the objectives in conjunction with one another, the Commission analyzes the overall financial health of the Postal Service as determined by its analysis described above. The Commission concludes that although the statutorily compliant CPI-based price cap system was anticipated, at the time of its implementation, to enable the Postal Service to produce sustained net income and generate retained earnings, that has not occurred. Consequently, the system has not resulted in a financially stable Postal Service. Although the system is appropriately allocating institutional costs and the Postal Service has been able to maintain financial stability in the short-term, thereby allowing it to ensure funds were available to enhance mail security and deter terrorism, the Commission finds that the Postal Service has not been financially healthy under the current ratemaking system. The Commission determines that financial stability, including retained earnings, has not been maintained for the Postal Service in the medium and long-term time frames and that cost reductions and operational efficiency gains have not been maximized. The Commission finds that reasonable rates were not achieved under the current system, further contributing to the poor financial health of the Postal Service.

1. Relevant Factors

In determining whether the system has achieved the objectives of the PAEA as they relate to the Postal Service’s financial health, the Commission takes into account Factors 1, 2, 5, 7, 10, 12, 13, and 14 as discussed below.

Factor 1 states that consideration should be given to “the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery.” 39 U.S.C. § 3622(c)(1). With respect to the financial health of the Postal Service, the Commission observes that mail security adds to the value of the mail service to both the senders and recipients of mail. All users of mail benefit from more secure collection, transportation, and delivery of the mail.

Factor 2 states that consideration should be given to “the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type.” 39 U.S. C. § 3622(c)(2). For the analysis of the financial health of the Postal Service, the Commission examines both the financial stability of the Postal Service and the reasonableness of rates. In its examination of whether rates are reasonable, the Commission looks to whether rates under the current system threatened the financial integrity of the Postal Service. Factor 2 is relevant to this analysis because failure to cover attributable costs and a portion of the other costs threatens the financial integrity of the Postal Service. Rates that threaten the financial integrity of the Postal Service also negatively affect financial stability.

Factor 5 states that consideration should be given to “the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service.” 39 U.S.C. § 3622(c)(5). The Commission takes Factor 5 into account with respect to financial stability, the reduction of costs, and increased efficiency because mail preparation reduces the costs to the Postal Service and increases efficiency. The Commission also notes that certain inefficiencies in the worksharing process adversely affect financial stability.

Factor 7 states that consideration should be given to “the importance of pricing flexibility to encourage increased mail volume and operational efficiency.” 39 U.S.C. § 3622(c)(7). The Commission takes Factor 7 into account with respect to financial stability and operational efficiency because the factor recognizes the importance of pricing as a tool to achieve efficiency gains.

Factor 10 states that consideration should be given to:

[T]he desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that— (A) either— (i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or (ii) enhance the performance of mail preparation, processing, transportation, or other functions; and (B) do not cause unreasonable harm to the marketplace.

39 U.S. C. § 3622(c)(10). The Commission takes Factor 10 into account, because it provides guidance for market dominant NSAs between the Postal Service and postal users. The factor is relevant to the analysis because these agreements should improve the net financial position of the Postal Service or enhance specified operational functions. Either of these goals, if achieved, would improve the Postal Service’s financial health due to cost reductions or operational efficiency gains.

Factor 12 states that consideration should be given to “the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services.” 39 U.S.C. § 3622(c)(12). Increased efficiency and reduced costs improve financial stability. As discussed in section II.D., *infra*, increased efficiency and reduced costs should not come at the expense of service quality. The Commission also takes Factor 12 into account regarding cost reductions because cost reductions and efficiency gains should support the Postal Service’s ability to maintain high quality and affordable postal services.

Factor 13 states that consideration should be given to “the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail.” 39 U.S.C. § 3622(c)(13). The Commission takes Factor 13 into account as it relates to operational efficiency because intelligent mail is valuable to the Postal Service as it increases the efficiency of the Postal Service. This factor also underscores the importance of technological advances in mail identification and tracking to mail users in order to enhance mail security and deter terrorism.

Factor 14 states that consideration should be given to “the policies of this title as well as such other factors as the Commission determines appropriate.” 39 U.S.C. § 3622(c)(14). Where appropriate, the Commission considers other policies of this title and other factors.

2. Financial Stability

The Commission begins its review of the Postal Service’s overall financial health by turning to Objective 5 and whether the system “assure[d] adequate revenues, including retained earnings, to maintain financial stability.” 39 U.S.C. § 3622(b)(5). For this analysis, the Commission reviews the Postal Service’s short, medium, and long-term financial stability during the PAEA era.

a. Comments

Comments received in response to the ANPR’s financial stability discussion range from stating the Postal Service’s current financial position is not sustainable to asserting the Postal Service is financially stable and is not in need of financial assistance.²⁴³

²⁴³ See, e.g., ANM *et al.* Comments at 3 (“[R]eports of the Postal Service’s impending demise are greatly exaggerated.”); see PR Comments at 21.

Commenters from major mailing associations tend to fall in the latter category. A common contention among this group is that revenue from market dominant products is adequate because it exceeds controllable or attributable costs. See, e.g., MMA, NAPM, and NPPC Comments at 35-36. Some commenters assert that the market dominant system is not responsible for providing sufficient revenue to meet all of the Postal Service's obligations.²⁴⁴ Furthermore, several commenters suggest that the financial measures used to evaluate the Postal Service present a distorted view of the Postal Service's financial health and are not useful.²⁴⁵ One disputed measure is real estate valuation; commenters assert that real estate valuations for the Postal Service's properties are understated because they are listed at book cost rather than fair market value.²⁴⁶ "Overstated liabilities" are also cited as a reason for what some commenters consider to be excessively dismal views of the Postal Service's financial condition. SMC *et al.* Comments at 5.

The Postal Service and the unions representing its employees present a contrary view, asserting that the market dominant ratemaking system, specifically the price cap, prevents the Postal Service from generating adequate revenue.²⁴⁷ The Postal Service offers the conclusion that its "overall financial health is dire." Postal Service Comments at 84. The Postal Service points to net losses since the passage of the PAEA, exhausted borrowing authority, and low liquidity as evidence that the ratemaking system prevents financial stability. *Id.* at 8. Similarly, the Public Representative notes the continuing losses since the PAEA, the Postal Service's default on RHBF payments, and the exhausted borrowing authority. PR Comments at 19-22.

²⁴⁴ See, e.g., GCA Comments at 20; Netflix Comments at 12.

²⁴⁵ See, e.g., ANM *et al.* Comments at 3-5; MMA, NAPM, and NPPC Comments at 41-46.

²⁴⁶ See, e.g., ANM *et al.* Comments at 5-6; SMC *et al.* Comments at 5.

²⁴⁷ NALC Comments at 6 ("CPI-U price cap has thwarted USPS's ability to achieve financial stability."); Postal Service Comments at 234.

Many commenters also discuss the Postal Service's statutory obligations, specifically the RHBF prefunding mandate. These comments are addressed in the application of measurement section of the Commission's analysis. See section II.C.2.b., *infra*.

b. Application of Measurement

In reviewing the financial stability of the Postal Service, the Commission analyzes Objective 5, which looks to whether the system has assured "adequate revenues, including retained earnings, to maintain financial stability." 39 U.S.C. § 3622(b)(5).

As stated in the ANPR, "[i]n a system achieving Objective 5, the Postal Service is financially solvent while able to respond to changes in its environment (e.g., volume erosion, legal or regulatory framework, demographic trends) and meet its statutory obligations (e.g., pricing and universal service)." Order No. 3673 at 7. The key measurable concept for Objective 5 is 'financial stability,' which incorporates adequate revenues and retained earnings." *Id.*

As set forth in the ANPR, the Commission proposed measuring financial stability by analyzing three tiers: short, medium, and long-term financial stability. *Id.* In the ANPR, the Commission suggested specific metrics that could be used to analyze each tier of the financial stability analysis. In addition to the suggested metrics, the Commission noted that it has analyzed the concepts set forth in each tier of financial stability in past financial reports and gave the "Sustainability, Liquidity, Activity, and Financial Solvency" analysis as an example.²⁴⁸

Some comments received relate to the definition in the ANPR. One comment suggests inferring the definition of financial stability from the exigent provision

²⁴⁸ *Id.* (citing FY 2015 Financial Report at 75-86).

subsection. MMA, NAPM, and NPPC Comments at 33. MMA, NAPM, and NPPC submit that because the exigent provision allows the Postal Service to increase rates to allow it “to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States” when using “best practices of honest, efficient, and economical management,” that this standard provides the “normal, expected financial condition” of the Postal Service. *Id.* at 33-34 (citing 39 U.S.C. § 3622(d)(1)(E)). Therefore, MMA, NAPM, and NPPC suggest that the Commission adopt this standard as the definition of financial stability, and contend that the Postal Service has been successful under this standard primarily because the Postal Service continues to provide uninterrupted service. *Id.* at 34-36. The Postal Service proposes additional metrics to measure financial stability, and suggests that the Commission examine liquidity, profitability, and leverage in addition to the short, medium, and long-term metrics.²⁴⁹

The Commission considers these suggestions, but ultimately concludes that the definition and metrics set forth in the ANPR (with some minor adjustments, as discussed below) provide the most comprehensive review of the Postal Service’s financial stability throughout the PAEA era. As discussed below, the Commission’s analysis of financial stability is based on the short, medium, and long-term metrics, but the Commission also includes an examination of additional considerations beyond the short, medium, and long-term metrics. These additional considerations are similar to the analysis suggested by the Postal Service and include working capital, capital expenditure ratio, and debt ratio. With regard to the suggestion to use the exigent provision standard as a measurement metric,²⁵⁰ the Commission disagrees with this suggestion because it does not adequately address the Objective 5 mandate for the Postal Service to generate retained earnings as a part of financial stability. Finally, in

²⁴⁹ Postal Service Comments at 50 n.84; Appendix B at 35-37.

²⁵⁰ MMA, NAPM, and NPPC Comments at 33-34.

response to commenters who suggest that the Postal Service's financial condition is distorted by undervalued real estate,²⁵¹ the Commission notes that the PAEA requires the Postal Service to provide annual financial reports in accordance with the rules and regulations promulgated by the U.S. Securities and Exchange Commission for such reports. This requires the financial statements to be prepared in accordance with Generally Accepted Accounting Principles (GAAP), which does not allow real estate to be solely restated at fair market value except in limited circumstances not applicable in this instance. The Postal Service's valuation of its real estate holdings follows GAAP. In addition, in order for the Postal Service to realize the full value of its real estate, it would have to dispose of those assets and either curtail operations or replace the real estate with new assets, presumably purchased at market value. Consequently, the Commission does not view these assertions about the value of the Postal Service's real estate as pertinent to the instant review.

Because Objective 5 requires the market dominant ratemaking system to enable the Postal Service to "*maintain* financial stability," the Commission finds that section 3622 presumes that the financial condition at the time of the passage of the PAEA was adequate. See 39 U.S.C. § 3622(b)(5) (emphasis added). Accordingly, the Commission's analysis is limited to the Postal Service's ability to maintain financial stability in the years since the enactment of the PAEA.²⁵²

The Commission also received numerous comments on the issue of whether it should consider the statutory obligations of the Postal Service in this review. The Commission summarizes a few representative comments on this issue.

The Postal Service submits that the Commission should not disregard its statutory obligations, most notably the requirement to prefund the RHBF, in determining

²⁵¹ See, e.g., ANM *et al.* Comments at 5-6; SMC *et al.* Comments at 5.

²⁵² See also section II.A.4., *supra*.

whether the system of ratemaking established by the PAEA has achieved the objectives of section 3622(b).²⁵³ It asserts that the Commission should avoid questioning the utility of the statutory obligations or consequences for failing to meet the obligations. With respect to the RHBF payment, it contends that “the fact that the Postal Service has been forced to default on these statutory obligations is evidence that the current system has failed to achieve the objectives, not that those payments need not be [] paid by the Postal Service.” Postal Service Comments at 69 (emphasis in original). The Postal Service contends that the Commission must consider all statutory obligations in order to properly address whether the market dominant ratemaking system has achieved the objectives of the PAEA. *Id.* at 5-7, 63-66, 78-80.

GCA recognizes the “[u]nique status of the Postal Service as a regulated Federal establishment” as it “faces requirements not normally imposed on private-sector enterprises, even those otherwise subject to regulation.” GCA Comments at 4. Yet, GCA contends that the market dominant ratemaking system should not be expected to cover costs outside of the Postal Service’s control, in this case, the RHBF prefunding payment.²⁵⁴ Accordingly, GCA implies that the Commission should not include the RHBF obligation in its review. GCA Comments at 5.

²⁵³ Postal Service Comments at 67-68. See also PR Comments at 3, 36-37 (including fulfillment of the Postal Service’s statutory obligations, specifically the RHBF obligation, as part of its analysis submitted in the comments); NALC Comments at 2, 5-6 (stating Postal Service must be able to pay all its obligations and includes role of market dominant products in analysis); APWU Comments at 18-23, 29 (RHBF obligation and universal service requirement included in analysis).

²⁵⁴ GCA Comments at 4-8. See also NNA Comments at 4, 32-33 (“The introduction of postal reform legislation in the 115th Congress marks the fourth Congress in which an attempt to lift the . . . [RHBF] prepayments has been filed. Yet despite widespread agreement among many . . . legislation has not succeeded. . . . the Commission should not ‘help’ Congress avoid the need to finish the job by making mailers shoulder the burden of erasing balance sheet losses.”); DMA *et al.* Comments at 3 (the RHBF requirement is a “Congressionaly-forced, extraordinary payment schedule [that] is not part of the PAEA rate setting plan.”); ANM *et al.* Comments at 38-44 (RHBF obligation should not be used to support to justify changing the price cap.); SMC *et al.* Comments at 5 (“A rate making system cannot help (or hinder) management in coping with non-controllable costs.”).

The Public Representative suggests that the RHBF obligation “has frustrated the Postal Service’s efforts to establish sufficient rates and created an enduring issue that the Postal Service has not been able to overcome.” PR Comments at 40.

NNA asserts that the RHBF obligation caused “devastation” and “sent the Postal Service into a downward spiral that was accelerated by the Great Recession.” NNA Comments at 4. Some commenters, including NNA, suggest that congressional action to address the RHBF schedule would help alleviate the Postal Service’s financial difficulties.²⁵⁵

The Commission considers the wide-ranging comments regarding inclusion of the statutory obligations of the Postal Service as part of the section 3622 review.

In this review of the market dominant ratemaking system established under the PAEA, the Commission considers the broader statutory obligations of the Postal Service. For instance, obligations imposed by the USO are considered as a part of the cost and efficiency section. See section II.C.3.b.(1)(c), *infra*.

The statutory mandate to conduct this section 3622 review specifically authorizes the Commission to consider other parts of title 39. Factor 14 in section 3622(c) specifically states the Commission “shall take into account the policies of this title as well as other factors as the Commission determines appropriate.” 39 U.S.C. § 3622(c)(14). 39 U.S.C. § 1005(d)(1) requires the Postal Service to make payments in accordance with chapter 83 and subchapter II of chapter 84 of title 5; subsection (c) obligates the Postal Service to follow chapter 81 regarding workers’ compensation; and subsection (f) indicates chapter 89 is also applicable to Postal Service employees. These sections of title 5 require the Postal Service to prefund the RHBF,²⁵⁶ make

²⁵⁵ See, e.g., *id.* at 7; SMC Comments at 5.

²⁵⁶ 5 U.S.C. § 8909(a).

supplemental contributions to Federal Employees Retirement System (FERS) when necessary,²⁵⁷ and make adjustments to the workers' compensation liability.²⁵⁸ To ignore these obligations in this review would be inconsistent with Factor 14's intent that the Commission takes into account the policies of title 39.

Moreover, the RHBF payment requirement was established within the PAEA.²⁵⁹ General principles of statutory construction would dictate that a provision creating an obligation would be applicable in a review mandated by the same legislation.²⁶⁰

It is consistent with Commission precedent to consider the statutory obligations of the Postal Service. In Commission financial reports, the Commission disaggregates the statutory obligations as non-operating expenses (similar to the short-term analysis below) in order to facilitate an in-depth analysis, but includes the obligations in the net income/loss figure (identical to the medium-term analysis that follows).²⁶¹ Similarly, the RHBF obligation is treated as part of total costs in the annual CRA report and the Form 10-K financial statements filed with the Commission, both of which are sources of data in the Commission's financial stability analysis below.

Finally, a plain language interpretation of Objective 5 requires the Commission to consider the statutory obligations of the Postal Service (such as the RHBF) in its overall financial stability analysis. The objective requires that the Postal Service generate "retained earnings." 39 U.S.C. § 3622(b)(5). Retained earnings, by definition, are an

²⁵⁷ See 5 U.S.C. § 8423(b)(2).

²⁵⁸ See 5 U.S.C. § 8147(c).

²⁵⁹ Pub. L. 109-435 § 803, 120 Stat. 3198.

²⁶⁰ 2A Norman & Shambie Singer, Sutherland Statutes and Statutory Construction § 46:5 (7th ed. 2014) ("A statute is passed as a whole and not in parts or sections and is animated by one general purpose and intent. Consequently, each part or section should be construed in connection with every other part or section to produce a harmonious whole.").

²⁶¹ See, e.g., FY 2016 Financial Report at 6.

accumulation of an entity's net income. Net income (discussed further in the medium-term stability section below) can only be calculated after an entity has accounted for all of its obligations. Accordingly, the retained earnings calculation (discussed further in the long-term stability section below) can only be completed if all obligations are paid (or accrued). Therefore, by its very definition, Objective 5 necessitates inclusion of the Postal Service's obligations.

For these reasons, the Commission includes the RHBF and other statutory obligations in its medium and long-term stability analyses, which follow the short-term stability analysis below.

In accordance with the ANPR, the Commission analyzes the three tiers of financial stability to determine whether the Postal Service is financially solvent while able to respond to changes in its environment and meet its statutory obligations. Order No. 3673 at 7. The three tiers build upon each other, and in order for the Commission to find that the system has maintained financial stability, including retained earnings, throughout the PAEA era, the Postal Service must have achieved all three tiers of the financial stability metric.

(1) Short-Term Stability

The Commission measures short-term financial stability by analyzing the Postal Service's operating profit (*i.e.*, operating revenue – operating expenses).²⁶² Order No. 3673 at 7. After determining operating profit, the Commission adjusts the amount of operating profit to reflect additional funds available to the Postal Service (*i.e.*, statutory borrowing authority and end-of-year cash reserves). In the short-term, the Postal

²⁶² In the ANPR, the Commission used the terms “operational revenue” and “operational expenses” to describe operating profit. In this order, the Commission replaces these terms with the commonly used terms “operating revenue” and “operating expenses.” This minor change in verbiage does not change the measurement metric.

Service must be able to meet its operational needs using mail revenue, unused borrowing authority, and accumulated cash reserves.

In the first part of its analysis below, the Commission calculates the operating profit of the Postal Service by subtracting operating expenses from operating revenue. In general, operating expenses are the essential costs of running the entity on a day-to-day basis.²⁶³ Operating revenue is the revenue generated from mailing products and services and is reported on the Postal Service's financial statements. The Commission's calculation of operating expenses is shown in Table II-6.

²⁶³ For consistency across years, in this review, the Commission calculates operating expenses by reducing the Postal Service's total costs (as reported in the Postal Service Form 10-K reports) by interest expense (shown as a non-operating expense on the Postal Service's income statement in the Postal Service's Form 10-K financial statements), and the accruals for payments to the RHBF, non-cash workers' compensation, and supplemental contribution to the FERS annuity. The Commission explains these terms and why they are excluded from the short-term analysis later in this section. This approach is consistent with that taken in the Commission's annual financial reports. See, e.g., FY 2016 Financial Report at 6 n.6.

Table II-6
Postal Service Operating Expenses FY 2007 – FY 2016

Fiscal Year	Total Costs <i>(\$ in millions)</i>	Less: Statutory Accruals to RHB <i>(\$ in millions)</i>	Less: Noncash Workers' Compensation <i>(\$ in millions)</i>	Less: Supplemental contribution to FERS annuity <i>(\$ in millions)</i>	Less: Interest Expense <i>(\$ in millions)</i>	Operating Expenses <i>(\$ in millions)</i>
2007	\$80,115	\$8,358	\$0	\$0	\$10	\$71,747
2008	\$77,774	5,600	417	0	36	71,721
2009	\$71,910	1,400	1,343	0	80	69,087
2010	\$75,582	5,500	2,500	0	156	67,426
2011	\$70,806	0	2,242	0	172	68,392
2012	\$81,153	11,100	2,356	0	190	67,507
2013	\$72,319	5,600	(311)	0	191	66,839
2014	\$73,362	5,700	1,182	7	184	66,289
2015	\$74,011	5,700	307	241	185	67,578
2016	\$77,121	5,800	1,214	248	222	69,637

Source: Library Reference PRC-LR-RM2017-3/1

After calculating operating expenses, the Commission calculates operating profit by subtracting operating expenses from operating revenue. Table II-7 provides a summary of the Postal Service's operating profit throughout the PAEA era.

Table II-7
Operating Profit FY 2007 – FY 2016

Fiscal Year	Operating Revenue (\$ in millions)	Operating Expenses (\$ in millions)	Operating Profit (Loss) (\$ in millions)
2007	\$74,778	\$71,747	\$3,031
2008	\$74,932	71,721	3,211
2009	\$68,090	69,087	(997)
2010	\$67,052	67,426	(374)
2011	\$65,711	68,392	(2,681)
2012	\$65,223	67,507	(2,284)
2013	\$67,318	66,839	479
2014	\$67,764	66,289	1,475
2015	\$68,790	67,578	1,212
2016	\$71,429	69,637	1,792

Source: Library Reference PRC-LR-RM2017-3/1

As demonstrated in Table II-7, the operating profit of the Postal Service fluctuated over the course of the PAEA era. In 6 out of the 10 years, the Postal Service had an operating profit as it was able to generate sufficient operating revenue to cover its operating expenses. Between FY 2009 and FY 2012, it generated a cumulative operating loss of almost \$6.4 billion. The Commission notes that the operating profits in FY 2014 to FY 2016 coincide with the exigent surcharge that was in place from January 2014 through April 2016.²⁶⁴

²⁶⁴ The exigent surcharge was the result of a proceeding conducted in accordance with 39 U.S.C. § 3622(d)(1)(E) and 39 C.F.R. part 3010, subpart E. As a result of that proceeding, the Postal Service was authorized to implement a surcharge on market dominant products to recoup for contribution loss due to the Great Recession. See *generally* Order No. 1926.

Next, the Commission analyzes operating profit adjusted to include available borrowing authority²⁶⁵ and end-of-year cash reserves because the Postal Service utilizes these tools to meet its short-term obligations. As shown in Table II-8, the Postal Service had no borrowing capacity in FY 2012. The Postal Service's end-of-year cash reserves are reported as its cash balance in the annual Form 10-K report. The Postal Service had cash reserves despite showing losses every year, primarily because of limited capital investment and nonpayment of the statutory RHBF payments.²⁶⁶ The result from this adjustment, referred to as the adjusted operating profit, explains how the Postal Service was able to maintain operations while experiencing significant operating losses from FY 2009 to FY 2012 as demonstrated in Table II-7.

The adjusted operating profit, which builds on the operating profit analysis in Table II-7, is illustrated in Table II-8. It represents the total funding available for the Postal Service to pay its operating expenses.

²⁶⁵ The Postal Service is authorized to borrow up to \$3 billion annually, with a maximum debt balance of \$15 billion. 39 U.S.C. § 2005(a). The Postal Service reached the maximum debt limit in FY 2012. United States Postal Service, 2012 Report on Form 10-K, November 15, 2012, at 84 (Postal Service FY 2012 Form 10-K).

²⁶⁶ See FY 2016 Financial Report at 25 ("The growth in cash reserves is likely the result of limited investment in capital infrastructure and equipment and the nonpayment of the statutory prefunding of RHBF.").

Table II-8
Postal Service Adjusted Operating Profit FY 2007 – FY 2016

Fiscal Year	Operating Profit (Loss) (\$ in millions)	Available Borrowing Authority (\$ in millions)	EOY Cash Reserves (\$ in millions)	Adjusted Cash Operating Profit (Loss) (\$ in millions)
2007	\$3,031	\$3,000	\$899	\$6,930
2008	\$3,211	3,000	1,432	7,643
2009	(\$997)	3,000	4,089	6,092
2010	(\$374)	3,000	1,161	3,787
2011	(\$2,681)	2,000	1,283	602
2012	(\$2,284)	0	2,086	(198)
2013	\$479	0	2,326	2,805
2014	\$1,475	0	4,906	6,381
2015	\$1,212	0	6,634	7,846
2016	\$1,792	0	8,077	9,869

Source: Library Reference PRC-LR-RM2017-3/1

As shown in Table II-8, in every year during the PAEA era, except for FY 2012,²⁶⁷ the Postal Service had a positive adjusted operating profit. It was able to pay all operating expenses using a combination of revenue, available borrowing authority, and cash reserves arising from delinquent payments and non-cash expenses.²⁶⁸ One of the main drivers of the Postal Service's ability to achieve short-term stability was the availability of the end-of-year cash reserves. Although the Postal Service's ability to achieve operating profit was mixed, the Commission finds that the Postal Service was able to use revenue, statutory borrowing authority, and cash reserves to maintain a positive adjusted operating profit.

²⁶⁷ In FY 2012, the Postal Service had the lowest operating revenue in any year under PAEA (see Table II-8), and it was the first year the Postal Service had no available borrowing authority.

²⁶⁸ As a result of operating profits in FY 2007 and FY 2008, the Postal Service did not borrow the full \$3 billion annual maximum borrowing authority each year.

The Postal Service's ability to maintain a positive adjusted operating profit explains how it has been able to operate continuously without service interruption. This leads the Commission to conclude that the current system has allowed the Postal Service to maintain short-term financial stability.

(2) Medium-Term Stability

After analyzing short-term stability, the Commission turns to its medium-term stability analysis. In the ANPR, the Commission suggested that economic profit could be analyzed by looking at (total revenue – [variable cost + fixed cost]). Order No. 3673 at 7. In the instant analysis, the Commission employs the same theory, but uses terms more familiar to Postal Service stakeholders,²⁶⁹ consistent with the approach throughout the section 3622 review and its prior analyses of the Postal Service's financial health.

Accordingly, the Commission replaces the term "economic profit" with the term "net income." The Commission modifies the components of total cost as a function of (variable costs + fixed costs) to a function of (attributable costs + institutional costs). Therefore, for medium-term stability, the Commission analyzes net income, which consists of (total revenue – [attributable costs + institutional costs]).

As an additional consideration, the Commission also reviews available borrowing authority, which could have been used by the Postal Service to meet its medium-term obligations. With the availability of borrowing authority, a net loss for a given year does not necessarily threaten the Postal Service's medium-term financial stability. For example, if the Postal Service had a few years of net income, a year of net loss, and more years of net income and the ability to borrow to cover expenses during the year of net loss, financial stability in the medium-term would be attainable. However, borrowing authority is limited by law so ultimately, in the medium-term, revenues must be sufficient

²⁶⁹ See, e.g., ANM *et al.* Comments at 11, 36; APWU Comments at 22; NALC Comments at 2, 4.

to cover both attributable and institutional costs, resulting in net income.²⁷⁰ For this reason, the adjusted net income analysis is an additional consideration, rather than a determinative metric for medium-term stability.

The Commission first calculates total costs as a function of (attributable costs + institutional costs). For this analysis, the data for attributable and institutional costs are retrieved from the Postal Service Form 10-K reports and the library references that accompany the Commission's Annual Financial Reports.²⁷¹ Table II-9 shows total costs as calculated by the Commission.

²⁷⁰ This analysis assumes competitive products are meeting their cost coverage requirements. Collectively, competitive products satisfy the requirement to provide a minimum contribution of 5.5 percent of institutional costs, in addition to covering all of their attributable (incremental) costs. See, e.g., FY 2016 ACD at 78.

²⁷¹ Prior to 2013, these data were found in the Commission's library references for the ACD.

Table II-9
Postal Service Total Costs FY 2007 – FY 2016²⁷²

Fiscal Year	Total Attributable Costs (\$ in millions)	Total Institutional Costs (\$ in millions)	Total Costs (\$ in millions)
2007	\$45,509	\$31,648	\$80,115
2008	45,637	32,137	77,774
2009	43,005	28,905	71,910
2010	41,576	34,006	75,582
2011	41,252	29,554	70,806
2012	40,528	40,625	81,153
2013	39,169	33,149	72,319
2014	39,175	34,187	73,362
2015	40,196	33,815	74,011
2016	40,758	36,363	77,121

Source: Library Reference PRC-LR-RM2017-3/1

After determining total costs, the Commission calculates net income. Table II-10 below demonstrates net income (total revenue – total costs) over the course of the PAEA era. For this analysis, the total revenue data are retrieved from the Postal Service Form 10-K reports and the library references that accompany the Commission's Annual Financial Reports.²⁷³

²⁷² FY 2007 Total Costs include an April 2007 transfer of \$2.958 billion in funds held in escrow to the RHBF, as required by Pub. L. § 108-18. United States Postal Service, 2007 Report on Form 10-K, November 14, 2007, at 10 (Postal Service FY 2007 Form 10-K). The Postal Service recognized the escrow in the FY 2006 Cost and Revenue Analysis report, because there was no declared purpose for the funds at the time. The escrow reconciliation is not included in either attributable or institutional costs. Costs for other years may not add to the totals due to rounding.

²⁷³ Prior to FY 2013, these data were found in the Commission's library references for the ACD.

Table II-10
Postal Service Net Income (Loss) FY 2007 – FY 2016

Fiscal Year	Total Revenue (\$ in millions)	Total Costs (\$ in millions)	Net Income (\$ in millions)
2007	\$74,973	\$80,115	(\$5,142)
2008	74,968	77,774	(2,806)
2009	68,116	71,910	(3,794)
2010	67,077	75,582	(8,505)
2011	65,739	70,806	(5,067)
2012	65,247	81,153	(15,906)
2013	67,342	72,319	(4,977)
2014	67,854	73,362	(5,508)
2015	68,951	74,011	(5,060)
2016	71,530	77,121	(5,591)

Source: Library Reference PRC-LR-RM2017-3/1

As shown in Table II-10, the Postal Service had a net loss in every year because total revenue generated was inadequate to cover total costs. Therefore, medium-term stability was not maintained during the PAEA era.

Next, in Table II-11, the Commission adjusts net income from Table II-10 to determine if available statutory borrowing authority was sufficient to cover the revenue shortfall.²⁷⁴ The Commission considers this additional information, but ultimately relies on the findings in the previous analysis, because as stated above, the available borrowing authority is limited by statute.

²⁷⁴ Unlike in the short-term analysis above, the Commission does not consider end-of-year cash reserves for the adjusted net income calculation. Including the cash reserves is not appropriate in this analysis because the adjusted net income calculation assumes the Postal Service pays all expenses each year, and therefore, does not accrue cash reserves from unpaid or delayed payment of expenses.

Table II-11
Adjusted Net Income FY 2007 – FY 2016

Fiscal Year	Net Income (Loss) <i>(\$ in millions)</i>	Available Borrowing Authority <i>(\$ in millions)</i>	Adjusted Net Income (Loss) <i>(\$ in millions)</i>
2007	(\$5,142)	\$3,000	(\$2,142)
2008	(2,806)	3,000	194
2009	(3,794)	3,000	(794)
2010	(8,505)	3,000	(5,505)
2011	(5,067)	2,000	(3,067)
2012	(15,906)	0	(15,906)
2013	(4,977)	0	(4,977)
2014	(5,508)	0	(5,508)
2015	(5,060)	0	(5,060)
2016	(5,591)	0	(5,591)

Source: Library Reference PRC-LR-RM2017-3/1

Table II-11 demonstrates that even when the available borrowing authority is considered, the Postal Service was not able to maintain medium-term financial stability for 9 out of 10 years during the PAEA era. The revenue shortage persisted despite the inclusion of the exigent surcharge for a portion of this period, as discussed in the short-term analysis above. Even with the additional revenue received during the surcharge period and the inclusion of the Postal Service's borrowing authority, the total revenue generated by the market dominant ratemaking system was not sufficient to cover total costs. This additional analysis supports the Commission's finding that medium-term stability was not maintained.

(3) Long-Term Stability

The Commission concludes its evaluation of the three tiers of financial stability by analyzing long-term stability. In the long-term, revenue must exceed costs year after year, thus building up retained earnings that would allow the Postal Service to invest in capital improvements and pay down its debt. To achieve long-term financial stability,

the Postal Service must have sufficient net income to generate retained earnings, which support its long-term solvency.

To review the Postal Service's long-term financial stability, the Commission analyzes the Postal Service's retained earnings, which is one potential measurement of solvency. The ANPR proposed measuring solvency by dividing total assets by total liabilities, but the Commission considers that measurement (*i.e.*, the Postal Service's debt ratio) as an additional consideration in a later section. Order No. 3673 at 7. Instead, for the long-term stability analysis, the Commission determines whether the Postal Service has been able to generate retained earnings under the PAEA.

Retained earnings is a more appropriate key measurable concept for long-term financial stability because it is specifically included in the stated goal of Objective 5 ("to assure adequate revenues, *including retained earnings*, to maintain financial stability"). 39 U.S.C. § 3622(b)(5) (emphasis added). Retained earnings is the accumulation of net income. It can be used to fund capital improvements and limit the use of debt. If an entity accumulates net losses instead of net income, the result is an accumulated deficit rather than retained earnings. This can restrict the ability to fund capital improvements and often leads to an increase in the use of debt. If the Postal Service is stable in the medium-term, any net income accumulated when revenue exceeds costs will result in retained earnings over time. If the Postal Service is not financially stable in the medium-term, the accumulated net losses will result in an accumulated deficit.

Table II-12 shows this balance and the accumulation of the net income (loss) for each subsequent year under the PAEA.²⁷⁵

Table II-12
Net Income (Loss) and Retained Earnings (Accumulated Deficit) from
FY 2006 – FY 2016

Fiscal Year	Net Income (Loss) (\$ in millions)	Retained Earnings (Deficit) (\$ in millions)
2006	N/A	\$3,242
2007	(\$5,142)	(1,900)
2008	(2,806)	(4,706)
2009	(3,794)	(8,500)
2010	(8,505)	(17,005)
2011	(5,067)	(22,071)
2012	(15,906)	(37,978)
2013	(4,977)	(42,955)
2014	(5,508)	(48,463)
2015	(5,060)	(53,522)
2016	(5,591)	(59,113)

Source: Library Reference PRC-LR-RM2017-3/1

As shown in Table II-12, the accumulation of net losses resulted in accumulated deficits since 2006. The accumulated deficit of \$59.1 billion includes \$54.8 billion in expenses related to prefunding the RHBF.²⁷⁶ Because the Postal Service has not generated retained earnings during the PAEA era, long-term stability was not maintained.

²⁷⁵ Although the cost-of-service model under the PRA generally prevented the Postal Service from accumulating retained earnings, a change in the law for funding the Postal Service's civil service retirement liability resulted in reduced expenses and a retained earnings balance in fiscal years 2004, 2005, and 2006. FY 2013 Financial Report at 41 n.29 (citing Pub. L. 108-18, 117 Stat. 624 (2003)). The starting point for the Commission's analysis is the retained earnings that existed at the end of the PRA period, which is the end of FY 2006.

²⁷⁶ United States Postal Service, 2016 Report on Form 10-K, November 15, 2016, at 58 (Postal Service FY 2016 Form 10-K).

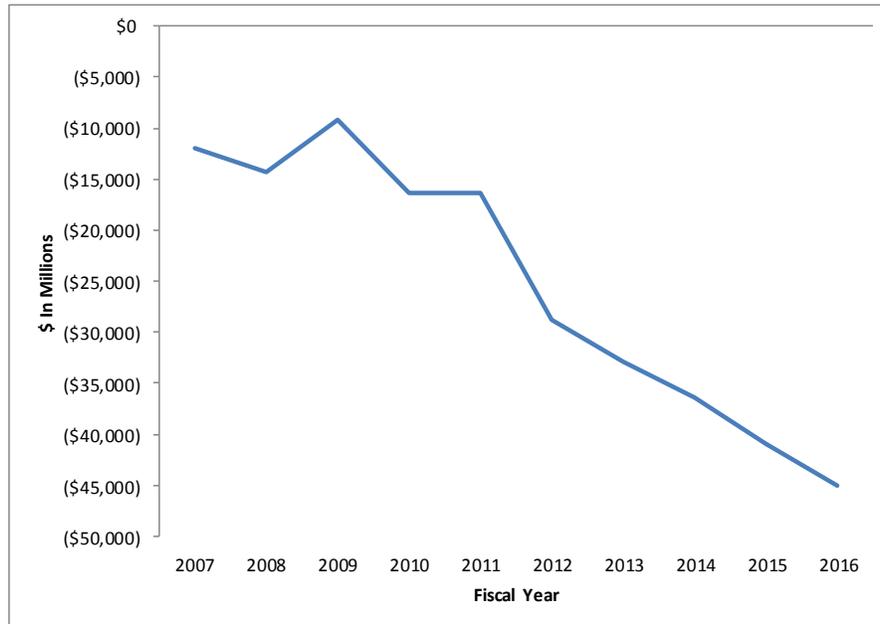
(4) Additional Considerations

In addition to the Commission's short, medium, and long-term stability analyses above, the Commission also examines several financial ratios to provide additional information regarding the Postal Service's financial condition. As stated in previous Commission financial reports, the Commission notes that the Postal Service differs from private sector companies, and as a result, standard financial measurements as reflected in the ratios may not be directly applicable. See, e.g., FY 2016 Financial Report at 75. Although these ratios may provide additional insight regarding the Postal Service's financial condition, the Commission's findings that the system has maintained the Postal Service's short-term stability, but not medium or long-term stability under the PAEA, are based on its short, medium, and long-term financial stability analyses outlined above.

Working capital. Working capital is the amount by which the value of an entity's current assets exceeds its current liabilities. See, e.g., FY 2013 Financial Report at 40. Working capital measures how well the Postal Service can meet its short-term obligations using its current assets. It is also referred to as a "liquid reserve," which "determines if a company can pay its current liabilities when due." *Id.* Working capital acts as a liquid financial cushion available for emergencies and unplanned needs. The Commission has previously analyzed working capital in its financial reports. See *id.* The Postal Service reports its working capital on a fiscal year basis in its financial statements and annual reports.

Figure II-9 below shows the negative growth in the Postal Service's working capital during the PAEA era.

Figure II-9
Postal Service Working Capital FY 2007 – FY 2016



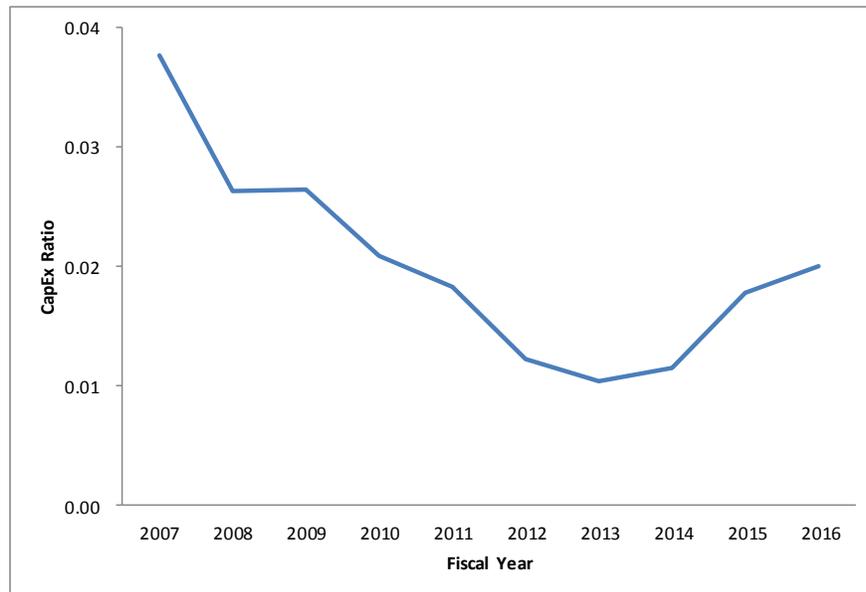
Source: Library Reference PRC-LR-RM2017-3/1

As demonstrated in Figure II-9, the Postal Service has not had any working capital for the entire PAEA era. Although the Postal Service had retained earnings at the end of FY 2006 and there was availability of \$12.9 billion in borrowing authority, the Postal Service's low cash reserves were insufficient to cover its current liabilities.²⁷⁷ Working capital fluctuated in FY 2007 and FY 2008 and then continuously declined from FY 2009 to FY 2016.

Next, the Commission analyzes the Postal Service's capital expenditure (CapEx) ratio, which compares capital outlays to total revenue. This ratio indicates the extent to which the Postal Service is reinvesting its revenue into capital assets and is equal to capital outlays divided by total revenue.

²⁷⁷ See Postal Service Annual Report 2006 at 34. At the end of FY 2006, the Postal Service had borrowed \$2.1 billion of its \$15 billion borrowing limit.

Figure II-10
Postal Service CapEx Ratio FY 2007 – FY 2016



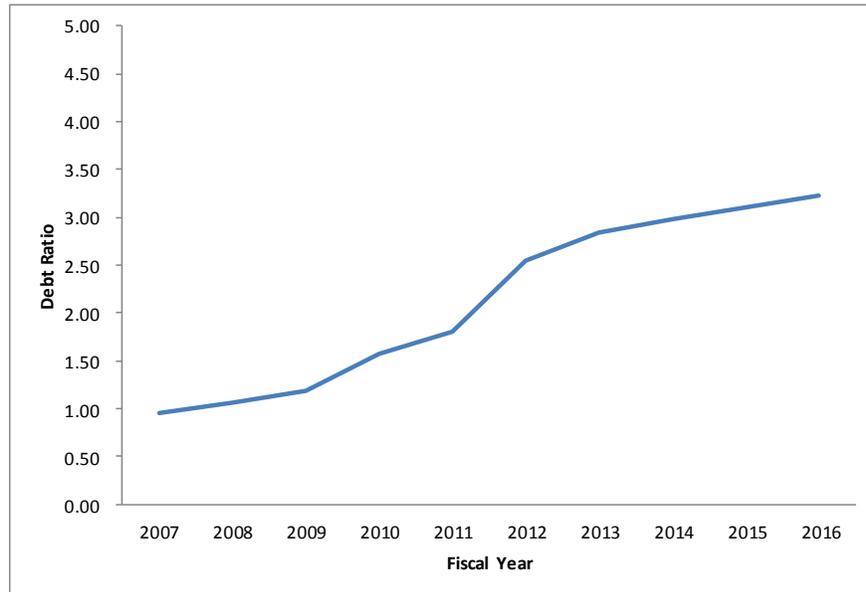
Source: Library Reference PRC-LR-RM2017-3/1

Figure II-10 shows the CapEx ratio declined from FY 2007 to a low of 0.01 in FY 2013, and then increased in FY 2015, reaching 0.02 in FY 2016. CapEx ratios of 0.04 in FY 2007 and 0.02 in FY 2016 indicate that in FY 2007, the Postal Service invested approximately 4 percent of revenue on capital outlays, but by FY 2016 the amount invested had dropped to 2 percent.

Debt ratio measures the Postal Service's total debt against its total assets, and indicates how much of the Postal Service's assets are financed by debt. This ratio represents the analysis proposed in the ANPR to represent solvency. See Order No. 3673 at 7. The debt ratio (calculated by dividing total liabilities by total assets) shows how much an entity "relies on debt to finance assets." FY 2013 Financial Report at 38.

Figure II-11 shows the Postal Service's debt ratio from FY 2007 to FY 2016.

Figure II-11
Postal Service Debt Ratio FY 2007 – FY 2016



Source: Library Reference PRC-LR-RM2017-3/1

Figure II-11 shows the steady increase in the Postal Service's debt ratio since FY 2007, which indicates the Postal Service's liabilities increased at a faster rate than its assets. A debt ratio greater than one indicates that the Postal Service does not possess sufficient assets to meet its financial obligations. The accruals for nonpayment of the RHBF and the long-term workers' compensation obligations significantly impacted the Postal Service's debt ratio. See FY 2016 Financial Report at 25.

The Commission relies on the metrics described in the short, medium, and long-term analyses in the previous sections in reaching its conclusion on financial stability. These additional considerations provide supplemental insight into the analysis of the Postal Service's short, medium, and long-term financial stability.

(5) Commission Precedent

As stated in the ANPR, the Commission has analyzed the Postal Service's financial stability in great detail in recent financial reports. Order No. 3673 at 7. As noted in the first and subsequent financial reports, "[i]t is difficult to determine a single measurement that signifies financial health for a government entity." FY 2013 Financial Report at ii. In its financial reports, the Commission uses "a qualitative assessment" of the Postal Service's finances that has developed over time and uses many of the same or similar metrics as the section 3622 review. See, e.g., *id.* The Commission briefly reviews its conclusions reached in recent financial reports. These conclusions are consistent with findings in ACDs prior to the creation of the separate financial reports.²⁷⁸

In the FY 2013 Financial Report, the Commission determined that the Postal Service's "current financial situation call[ed] into question its long-term viability." FY 2013 Financial Report at ii. The major findings elaborated on this serious message: the Commission found that sustained losses and lack of any additional borrowing authority left the Postal Service with a significant net deficit, insufficient liquid assets to meet current liabilities, and no flexibility for funding capital improvement. *Id.*

The following year, the findings remained serious. In the FY 2014 Financial Report, the Commission reported the Postal Service "recorded its eighth consecutive financial loss, bringing the total net deficit since FY 2007 to \$51.7 billion." FY 2014 Financial Report at 2. The total net loss (the medium-term test described above) of

²⁷⁸ See, e.g., Revised FY 2012 ACD at 3 ("The Postal Service's net financial losses eroded its already precarious situation even further in FY 2012. The Postal Service incurred losses of \$15.9 billion."); FY 2011 ACD at 22 ("Since FY 2007, the Postal Service has lost \$25.3 billion. These losses have created a situation where there may not be enough cash or borrowing authority available to finance postal operations beyond the summer of 2012 . . . the continued losses have seriously eroded the retained earnings and increased the total debt of the Postal Service."); FY 2010 ACD at 25 (Although the Postal Service plans several cost reduction initiatives and "while these actions will reduce the costs of the Postal Service, they will not provide the \$4-\$5 billion annual cost savings necessary to bring the Postal Service long term financial solvency and stability.").

\$5.5 billion in FY 2014 exceeded the previous year's loss by \$500 million "primarily due to increases in workers' compensation costs and RHBF payments." *Id.* The report focused again on insufficient liquidity to improve operational efficiency or even meet current liabilities. *Id.*

In the FY 2015 Financial Report, some positive developments with respect to finances included an increase in market dominant revenue for the second consecutive year and volume and revenue increases from competitive products. FY 2015 Financial Report at 3. The Commission noted, as some commenters point out in this review,²⁷⁹ that the Postal Service's cash position was reported at the highest level since FY 2007; however, the Commission also noted that "significant balance sheet liabilities and off-balance sheet unfunded liabilities for pension and annuitant health benefits threaten[ed] the improvements in liquidity." FY 2015 Financial Report at 4. The report showed an increase in revenue over FY 2014, but an overall decrease since the implementation of PAEA. *Id.* at 83.

The FY 2016 Financial Report found that "[f]inancial sustainability continues to erode due to large personnel related liabilities and the slow replacement of fully depreciated capital assets." FY 2016 Financial Report at 3. The report concluded that the \$5.6 billion total net loss (the medium-term test described above) was "largely driven by a \$1.5 billion increase in overall compensation and benefits costs and an increase in non-cash workers' compensation expenses of \$0.9 billion caused by a decrease in the discount rate." *Id.* at 1. The Commission noted that, as it did in the FY 2015 Financial Report, the Postal Service's cash balance remained high, but liabilities continued to affect improvements in financial condition. *Id.* at 3.

²⁷⁹ See, e.g., ANM *et al.* Comments at 4.

The Commission's financial reports have repeatedly acknowledged the Postal Service's financial instability throughout the PAEA era, which is consistent with the Commission's financial stability analysis above. Based on the financial stability analysis, supported by the discussion of additional considerations and Commission precedent, the Commission determines that the Postal Service has not been financially stable during the PAEA era because the Postal Service has not achieved "adequate revenues, including retained earnings, to maintain financial stability." 39 U.S.C. § 3622(b)(5).

3. Costs and Operational Efficiency

The Commission continues its review of the Postal Service's overall financial health by turning to Objective 1 and whether the system "maximize[d] incentives to reduce costs and increase efficiency." 39 U.S.C. § 3622(b)(1). For this analysis, the Commission reviews whether the system used available mechanisms "to the fullest extent possible to incentivize the reduction of costs and increases in operational . . . efficiency." Order No. 3673 at 4.

a. Comments

Many commenters submit that the price cap has worked as an incentive to control costs over the PAEA era.²⁸⁰ Some commenters suggest that the Postal Service has been successful in achieving cost reductions.²⁸¹ DMA *et al.* state that although the Postal Service has successfully reduced costs, efforts have slowed in recent years. DMA *et al.* Comments at 1-2.

²⁸⁰ ANM *et al.* Comments at 15, 20; DMA *et al.* Comments at 9, 12; GCA Comments at 9; JVMI Comments at 1; Minnesota Power Comments at 2; SMC *et al.* Comments at 9; UPS Comments at 2.

²⁸¹ APWU Comments at 26; eBay Comments at 7; GCA Comments at 10; MMA, NAPM, and NPPC Comments at 2; PSA Comments at 3; NALC Comments at 2-3.

The Postal Service contends that the price cap was not the driving incentive for its cost reduction efforts. The Postal Service states that the price cap is based on “an index that measures general price levels in the economy, and it does not consider Postal Service volume changes, unit cost trends, or the fact that many of the Postal Service’s costs rise at levels independent of the trends in consumer inflation.” Postal Service Comments at 100. Based on this tension between the limits created by the price cap and its ability to reduce costs, the Postal Service asserts that “absent changes to the structure under which it operates, the Postal Service would need to implement a substantial increase in order to sustainably cover its costs.” *Id.* at 182. This is because, according to the Postal Service, it was “undertaking aggressive efforts to cut costs and improve efficiency well before the PAEA was enacted, meaning that the imposition of the price cap by the PAEA was not the causal factor for Postal Service’s continued cost reductions and efficiency gains over the past decade.” *Id.* at 190.

The Postal Service explains that its cost cutting efforts include “right-siz[ing] operations, increas[ing] workforce flexibility, and establish[ing] a more affordable, two-tiered wage system . . . result[ing] in cost savings of approximately \$14 billion annually.” *Id.* at 113 (internal citation omitted). This is in light of its obligation to “consider the impact of its cost-cutting activities on its ability to continue to provide postal services consistent with the policies of title 39, United States Code.”²⁸²

Some commenters contend that there are ample opportunities to reduce costs and increase efficiency in ways that would significantly improve the Postal Service’s financial position but that the Postal Service is missing those opportunities.²⁸³ One commenter notes that these cost reductions have failed to incentivize efficiency while maintaining quality service. APWU Comments at 12. Another commenter suggests

²⁸² *Id.* at 117 n.222 (citing Order No. 1926 at 131).

²⁸³ See, e.g., ANM *et al.* Comments at 6-8, 43, 52.

that the Postal Service is reaching its limits of potential efficiency gains and cost savings. NALC Comments at 6-9. Some commenters submit that the incentives to reduce costs and increase efficiency have not been sufficiently maximized under the PAEA.²⁸⁴

When considering the Postal Service's ability to cut costs and increase efficiency, commenters contend that the Commission also needs to consider the Postal Service's other obligations and constraints. Numerous commenters point to the Postal Service's USO (discussed below) and RHBF (discussed in section II.C.2.b., *supra*) obligations as limiting the Postal Service's ability to reduce costs and increase efficiency as intended by Objective 1.²⁸⁵ The Postal Service contends that the Commission should consider the costs imposed by the statutory obligations, stating that "it would be impermissible for the Commission to conclude that it can appropriately disregard costs that are dictated by, or result from, the application of the statute, simply because it believes those costs to be excessive." Postal Service Comments at 65. To the contrary, many commenters submit that the Commission should not include the RHBF obligation as part of the Postal Service's costs under Objective 1.²⁸⁶ As discussed in section II.C.2.b., *supra*, the Commission considers the RHBF payments a statutory obligation that must be considered in analyzing the market dominant ratemaking system's success and includes RHBF as an additional consideration where relevant.

The Postal Service further asserts that it has limited control over specific costs it incurs, including benefits costs, and collective bargaining and arbitration costs, and

²⁸⁴ MMA, NAPM, and NPPC Comments at 13-16, 19; Pitney Bowes Comments at 10, 49.

²⁸⁵ See, e.g., APWU Comments at 26; Postal Service Comments at 66-78; see also section II.C.2.b., *supra*.

²⁸⁶ See e.g., GCA Comments at 7, 25-26 (the Commission should not consider costs outside of the Postal Service's control when evaluating Objective 1 because it is impossible to provide an incentive to control non-controllable costs); SMC *et al.* Comments at 4 (a ratemaking system cannot help or hinder management in coping with non-controllable costs).

costs involved in complying with its USO. Postal Service Comments at 66-78. The Postal Service contends that the Commission must consider the impact of the USO, declining mail volume, and change in mail mix on its ability to reduce costs during the PAEA era. *Id.* at 9-13.

Several commenters discuss the tension between Objective 1 and other objectives. The Postal Service contends that Objective 1 can only be achieved if the Postal Service is financially stable, as required under Objective 5. *Id.* at 40-50. APWU submits that the consideration of the achievement of Objective 1 and the Postal Service's ability to cut costs and increase efficiency must be balanced against Objective 3 (to maintain high quality service standards) and Objective 5 (to maintain financial stability, including retained earnings). APWU Comments at 28. The Public Representative states that the failure to achieve Objective 5 adversely affects the ability of the system to achieve Objective 1. PR Comments at 23-24.

Most commenters that directly address operational efficiency contend that the operational efficiency of the Postal Service has increased since the implementation of the PAEA but has recently stagnated. ANM *et al.* note the Postal Service's productivity growth has stagnated in the past few years and that this reduction in productivity growth coincides with the year in which the exigent surcharge took effect. ANM *et al.* Comments at 6, 20. Other commenters submit that there are limits to the potential efficiency gains achievable by the Postal Service.²⁸⁷ The Postal Service states that the Commission must consider the statutory constraints placed on Postal Service and its operations when analyzing efficiency. Postal Service Comments at 58-62. APWU contends that the Postal Service has realized the majority of potential efficiency gains. APWU Comments at 26. Commenters also note that the price cap's limitations on revenue are a constraint on the Postal Service's ability to make capital expenditures

²⁸⁷ Postal Service Comments at 58-60; APWU Comments at 26.

intended to improve long-term performance.²⁸⁸ The Postal Service contends that its lack of financial stability will inhibit its operational efficiency. Postal Service Comments at 53.

b. Application of Measurement

Objective 1 looks to whether the market dominant ratemaking system has “maximize[d] incentives to reduce costs and increase efficiency.” 39 U.S.C. § 3622(b)(1). As set forth in the ANPR, a system “achieving Objective 1 uses available mechanisms, such as flexibility under the price cap, pricing differentials, and workshare discounts, to the fullest extent possible to incentivize the reduction of costs and increases in operational and pricing efficiency.” Order No. 3673 at 4. As discussed in section II.B.3.d., *supra*, the Commission adopts this definition for purposes of this review.

Several commenters provide input on how to evaluate Objective 1 as related to cost reduction and operational efficiency. The Postal Service suggests that the Commission expand its analysis as set forth in the ANPR under Objective 1 to include a range of measures including cost reduction initiatives and future operational plans as well as exogenous factors affecting cost data. Postal Service Comments at 56-58. The Commission does not consider future operational plans because this review is a backward-looking review that considers actual results from the 10 years following the enactment of the PAEA. Cost reduction initiatives and exogenous factors are discussed as additional considerations in the analysis below. NNA contends that the Commission should look at incentives from the perspective of the mailers and the Postal Service, not solely how the system incentivizes the Postal Service to reduce costs and increase efficiency. NNA Comments at 3. The Commission incorporates a partial review of

²⁸⁸ APWU Comments at 6, 26; NALC Comments at 7-8, 12.

incentives to mailers in its discussion of pricing efficiency and in its consideration of worksharing in section II.B.3.d.(2), *supra*. In this section, it focuses its analysis on the cost reductions and operational efficiency increases made by the Postal Service, as Objective 1 looks to whether the system has maximized incentives for the Postal Service to reduce costs and increase efficiency.

The Commission considers these comments and adopts the following approach. As set forth in the ANPR, there are “three measurable key concepts within [Objective 1]: (1) maximize incentives, (2) reduce costs, and (3) increase efficiency.” Order No. 3673 at 4. As explained in section II.B.3.d., *supra*, the Commission separates its analysis of efficiency gains into pricing efficiency and operational efficiency. The Commission’s analysis of pricing efficiency is in section II.B.3.d., *supra*. The Commission analyzes each measurable concept separately. As explained in section II.B.3.d., *supra*, the first step in the Commission’s analysis is to determine whether: (1) costs have been reduced, and (2) operational efficiency has increased during the PAEA era.

To analyze whether costs have been reduced during the PAEA era, the Commission uses, as its determinative metric, the change in real unit market dominant attributable costs. The Commission performs a supplementary analysis by reviewing changes in average cost per piece by function and mail mix changes as potential drivers of cost reductions. The Commission also reviews additional considerations that potentially constrain cost reduction efforts, such as the nature of the Postal Service’s cost structure and the USO. The Commission then summarizes Commission precedent related to cost reduction efforts.

To analyze whether efficiency has increased, the Commission uses, as its determinative metric, the change in total factor productivity (TFP) during the PAEA era. A review of additional considerations related to operational efficiency are the Labor Productivity Index (LPI), workhour analysis, machine productivities, and considerations

related to worksharing. The Commission then summarizes Commission precedent related to operational efficiency.

As explained in section II.B.3.d., *supra*, the Commission's second step is to review whether the incentives to reduce costs and improve operational efficiency have been maximized. The Commission analyzes whether the "maximum benefit" was provided by each incentive mechanism as a function of whether: (1) the gains realized through cost reductions and efficiency increases were sufficient to contribute to the financial stability of the Postal Service; and (2) the rate of cost reductions and operational efficiency increases exceeded the rate of cost reductions and operational efficiency increases during the relevant comparable time period. For purposes of this review, the Commission considers the 10 years immediately preceding implementation of the PAEA to be the relevant time period.

For the Commission to determine that the system has enabled the Postal Service to achieve Objective 1, as it relates to the Postal Service's finances: (1) the costs must have been reduced; (2) the operational efficiency must have increased; and (3) the incentives must have been maximized.

(1) Cost Reductions

As set forth in the ANPR, the proposed metric for evaluating cost reductions included "an evaluation of the costs, including unit operating costs and controllable costs, before and after the PAEA was implemented." Order No. 3673 at 4. After further consideration, the Commission modifies the metric to evaluate attributable cost as attributable cost data that have been developed using methods that have been refined with stakeholder input over time.²⁸⁹ The Commission reviews total attributable cost and

²⁸⁹ See Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2016, January 12, 2017, at 32-34 (FY 2016 Annual Report).

market dominant attributable cost, then adjusts market dominant attributable cost for inflation and volume to evaluate real unit market dominant attributable cost. The Commission determines that the real unit market dominant attributable cost represents the best metric for assessing cost reductions.²⁹⁰

Accordingly, to determine whether costs have been reduced, the Commission analyzes the change in costs over the PAEA era by reviewing real unit market dominant attributable cost from FY 2007 to FY 2016. Following this analysis, the Commission provides a supplementary analysis. In the supplementary analysis, the Commission discusses changes in average cost per piece by function and reviews mail mix changes as potential drivers of cost reductions. Then, the Commission turns to additional considerations relating to cost data over the PAEA era, including the nature of the Postal Service's cost structure and statutory obligations related to the USO. Finally the Commission discusses precedent related to cost reduction initiatives. After its analysis on operational efficiency, the Commission concludes with its determination of whether incentives have been maximized in section II.C.3.b.(3), *infra*. The Commission conducts an additional evaluation of real unit market dominant attributable cost, for the 10 years before and after the PAEA was implemented, as part of its analysis in that section.

(a) Attributable Cost

As set forth above, in order to determine whether costs have been reduced over the PAEA era, the Commission analyzes the change in attributable costs of the Postal Service over time. In analyzing attributable costs, the Commission starts with a broad overview of the total attributable cost and total market dominant attributable cost of the Postal Service and then adjusts total attributable cost and total market dominant

²⁹⁰ The underlying reasoning for the Commission's selection of this metric is described in more detail in the real unit market dominant attributable cost analysis below.

attributable cost for inflation to obtain the real costs. Finally, the Commission adjusts real market dominant attributable cost for volume and analyzes its determinative metric: real unit market dominant attributable cost.

The Commission chooses real unit market dominant attributable cost as its determinative metric for analyzing cost changes over the PAEA era for several reasons. First, real unit market dominant attributable cost measures those costs which have a reliably identified causal relationship with products. Second, this metric uses inflation-adjusted costs, which more accurately measure cost reduction efforts by eliminating the impact of inflation. Third, this metric controls for volume changes. Controlling for volume is necessary because most attributable costs are volume-variable, which means total attributable costs decline when volume declines.²⁹¹ Fourth, the Commission narrows the analysis to the market dominant system because the section 3622 review is limited in scope to the market dominant system. Finally, the real unit market dominant attributable cost is calculated using methods that have been refined with stakeholder input over time. See FY 2016 Annual Report at 32-34. An analysis of real unit market dominant attributable cost provides the most comprehensive representation of costs because the metric controls for the effects of inflation and system-wide volume changes. Accordingly, the Commission relies on the results of its real unit market dominant attributable cost analysis to determine whether costs have been reduced during the PAEA era.

Total attributable costs of the Postal Service are those which can be directly traced to products: costs that are exclusively incurred by a single product and costs

²⁹¹ The costs of most Postal Service operations are somewhat volume-variable. See generally John C. Panzar, *The Role of Costs for Postal Regulation*, available at <https://www.prc.gov/sites/default/files/reports/J%20Panzar%20Final%20093014.pdf>.

that vary with the volume of a product.²⁹² Attributable cost has made up 50 to 60 percent of the Postal Service's total costs per year throughout the PAEA era.²⁹³ Attributable cost is calculated and distributed to specific products through application of econometric techniques and are reported in the CRA.²⁹⁴ In this analysis, the Commission relies upon the attributable cost data reported by the Postal Service in the annual CRA.

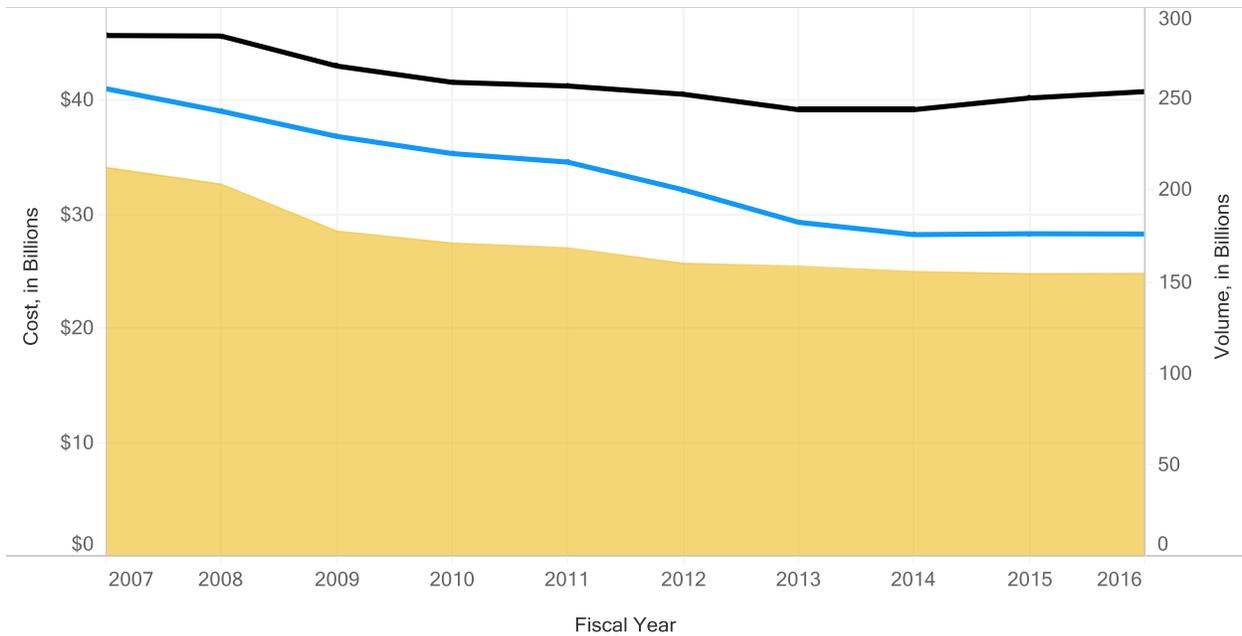
The Commission first examines total attributable cost (market dominant and competitive) and market dominant attributable cost from FY 2007 to FY 2016. Figure II-12 shows total volumes of mail for the same period on the right-hand scale for reference.

²⁹² See Docket No. RM2016-2, Order Concerning United Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three), September 9, 2016, at 6-15 (Order No. 3506) (discussion of attributable costs and Postal Service cost attribution). This matter is currently under review by the United States Court of Appeals, District of Columbia Circuit. See *United Parcel Service, Inc. v. Postal Regulatory Comm'n*, Nos. 16-1354, 16-1419, (D.C. Cir. *appeals docketed* 2016).

²⁹³ See Docket Nos. ACR2007-ACR2016, Library Reference PRC-ACR2007-16)-LR/1.

²⁹⁴ The Commission's review of attributable costs uses the scope employed prior to FY 2016 as this approach provides a more consistent evaluation of Postal Service's costs over the past 10 years. In FY 2016, the Commission expanded the scope of attributable costs to be a product's incremental costs. See *generally* Order No. 3506 (order changing the methodology for attributable costs by expanding the scope of cost attribution to be a product's incremental cost).

**Figure II-12
Total Attributable and Market Dominant Attributable Costs²⁹⁵
(Nominal, FY 2007 – FY 2016)**



Legend
 Total Attributable Cost
 Market Dominant Attributable Cost
 Volume

Source: Library Reference PRC-LR-RM2017-3/1

Figure II-12 shows that both total and market dominant attributable costs declined, with market dominant attributable cost declining at a faster rate than total attributable cost. Total attributable cost decreased \$5 billion, from \$46 billion in FY 2007 to \$41 billion in FY 2016. Market dominant attributable cost declined from \$41

²⁹⁵ The FY 2007 CRA did not separately identify costs for competitive and market dominant mail. The total cost of each market dominant class was separately identified. The Commission uses the FY 2007 total attributable cost of First-Class Mail, Standard Mail, Periodicals, Package Services, and Special Services to calculate the total attributable cost of market dominant mail. See United States Postal Service Cost and Revenue Analysis, Fiscal Year 2007, Revised March 20, 2008. The Commission uses this proxy for all of the FY 2007 cost data in this section.

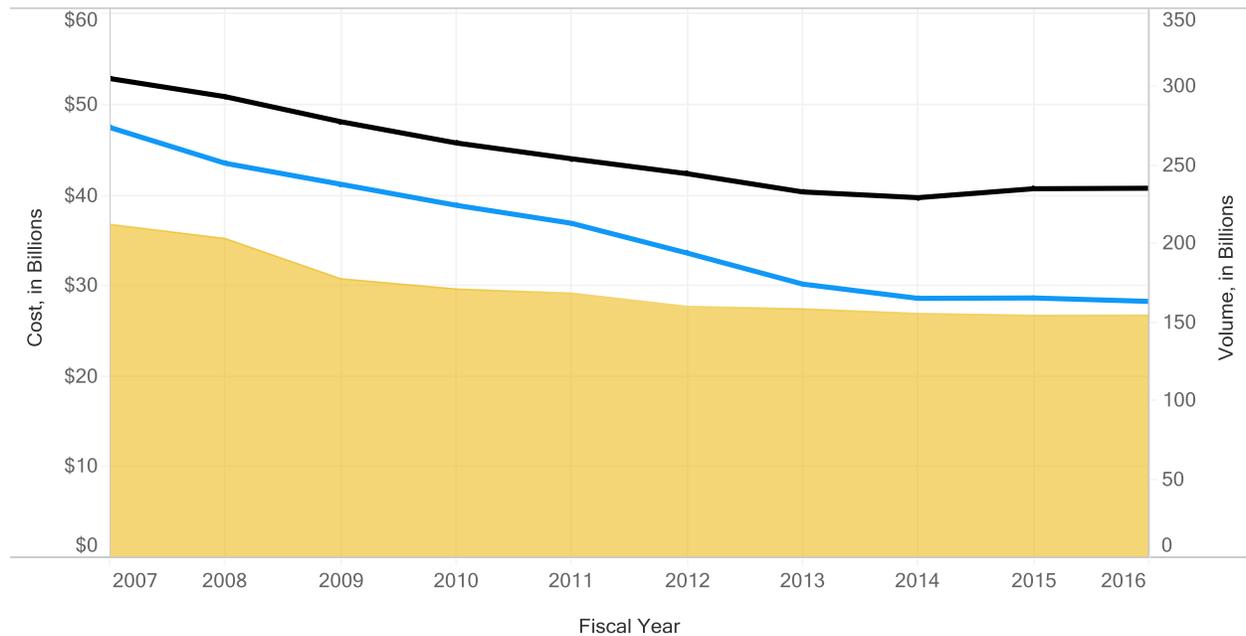
billion in FY 2007 to \$28 billion in FY 2016. Figure II-12 also demonstrates the relationship between total attributable cost and volume: total attributable cost and market dominant attributable cost generally declined and increased in relation to the total volume trends.

After reviewing total attributable cost, the Commission determines that adjusting for inflation leads to a more meaningful comparison of actual cost reduction results. The cumulative change in CPI-U from FY 2007 to FY 2016 was 15.75 percent.²⁹⁶ Figure II-13 displays both the total and the market dominant attributable costs of the Postal Service during the PAEA era in real terms.²⁹⁷ It also includes total volumes of mail for the same period on the right-hand scale for reference.

²⁹⁶ U.S. Bureau of Labor Statistics, Consumer Price Index for All Urban Consumers: All Items [CPIAUCNS], (last accessed November 21, 2017), available at <https://fred.stlouisfed.org/series/CPIAUCNS>. The Average Annual CPI-U Index for FY 2007 was 207.342. The Average Annual CPI-U Index for FY 2016 was 240.007, leading to a percent change of 15.75. See *id.*

²⁹⁷ Costs in this figure are all in 2016 dollars, using CPI-U as the inflator.

Figure II-13
Total Real Attributable and Market Dominant Real Attributable Cost
(Real, FY 2007 – FY 2016)



Legend
 Total Real Attributable Cost
 Real Market Dominant Attributable Cost
 Volume

Source: Library Reference PRC-LR-RM2017-3/1

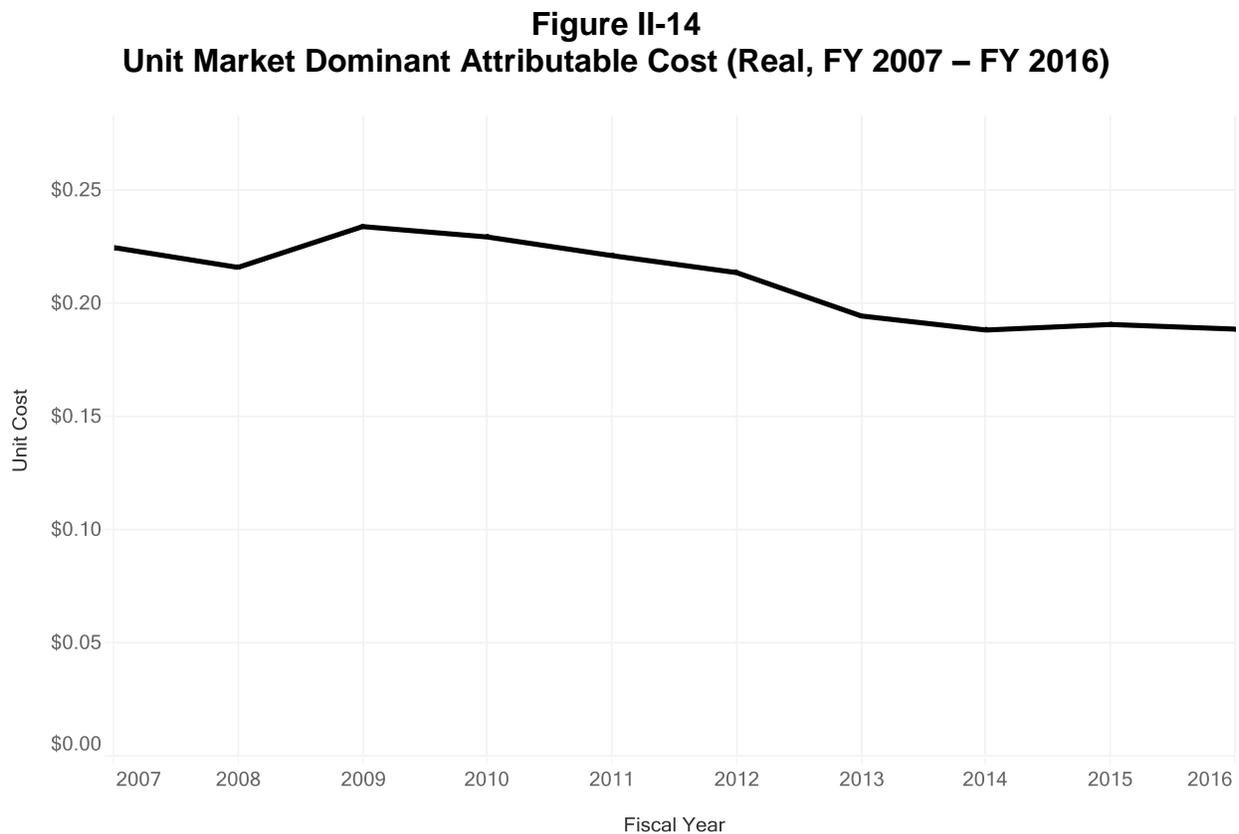
Figure II-13 shows that total and market dominant attributable cost declined, in real terms, during the PAEA era. Real market dominant attributable cost declined faster than real total attributable cost. Real total attributable cost decreased \$12 billion, from \$53 billion in FY 2007 to \$41 billion in FY 2016. Real market dominant attributable cost declined \$20 billion, from \$48 billion in FY 2007 to \$28 billion in FY 2016.²⁹⁸

After reviewing the total and market dominant attributable costs and real total and market dominant attributable costs of the Postal Service, the Commission focuses the

²⁹⁸ The real market dominant attributable cost in Figure II-13 and the nominal market dominant attributable cost in Figure II-12 are the same \$28 billion in FY 2016 because the real costs are adjusted for inflation using the FY 2016 CPI-U inflation for the adjustment.

analysis on market dominant mail. The Commission controls for volume changes by examining the real unit market dominant attributable cost. Using unit market dominant attributable cost controls for changes in volume that affect total cost, allowing for a more meaningful analysis of the change in costs over the PAEA era.

Figure II-14 shows the real unit market dominant attributable cost for all market dominant products from FY 2007 to FY 2016.



Source: Library Reference PRC-LR-RM2017-3/1

As shown in Figure II-14, real unit market dominant attributable cost also declined over the PAEA era. Real unit market dominant attributable cost declined by 16 percent, from \$0.22 to \$0.19. Therefore, because the Commission uses real unit market dominant attributable cost as the determinative metric, the Commission determines that costs were reduced during the PAEA era.

(b) Supplementary Analysis of Costs

As supplementary analysis, the Commission discusses changes in average cost per piece by function and mail mix changes. The cost by function analysis identifies the cost functions that contribute significantly to the decline in overall cost. Mail mix changes may have had an impact on cost reductions, and as a result, the Commission considers and discusses them. This analysis provides insight into the Postal Service's costs, but is not part of the determinative metric.

(i) Cost by Function

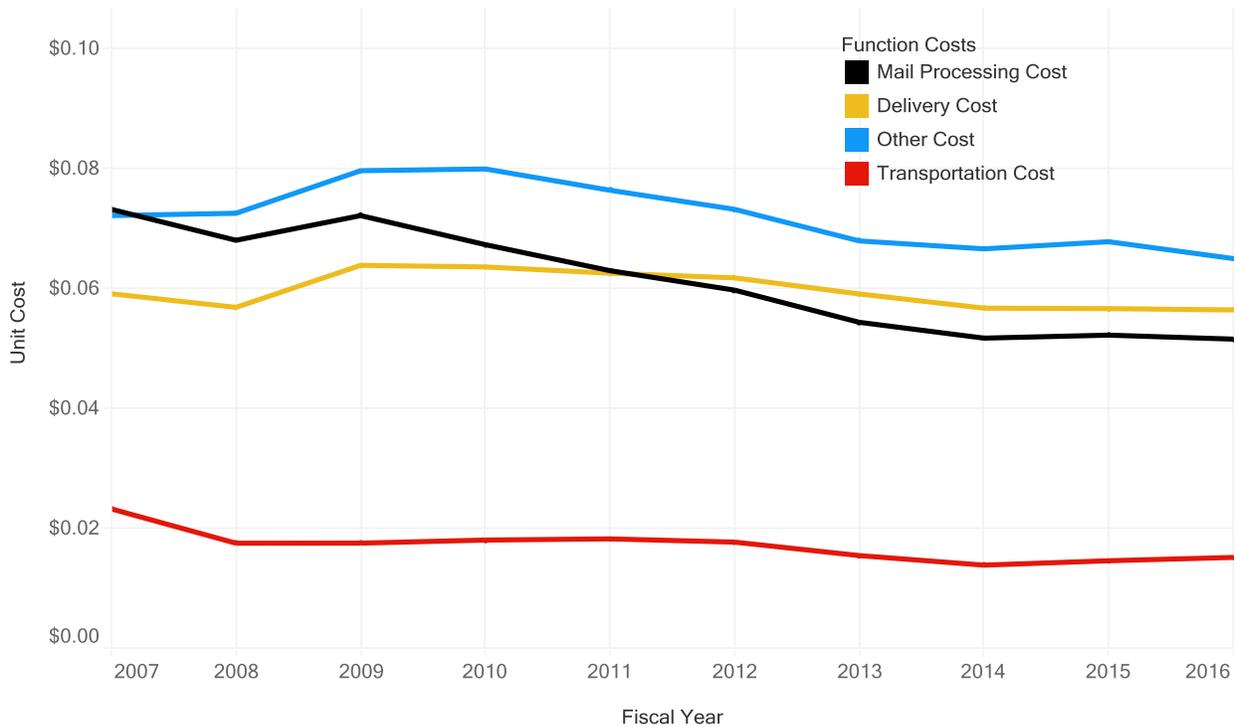
To gain insight into which Postal Service functions have had the greatest impact on cost reductions, the Commission analyzes changes in the average market dominant attributable cost per piece by function from FY 2007 to FY 2016. Understanding which functions contributed to cost reductions allows the Commission to analyze potential drivers impacting Postal Service costs.

The costs the Postal Service incurs in performing the various functions necessary to provide mail services are attributed to each product based on cost drivers, such as volume.²⁹⁹ The Postal Service groups its costs into different elements, known as cost segments, each with a specific characteristic or purpose (e.g., Postmasters, Clerks & Mail Handlers, and Rural Carriers). The Postal Service then distributes attributable costs to products from these segments. These cost segments can be classified into four major groupings: (1) processing, (2) transportation, (3) delivery, and (4) other, which represents the segments not covered by the other three sectors.

²⁹⁹ See Order No. 3506, Appendix A.

Figure II-15 shows the changes in average market dominant attributable costs by function for market dominant mail from FY 2007 to FY 2016.³⁰⁰

Figure II-15
Postal Service Average Market Dominant Attributable Cost by Function
(Real, FY 2007 – FY 2016)



Source: Library Reference PRC-LR-RM2017-3/1

Figure II-15 shows mixed results over time for changes in average market dominant attributable cost by function: mail processing cost declined the most throughout the PAEA era; transportation cost remained relatively static; and delivery

³⁰⁰ Figure II-15 reports average market dominant attributable costs in real terms, which are calculated by dividing the costs of each function that are attributable to market dominant products (in 2016 dollars) by total market dominant value. The mail processing category refers to cost segments 1 and 4 and part of cost segment 3; transportation refers to cost segments 8 and 14; delivery refers to cost segments 6, 7, and 10; and other refers to the remaining portions of cost segment 3 and all other cost segments. See e.g. Docket No. ACR2016, Library Reference USPS-FY16-2, December 29, 2016.

cost and other cost, which includes retail,³⁰¹ increased then decreased. For the analysis of reduced cost, the key take away is that while transportation, delivery, and other costs have remained relatively steady over this time frame, mail processing costs have declined. A primary reason for this decline is changes in mail mix.

(ii) Mail Mix Changes as a Potential Driver of Cost Reduction

After determining that real unit market dominant attributable cost has been reduced over the PAEA era, and that much of the decline was in the mail processing function, the Commission reviews the changes in mail mix over the PAEA era as a potential driver of cost declines.

Market dominant mailpieces are classified into four classes of mail: (1) First-Class Mail, (2) Periodicals, (3) Standard Mail, and (4) Package Services. In addition, the Postal Service offers a variety of products through the Special Services class, many of which can be added to mailpieces in each of the above classes.³⁰² Mail within a class is composed of different types of mailpieces that have differing characteristics, such as shape and levels of worksharing.³⁰³ These different types of mailpieces have different attributable costs. Changes in the composition of mail, by class, product and rate category, are known as mail mix changes. Changes to the mail mix within a class will affect the unit attributable cost of the class as a whole. The mail mix within and between classes has changed during the PAEA era. The Commission analyzes the

³⁰¹ Costs related to retail functions, such as retail window service clerks, postmasters, and building costs are all included within other costs.

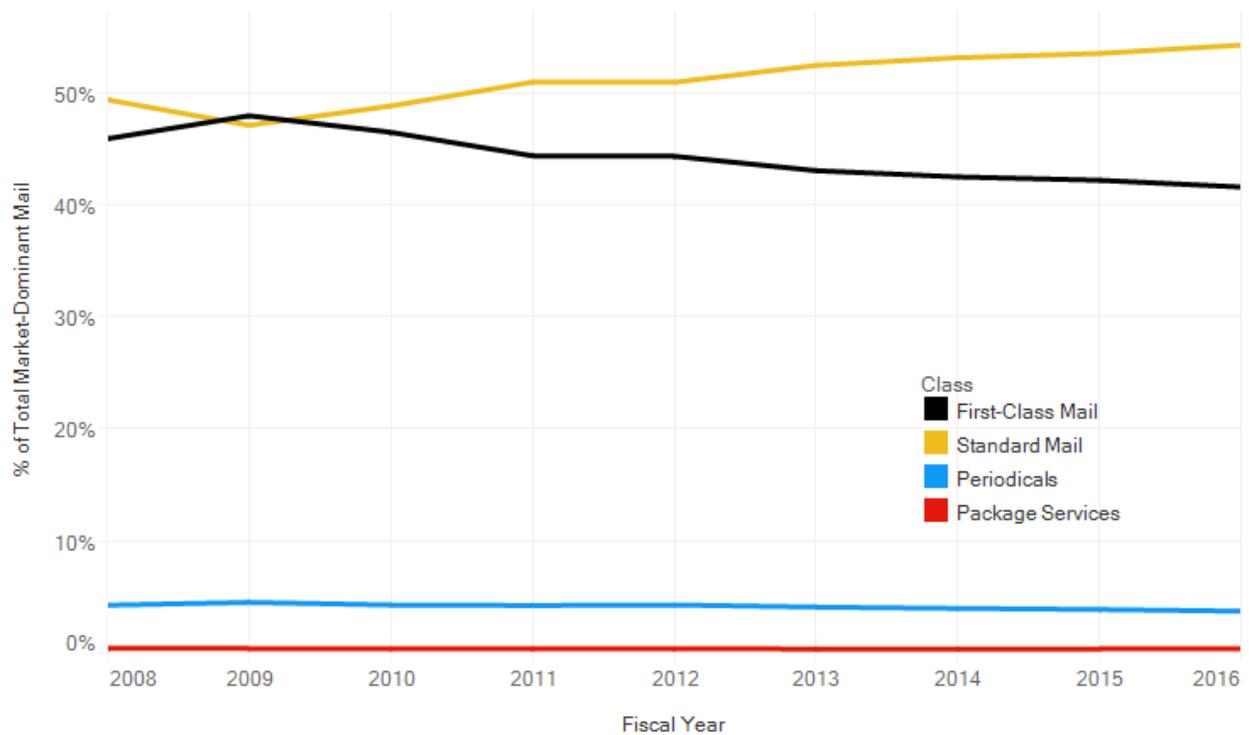
³⁰² The Postal Service also provides some special services not connected to other classes (e.g., Money Orders). Because of their unique nature and relatively low volume, they are not discussed here.

³⁰³ For an explanation of worksharing and workshare discounts, see Order No. 536; see also section II.B.3.d., *supra*.

composition of the classes and products within classes during the PAEA era to examine whether and how the mail mix changes have affected the Postal Service’s costs.

Figure II-16 shows the proportion of volume for each market dominant class relative to total market dominant mail volume since FY 2008.³⁰⁴

**Figure II-16
Relative Size of Market Dominant Classes**



Source: Library Reference PRC-LR-RM2017-3/1

As demonstrated in Figure II-16, the proportion of First-Class Mail volume steadily declined from FY 2008 to FY 2016 while the proportion of Standard Mail volume has steadily increased over that same time period. Since FY 2011, Standard Mail has represented a majority of market dominant mail volume.

³⁰⁴ The Postal Service provided FY 2007 data using PRA era classifications. FY 2008 is the first year with directly comparable data, which is why it is the Commission’s starting point for this analysis.

This shift in mail volume from First-Class Mail to Standard Mail resulted in a decline in unit market dominant attributable cost. The unit attributable cost of Standard Mail differs substantially from First-Class Mail for a variety of reasons, including that Standard Mail requires a minimum level of volume for entry and cannot be entered as a single piece requires some degree of worksharing; and has longer service standards. As a result, Standard Mail has historically had a lower unit attributable cost than First-Class Mail. For example, in FY 2016 the unit attributable cost for First-Class Mail was \$0.207 and the unit attributable cost for Standard Mail was \$0.138. Therefore, Standard Mail's growing proportion of market dominant mail volume has contributed to the declining real unit market dominant attributable cost.

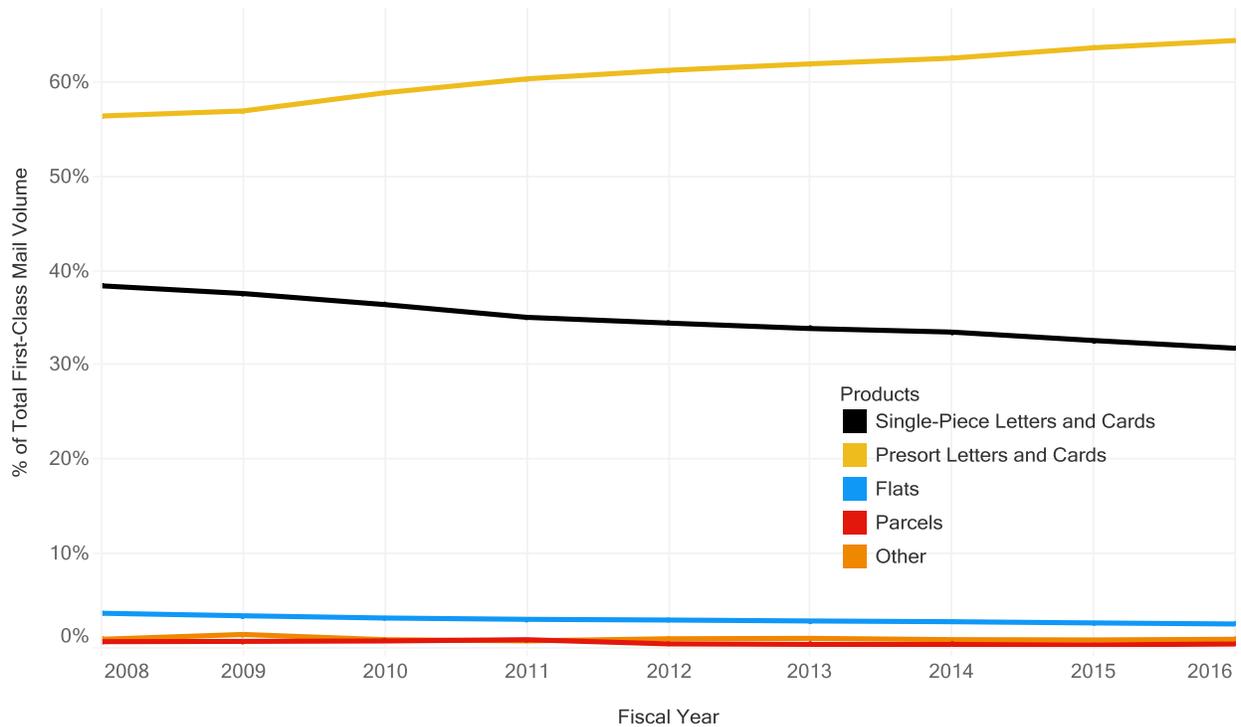
After reviewing the changes in mail mix between market dominant mail classes, the Commission looks at mail mix changes within an individual class, using First-Class Mail as an example.³⁰⁵ First-Class Mail consists of several products, each with its own distinct cost. For example, in FY 2016, the unit attributable cost was \$0.282 for Single-Piece Letters and Cards, \$0.115 for Presort Letters and Cards, \$0.975 for Flats, and \$2.315 for Parcels. The differences in unit attributable cost by product affect the attributable cost of the class as a whole when the mix of products changes over time.

Figure II-17 illustrates the relative volume of First-Class Mail products.³⁰⁶

³⁰⁵ See United States Postal Service Cost and Revenue Analysis (CRA) Reports, FY 2008 – FY 2016. The mail mix trend observed in First-Class Mail is representative of the overall trends of volume shifts within classes.

³⁰⁶ The "Other" category includes First-Class Mail NSAs and International First-Class Mail.

**Figure II-17
Share of First-Class Mail Volume by Product**



Source: Library Reference PRC-LR-RM2017-3/1

As shown in Figure II-17, from FY 2008 to FY 2016, the volume of Single-Piece Letters and Cards declined and the volume of Presort Letters and Cards increased as a share of total First-Class Mail. Presort Letters and Cards have a lower unit attributable cost than Single-Piece Letters and Cards.³⁰⁷ Therefore, the growing proportion of Presort Letters and Cards within First-Class Mail contributed to the decrease in the unit attributable cost of First-Class Mail as a whole because the lower cost product was more heavily weighted in the mail mix in FY 2016.

³⁰⁷ See United States Postal Service Cost and Revenue Analysis (CRA) Reports, FY 2008 – FY 2016.

Accordingly, a review of the overall composition of market dominant and the composition within classes shows that the volume of mail has shifted to less costly mail classes and products, resulting in reductions in the overall costs. This analysis suggests that mail mix changes have been the reason for some cost reductions during the PAEA era.

(c) Additional Considerations

The Commission discusses additional considerations related to the changes in costs over time. These considerations may constrain cost reductions, and as a result, the Commission considers and discusses them. In this section, the Commission discusses the Postal Service's cost structure and statutory obligations related to the USO.

(i) Cost Structure

The Commission reviews the nature of the Postal Service's cost structure as an additional consideration.³⁰⁸ The Postal Service, as a multiproduct network firm, has several unique elements to its cost structure that constrain its ability to control costs. The Postal Service has a large amount of common costs that do not exhibit reliably identified causal relationships to products. These costs are classified as institutional costs, and they have comprised 40 percent to 50 percent of the Postal Service's costs since the beginning of the PAEA era. The Postal Service has a large amount of institutional costs, which are generally incurred in the short-term regardless of the amount of mail the Postal Service handles.

³⁰⁸ The Commission previously analyzed the Postal Service's cost structure in Order No. 3506. See also Office of Inspector General - Examining Changes in Postal Product Costs, RARC-WP-17-005, March 13, 2017.

The Postal Service also has a unique cost structure with respect to labor costs. While most network industries are capital-heavy industries (e.g., electricity, telecom), the Postal Service's cost structure is labor-intensive.³⁰⁹ Binding arbitration agreements constrain the Postal Service's ability to set wage rates and adjust its mix of employees as quickly as may be optimal for its network. This is further demonstrated by the Postal Service's difficulty, as discussed below, in reducing workhours commensurate with volume in recent years. However, the Postal Service has been able to make significant reductions in the number of employees through attrition and engaged in relatively beneficial negotiations with labor unions for more flexible and affordable labor.

The Commission has noted that the nature of the Postal Service's cost structure and various constraints will "necessarily [encumber] its efforts to reduce costs." Order No. 547 at 81-82. As a consequence of this cost structure, the Postal Service is unable to "reduce costs immediately to reflect volume declines" and, therefore, may not see the full effect of its cost reduction efforts. *Id.* at 82.

(ii) Universal Service Obligation

The Postal Service, as a regulated government entity, has statutory obligations that impact its ability to reduce costs. The Postal Service operates under various legal constraints created by statutory obligations, including the USO. *Id.* at 81.

In its Universal Service Report, the Commission identified statutory language that established the "qualitative standards of the current USO."³¹⁰ The Commission stated that "[u]niversal service is enshrined in 39 U.S.C. § 101(a)," which provides that "[t]he Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business

³⁰⁹ See USPS Annual Tables, FY 2016 TFP (Total Factor Productivity), March 1, 2017.

³¹⁰ See Universal Service Report. See also 39 U.S.C. §§ 101(a), 101(b), 403, 3661(a).

correspondence of the people.”³¹¹ Further, the Commission noted that “[c]ongressional expectations [for the USO] are further set out in the remainder of 39 U.S.C. 101, and 39 U.S.C. 403 and 404.” *Id.* The USO also informs the nature of postal operations, which “rely on a vast delivery network of retail and processing facilities and a sizeable vehicle fleet.” FY 2014 Financial Report at 20. As the Commission has previously explained, “[u]nlike a private enterprise, the Postal Service must consider the impact of its cost-cutting activities on its ability to continue to provide postal services consistent with the policies of title 39, United States Code.” Order No. 1926 at 131.

(d) Commission Precedent

The Commission has reviewed the Postal Service’s cost reduction initiatives over the course of the PAEA and found mixed results. Although the Postal Service was able to reduce costs in response to the Great Recession, the Commission has found that cost savings estimates from some of the Postal Service’s initiatives are likely overstated and that the Postal Service could improve its quantitative measurement of the results of cost savings initiatives.

(i) Cost Reductions in Response to Volume Loss During the Great Recession

The total volume loss for market dominant products over the PAEA era was 60.8 billion pieces. FY 2016 Financial Report at 32. This decline in volume has been ascribed to many factors, including the electronic diversion of mail and the impact of the Great Recession. The Commission analyzed and quantified the impact of the Great Recession on mail volume losses in Docket No. R2013-11. In reviewing the Postal Service’s ability to cut costs in response to the Great Recession, the Commission found that the Postal Service was able to achieve “more than \$6 billion in cost reductions in

³¹¹ Universal Service Report at 3 (citing 39 U.S.C. § 101(a)).

2009.” Order No. 547 at 4. The Commission found that the price cap was incentivizing cost reductions and that the Postal Service had “reduced costs in response to volume declines as contemplated by the PAEA.” Order No. 547 at 80. The Commission noted that the Postal Service achieved substantial cost savings by reducing its career workforce.³¹²

(ii) Advisory Opinions

During the PAEA era, the Commission issued non-binding advisory opinions on several cost reduction initiatives.³¹³ Major initiatives included changes to the Postal Service’s retail network designed to realize substantial cost savings by better aligning its retail footprint with customer demand. In the Retail Access Optimization initiative, Docket No. N2011-1, the Postal Service identified more than 3,650 post offices for potential closing.³¹⁴ Two of the Postal Service’s goals in pursuing this initiative were to improve efficiency and capture cost savings. Docket No. N2011-1, Advisory Opinion at 4. The Commission found that the initiative was not likely to optimize the retail network and there was no effective mechanism to accurately identify cost savings. *Id.* at 1-3. The Postal Service did not complete its retail optimization initiative but instead initiated the Post Office Structure Plan (POStPlan), which was an “initiative to match post office retail hours with workload.”³¹⁵ The Postal Service estimated that POStPlan

³¹² *Id.*; see also Order No. 1926 at 60-83.

³¹³ The Postal Reorganization Act of 1970 required the Postal Service to file a request with the Commission for an Advisory Opinion on major changes to postal services within a “reasonable” time period before instituting the changes. See Pub. L. 91-375, 84 Stat. 764; 39 U.S.C. § 3661 (the PAEA retained the advisory opinion requirement). Under its rules, the Commission imposes a 90-day time frame from the date the Postal Service files its request to issuance of an Advisory Opinion. Due process is preserved by providing the public an opportunity to fully participate, ask questions, and provide comments.

³¹⁴ Docket No. N2011-1, Advisory Opinion on Retail Access Optimization Initiative, December 23, 2011, at 1 (Docket No. N2011-1, Advisory Opinion).

³¹⁵ Docket No. N2012-2, Advisory Opinion on Post Office Structure Plan, August 23, 2012, at 1 (Docket No. N2012-2, Advisory Opinion).

would save it \$516 million annually. *Id.* at 14. In its advisory opinion, the Commission suggested that “[a]n internal review and data collection plan will help the Postal Service evaluate whether the POSStPlan is meeting its objectives and goals.” *Id.* at 2.

Another major initiative reviewed by the Commission in an advisory opinion was the Network Rationalization initiative, which was “a significant consolidation of the Postal Service’s processing and transportation networks.”³¹⁶ According to the Postal Service, the Network Rationalization initiative was designed to better match the infrastructure with mail volumes and result in substantial cost savings. Docket No. N2012-1, Advisory Opinion at 2. The Postal Service initially estimated cost savings of \$2.1 billion but later revised that estimate downward to \$1.6 billion. *Id.* at 8. In its advisory opinion, the Commission found that the Postal Service likely overestimated the associated savings. See *id.* at Appendix H. It also found that the Postal Service had not taken full advantage of its modeling tools. Docket No. N2012-1, Advisory Opinion at 2.

The Commission also provided an advisory opinion on the “Standard Mail Load Leveling” initiative (Load Leveling), which sought to achieve a more even distribution of mail volume delivered throughout the week and to increase efficiencies in the collection, processing, and delivery of the mail.³¹⁷ The Commission found that the plan needed further development and recommended, among other things, that the Postal Service perform a cost-benefit analysis at the national level and develop a plan for measuring cost reductions. Docket No. N2014-1, Advisory Opinion at 2.

³¹⁶ Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012, at 42 (Docket No. N2012-1, Advisory Opinion).

³¹⁷ Docket No. N2014-1, Advisory Opinion on Service Changes Associated With Standard Mail Load Leveling, March 26, 2014, at 10-11 (Docket No. N2014-1, Advisory Opinion).

(iii) Other Commission Findings

The Commission has repeatedly advised the Postal Service that it must “do a better job of quantifying the savings from its cost reduction initiatives.”³¹⁸ In the joint Periodicals Mail Study, the Commission noted the Postal Service’s “inability to capture efficiencies in flat mail processing,” and stated that “[s]ubstantial opportunities for increasing the efficiency of flat mail processing and transportation exist.”³¹⁹ The Commission further stated that “[o]ver the past decades the Postal Service has introduced many programs designed to capture some of these efficiencies,” but that it was “unclear how successful these programs have been.” Periodicals Mail Study at 97. The Commission has also noted issues quantifying cost reductions from cost reduction initiatives related to the processing and delivery of flat shaped mailpieces in numerous ACDs. In FY 2016, the Commission found that “due to the lack of comprehensive data, the Postal Service cannot measure the impact or success of initiatives designed to improve flats cost and service issues.”³²⁰

(2) Increased Operational Efficiency

In the ANPR, the Commission set forth potential approaches to measure increases in efficiency under Objective 1. The Commission suggested reviewing both operational and pricing efficiency. Order No. 3673 at 4. Pricing efficiency is discussed in section II.B.3.d., *supra*. For operational efficiency, the Commission proposed metrics

³¹⁸ FY 2014 ACD at 69. The GAO has also noted the Postal Service’s difficulty in measuring the impact of cost reduction initiatives. See U.S. Government Accountability Office, Status of Workforce Reductions and Related Planning Efforts, GAO-15-43, November 2014, available at <http://www.gao.gov/assets/670/666884.pdf>.

³¹⁹ Periodicals Mail Study, Joint Report of the United States Postal Service and Postal Regulatory Commission, September 2011, at 97 (Periodicals Mail Study), available at https://www.prc.gov/docs/76/76767/Periodicals%20Mail%20Study_final_2131_2149.pdf.

³²⁰ FY 2016 Annual Report at 26 (citing Docket No. ACR2015, Analysis of the Postal Service’s FY 2015 Annual Performance Report and FY 2016 Performance Plan, May 4, 2016, at 47).

that would “involve reviewing trend analyses of total factor productivity (TFP), real unit operating costs, productivity data, and workhours.” Order No. 3673 at 4.

Few commenters submitted comments related to the operational efficiency measurement approach. The Public Representative submits that TFP, as a measure of the Postal Service’s efficiency, is not sufficiently transparent, and as a result, the Public Representative cannot conclude that the Postal Service has increased efficiency during the PAEA as intended by Objective 1.³²¹ Although the Commission agrees that the TFP methodology could be more transparent, as discussed in more detail below, the Commission determines that based on its analysis of the underlying data, TFP provides the most comprehensive measure of efficiency compared to other measures.

The Postal Service asserts that TFP is a valid measure of its operational efficiency, but suggests that the Commission expand its analysis to include a variety of factors relevant to its efficiency, including assessing “the operational efficiency of the Postal Service through the concept of ‘honest, efficient, and economical management’ (HEEM).” Postal Service Comments at 57-62. Specifically, the Postal Service contends that “efficient management does not mean taking any and all actions to reduce costs in the short term; rather, it requires a ‘balance [between] financial responsibility and the need to provide postal services of the kind and quality adapted to the needs of the United States.’”³²² The Commission declines to use the qualitative HEEM standard to evaluate operational efficiency. The Commission determines that Objective 1 requires a quantitative analysis of whether efficiency increased rather than a qualitative analysis of whether the Postal Service applied efficient management techniques as intended under the HEEM principles related to the exigent provision of 39 U.S.C. § 3622(d)(1)(E).

³²¹ PR Comments at 27-28. The Public Representative agrees that it is reasonable for the Commission to examine both operational and pricing efficiency under Objective 1. *Id.* at 26.

³²² Postal Service Comments at 77 (citing Order No. 1926 at 127-28 n.119).

The Commission considers the comments and modifies the proposed metrics as follows. For operational efficiency, the Commission uses, as its determinative metric, the change in TFP during the PAEA era. The Commission also analyzes productivity data and workhours as additional considerations relevant to operational efficiency. The Commission removes the metric “real unit operating costs” because unit attributable costs have already been examined in the cost reduction section. See section II.C.3.b.(1), *supra*. In addition to the suggested metrics proposed in the ANPR, as part of additional considerations relevant to operational efficiency, the Commission includes an analysis of machine productivities and worksharing as relevant to operational efficiency. The Commission also includes a discussion of relevant Commission precedent relating to operational efficiency over the PAEA era. Following that analysis, the Commission conducts an additional evaluation of efficiency changes, both before and after the PAEA was implemented, to determine whether incentives have been maximized.

(a) Total Factor Productivity

As set forth above, in order to determine whether operational efficiency increased over the PAEA era, the Commission analyzes the change in TFP over time. The Commission analyzes TFP and then turns to other related metrics calculated using subsets of TFP data to review changes in operational efficiency.

The Postal Service developed TFP to measure changes in postal efficiency.³²³ The Postal Service calculates TFP annually and files that figure and the supporting data with the Commission.³²⁴

³²³ Comments of the United States Postal Service, Appendix D, at 2 (“In 1983, the United States Postal Service commissioned Christensen Associates to develop a measure of TFP that could be used to evaluate Postal Service performance.”).

³²⁴ See, e.g., USPS Annual Tables, FY 2016 TFP (Total Factor Productivity), March 1, 2017.

The TFP data provided by the Postal Service include data related to inputs, outputs, and network indices. FY 2009 ACD at 39. The model calculates an index value for each of these components in order to compute a single annual TFP figure. The inputs index includes a combination of labor (workhours), capital, and materials. The outputs index is a weighted average of the mail volumes.³²⁵ The network index represents the delivery network and is the number of possible deliveries. Finally, the workload index is a combination of the outputs and the network indices. To arrive at the final TFP figure, the model divides the workload index by the input index as follows:

$$TFP = \frac{Workload}{Input} := \frac{f(Output, Network)}{g(Labor, Capital, Materials)}$$

The Commission uses TFP as its determinative metric for operational efficiency because it is the best available measure of efficiency. TFP contains all of the components needed to determine the efficiency of a multi-product firm, and it comprehensively accounts for both the inputs and outputs of the Postal Service. For example, when the Postal Service processes more mail (workload) using the same amount of inputs (labor, capital, and materials), TFP increases, reflecting that the Postal Service has increased its efficiency. Conversely, when the Postal Service uses more inputs for the same amount of workload, TFP decreases, reflecting a decline in Postal Service's efficiency. Because TFP comprehensively measures both inputs and workload, the efficiency changes that occur in a given year are reflected in TFP.

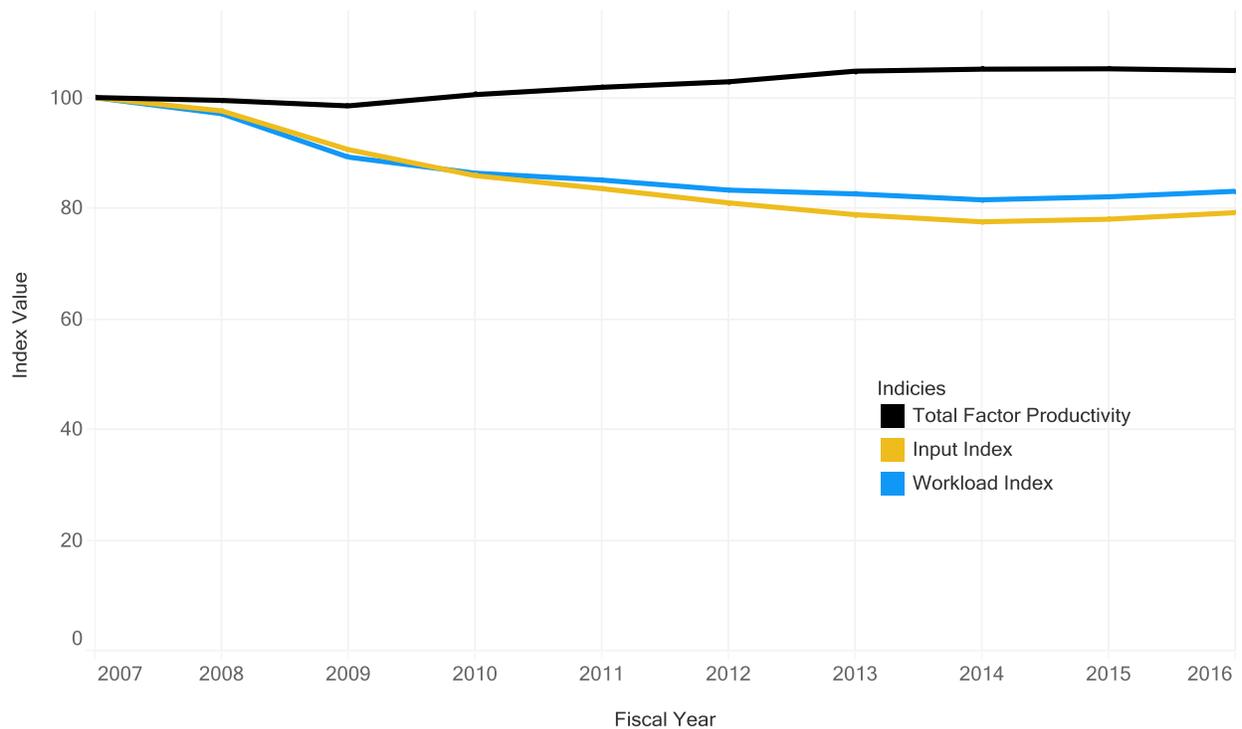
³²⁵ The volumes are weighted mail volumes and miscellaneous output which includes other services such as special services. The volumes are weighted by unit costs.

The Postal Service detailed the current TFP methodology in Docket No. N2010-1.³²⁶ The Commission considers this methodology an accepted analytical principle and has previously accepted TFP as a measure of efficiency during the PAEA era, explaining that “TFP measures the change in the relationship between outputs (workload processed) and inputs (resource usage) over a period of time.” FY 2009 ACD at 39. As such, any future changes to this methodology are subject to Commission review and approval through the rulemaking process defined in 39 C.F.R. § 3050.11. Additionally, the Commission intends to utilize the rules in 39 C.F.R. § 3050.2 concerning documentation of periodic reports (*e.g.*, calculations and links within and between spreadsheets) to ensure that TFP is measured and calculated in a transparent manner.

Figure II-18 displays TFP and its components (workload and input) during the PAEA era.

³²⁶ See Docket No. N2010-1, Responses of the United States Postal Service to MPA Interrogatories MPA/USPS-T2-2 – 7.a.-c., 8-12, Redirected from Witness Corbett, June 23, 2010.

Figure II-18
Workload, Input, TFP Indexes
(Indexes based to 100 in FY 2007)



Source: Library Reference PRC-LR-RM2017-3/1

As demonstrated in Figure II-18, TFP has generally increased since FY 2007. Figure II-18 also shows that the Postal Service has been able to reduce inputs (*i.e.*, labor, capital, and materials) as workload (*i.e.*, volumes and possible deliveries) decreased, which resulted in an overall upward trend in TFP.

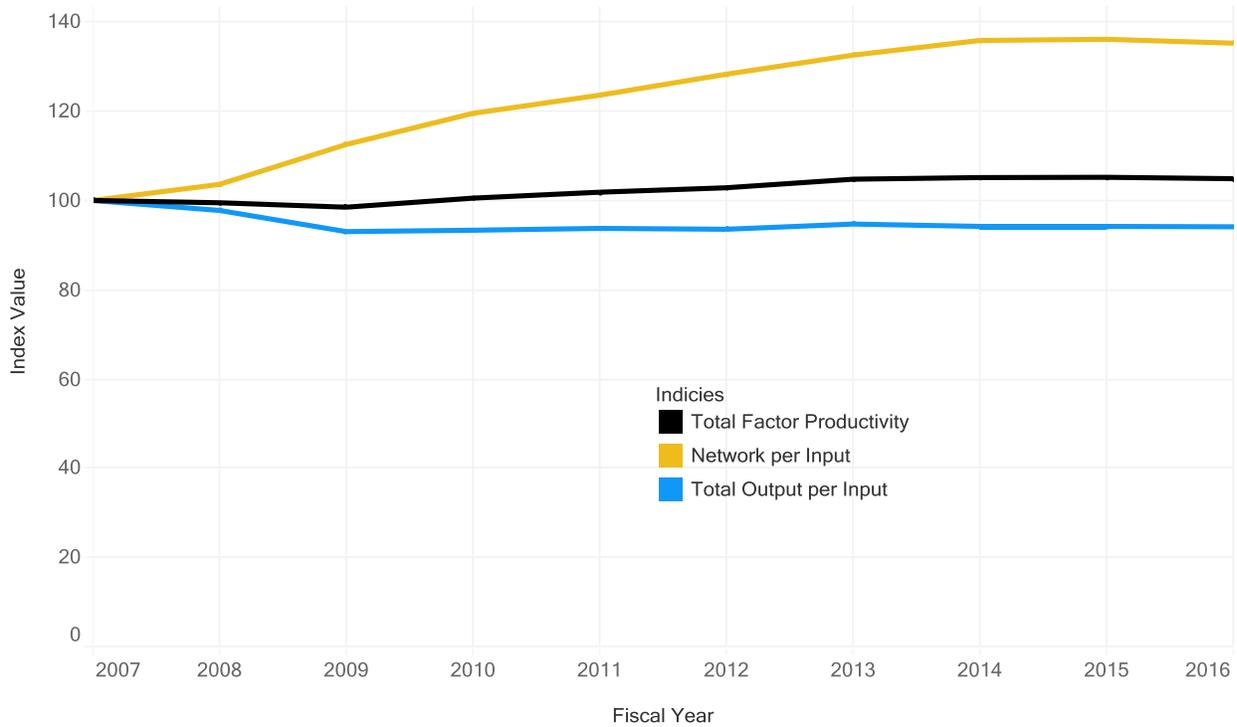
Although the TFP model is designed to develop a single TFP index, the data filed in support of that index can also be used for additional measures of Postal Service efficiency. These other measures, which are components of TFP, highlight the completeness, accuracy, and usefulness of TFP. To provide further insight into TFP, the Commission analyzes two alternative measures of productivity using the data filed in support of TFP: (1) Total Output (cost-weighted volume) per Input; and (2) Network (possible deliveries) per Input. TFP is calculated using a Workload index that combines

the Output index and the Network index. The two alternative measures use either the Output index or the Network index, and not the Workload index, which combines the two.

Total Output per Input measures the output (cost-weighted volume) per amount of input (labor, capital, materials). It is a less representative measure of the Postal Service's efficiency than TFP, because it omits the size of the Postal Service's network from its calculation. Because the Postal Service has certain obligations with regard to its delivery network, measures of efficiency that do not include this aspect are incomplete.

Network (possible deliveries) per Input measures the possible deliveries (city, rural, and highway contract deliveries) per Input (labor, capital, materials). It is an important element of Postal Service efficiency because as possible deliveries increase, the Postal Service must add or expand delivery routes to encompass new delivery points, even if output (cost-weighted volume) remains unchanged or declines. Metrics that compare volumes and input or delivery points and input (rather than the entire workload and input) are not comprehensive measures of the total efficiency of the Postal Service. However, the Commission can use these measures to highlight areas where the Postal Service's efficiency improvements have stagnated. Total Output per Input and Network per Input are shown in Figure II-19 below.

**Figure II-19
Efficiency Measures (PAEA era)**



Source: Library Reference PRC-LR-RM2017-3/1

As shown in Figure II-19, while overall efficiency, as measured by TFP, increased during the PAEA era, Total Output per Input declined and then remained flat, and Network per Input has been increasing sharply. This indicates that much of the improvement in overall TFP came from the increase in possible deliveries, and that input has not decreased as quickly as output.

While Total Output per Input and Network per Input are potential measures of efficiency, they are individually incomplete. TFP, which incorporates total workload (volume and possible deliveries), is complete and is, therefore, superior to these other measures. As set forth above, the Commission relies on TFP to measure Postal

Service efficiency. Therefore, using TFP as the determinative metric, the Commission determines that efficiency increased during the PAEA era.

(b) Additional Considerations

The Commission discusses several additional considerations related to the changes in efficiency over time. In this section, the Commission discusses the LPI, workhour analysis, machine productivities, and considerations related to worksharing.

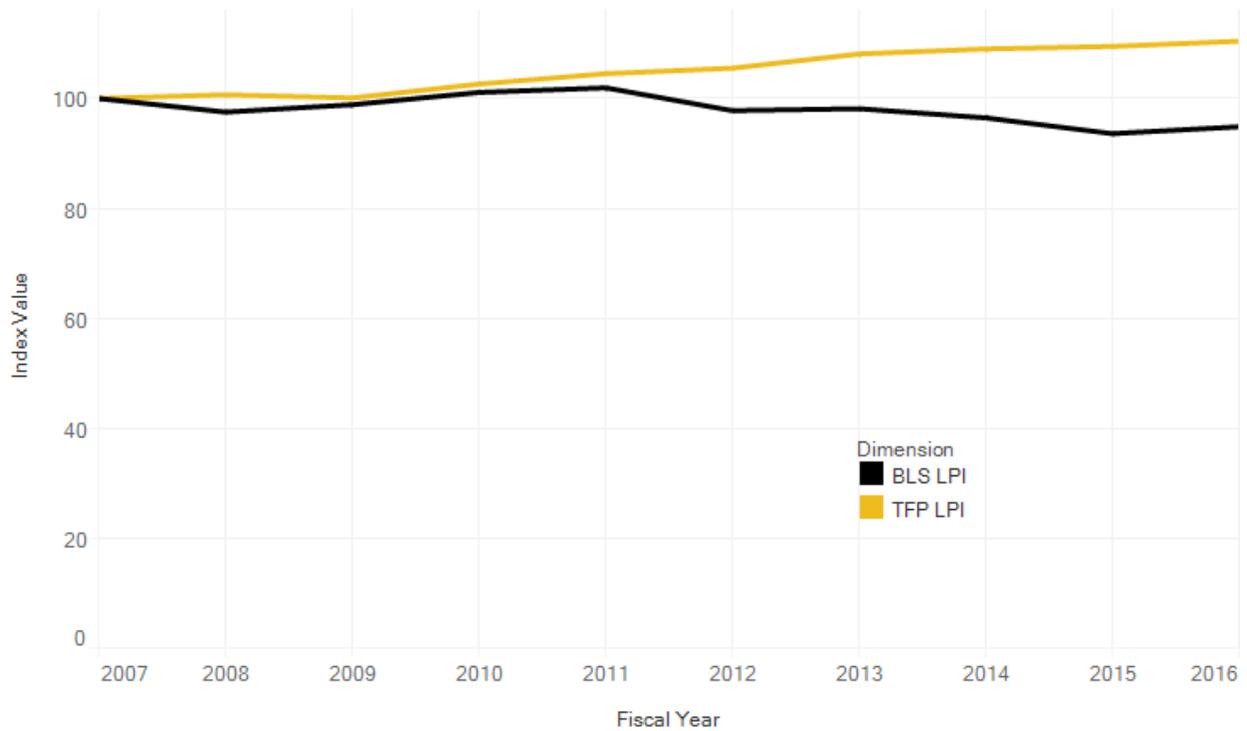
(i) Labor Productivity Index

To provide additional insight on operational efficiency, the Commission considers the LPI. The Bureau of Labor Statistics (BLS) defines labor productivity as “a measure of economic performance that compares the amount of goods and services produced (output) with the number of hours worked to produce those goods and services.”³²⁷ If an entity can produce the same amount of goods using fewer work hours, labor productivity will improve.

Figure II-20 compares the labor productivities for the Postal Service calculated using the TFP data and BLS data.

³²⁷ See United States Department of Labor, Bureau of Labor Statistics, Labor Productivity and Costs, available at <https://www.bls.gov/lpc/>.

Figure II-20
BLS Postal Service Labor Productivity Index (BLS LPI) and TFP LPI (PAEA era)³²⁸
(Indexes based to 100 in FY 2007)



Source: Library Reference PRC-LR-RM2017-3/1

Figure II-20 shows that the BLS LPI and the TFP LPI generally tracked each other until FY 2011, when TFP LPI continued to increase and the BLS LPI for the Postal Service began to decrease. This diversion can be explained by two differences between how the BLS measure and the TFP LPI measure are calculated. First, the BLS input data are based on nonsupervisory employees, whereas TFP LPI data include the workhours for all employees. Second, the BLS output value does not include

³²⁸ The base year is set to 2007 to be consistent with the BLS reporting.

possible deliveries.³²⁹ While both measures can be informative, they are less comprehensive than the TFP metric.

(ii) Workhour Analysis

The Commission next analyzes, as another additional consideration, the trend in workhours and volume.³³⁰ Changes in workhours reflect, in part, whether the Postal Service's management is able to effectively reduce workhours in response to volume declines in order to maintain or increase efficiency. Workhours are reported annually by the Postal Service in its financial statements.

In Order No. 1926, which permitted an exigent surcharge on market dominant products, the Commission performed a workhour analysis comparing changes in workhours and changes in volume to determine if the Postal Service was operating efficiently. See Order No. 1926 at 131-36. The Commission previously noted a positive trend when comparing the decline in workhours to the declines in mail volume, which suggested that the Postal Service was making efforts to adjust its mail processing operations in order to adapt to volume changes. *Id.*

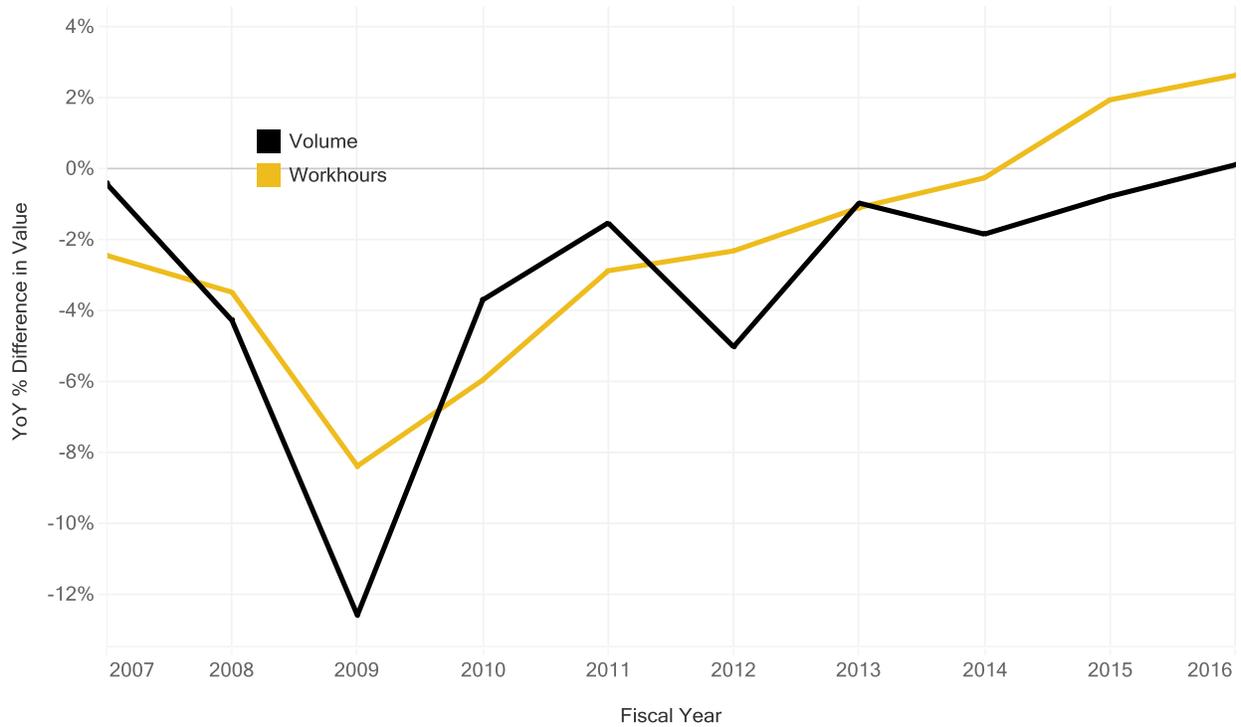
The following figure provides an updated analysis of the change in workhours since the Commission issued Order No. 1926 in December 2013. Figure II-21 shows the change in volume and workhours from FY 2007 to FY 2016.³³¹

³²⁹ See United States Department of Labor, Bureau of Labor Statistics, Technical Information about the BLS Major Sector Productivity and Cost Measures, March 11, 2008, available at <https://www.bls.gov/lpc/lpcmethods.pdf>.

³³⁰ As the Commission has previously analyzed the trends in workhour in volume data for part of the PAEA era, the Commission analyzes changes in these trends from FY 2007 to FY 2016. See Order No. 1926 at 131-136.

³³¹ The Commission also reviewed the change in volume and mail processing workhours, change in volume and city delivery workhours, and the change in volume and total delivery workhours. All of these measures showed similar trends.

**Figure II-21
Change in Volume and Workhours by Fiscal Year**



Source: Library Reference PRC-LR-RM2017-3/1

Although the relationship of workhours to volume is informative, this measure is not as comprehensive as the TFP measure because it does not include several important components that the TFP does account for, specifically, network, capital, and materials. Further, the labor and volume metrics of this analysis do not disaggregate between types of laborers and types of volume. These metrics therefore lack the sophistication of a TFP analysis, which can be used to evaluate these effects.

(iii) Machine Productivities

The Commission also reviews machine productivity data as an additional consideration providing insight into efficiency over the PAEA era. Machine productivity

data are reported by the Postal Service in the ACR as pieces processed per hour (PPH) by machine type. The Commission analyzes the change in these productivity measures over time.

Table II-13 shows the machine productivity data and year-over-year percent changes for three types of operations during the PAEA era.

Table II-13
Pieces per Hour (PPH) Sorted and Year-Over-Year Percent Changes

	AFSM100 Incoming Secondary	In BCS Secondary (2 Pass)	SPBS/APBS Incoming
2008	3,273	9,143	252
2009	3,138 -4.12%	8,388 -8.26%	224 -11.11%
2010	2,998 -4.46%	8,658 3.22%	208 -7.14%
2011	2,898 -3.34%	8,813 1.79%	201 -3.37%
2012	2,692 -7.11%	8,581 -2.63%	220 9.45%
2013	2,725 1.23%	8,919 3.94%	232 5.45%
2014	2,685 -1.47%	9,205 3.21%	219 -5.60%
2015	2,673 -0.45%	9,065 -1.52%	205 -6.39%
2016	2,567 -3.97%	8,444 -6.85%	194 -5.37%

Source: Library Reference PRC-LR-RM2017-3/1

The productivities for the Automated Flats Sorting Machine (AFSM) 100 Incoming Secondary and small parcel bundle sorter (SPBS)/Automated Parcel and Bundle Sorter (APBS) Incoming, operations that process flats, have generally trended downward since FY 2007. This trend could be related to the Postal Service's assertion

that lower volumes have reduced the automation productivity of flats sorting.³³² The Postal Service implemented several initiatives during the PAEA intending to improve mail processing productivity.³³³ The intended improvements were not realized. Declines in processing productivities mean that the Postal Service has to use the same number of employees to perform less work. As the Postal Service contends, some of this decline may be due to reduced volume. Some of this decline may, however, be due to aging machines and a lack of capital investment during the PAEA era.³³⁴

(iv) Worksharing

The Commission also reviews pricing decisions made by the Postal Service as an additional consideration and potential driver for operational efficiency changes.³³⁵ Specifically, workshare discounts set substantially below avoided costs may cause the Postal Service to maintain a larger network or retain more processing operations than necessary.³³⁶ This is because inefficient pricing incentivizes inefficient behavior. The Commission has acknowledged this issue in the past. For example, the Commission expressed concern that workshare discounts substantially below avoided costs “may

³³² See Docket No. ACR2014, Responses of the United States Postal Service to Questions 1-6, 8, 10, 12-13 and 15-22 of Chairman’s Information Request No. 2, January 23, 2015, question 8.

³³³ As discussed in section II.3.b.(1)(d), *supra*.

³³⁴ See Docket No. ACR2013, Responses of the United States Postal Service to Questions 1-11 of Chairman’s Information Request No. 2, January 23, 2014, question 1 (“The Postal Service completed the conversion of the remaining SPBS units to APBS units in FY2013. These conversions reduced operating costs and improved operational efficiency by replacing aging equipment with newer technology that includes more advanced Optical Character Reader capabilities. These enhancements resulted in improved throughput per hour performance.”).

³³⁵ Workshare discounts are discussed in section II.B.3.d., *supra*.

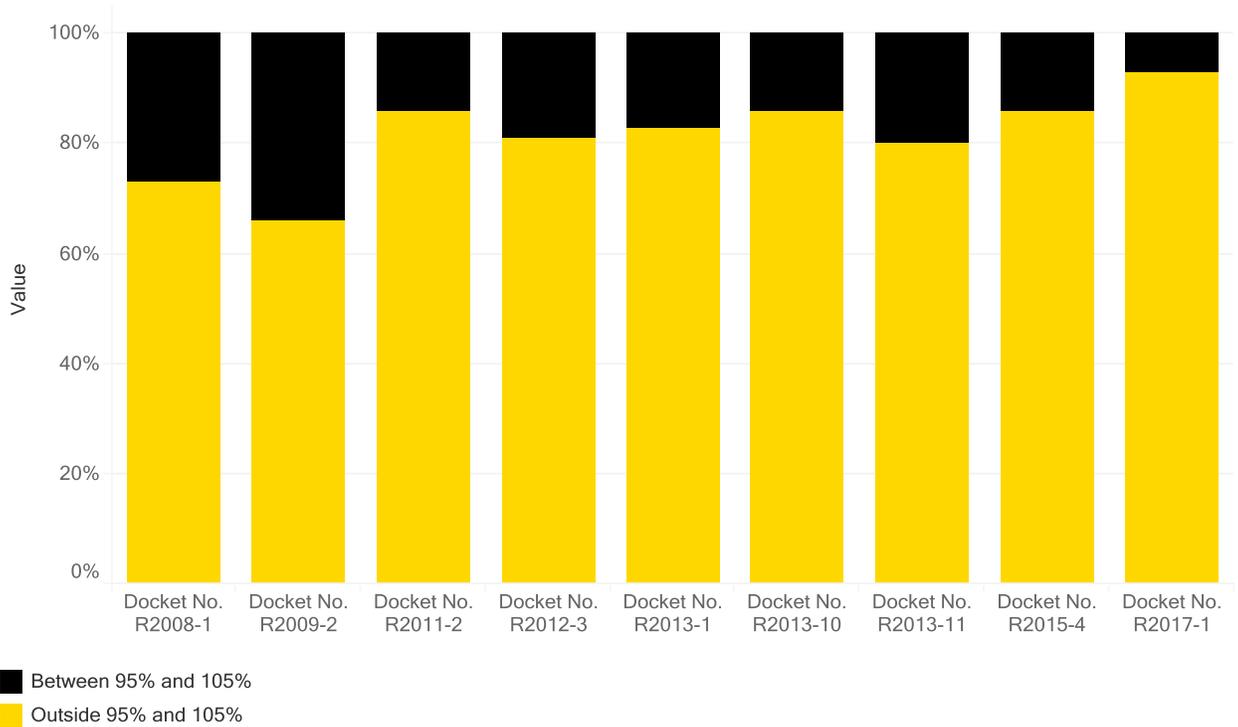
³³⁶ Order No. 987. In that docket, the Postal Service stated that because it had “excess mail processing capacity,” it proposed identical AADC and 3-digit presort letter prices to encourage “the preparation of AADC/3-digit” presort letter mail. *Id.* at 10. Commenters stated that “pricing to absorb excess capacity” sends the wrong pricing signals and rather than pricing to absorb excess capacity, the Postal Service should decrease the size of the network. *Id.* at 11. The Commission expressed concern that the Postal Service “may not have fully considered the price signals implied by pricing to excess capacity.” *Id.* at 12-13.

have an adverse effect on the efficient operations of the Postal Service.” *Id.* at 13. Additionally, the Commission has recognized that workshare discounts substantially below avoided costs could lead to inefficiencies because the Postal Service performs work that the mailers could perform at a lower cost.³³⁷

During the PRA era, economic literature regarding ECP was developed and refined and the Commission followed this evolving literature in its implementation of ECP. For example, in Docket No. R2006-1, the Commission recommended that the majority of workshare discounts be set equal to avoided costs, with any exceptions explained and supported. The expectation, therefore, was that under the PAEA, the Postal Service would continue to set workshare discounts in accordance with ECP. However, as discussed in section II.B.3.d., *supra*, under the current ratemaking system, the Postal Service has not adhered to but moved further from ECP over the PAEA era when setting its workshare discounts. In that section, the analysis showed that passthroughs between 85 and 115 percent declined during the PAEA era. See section II.B.3.d.(2)(a), *supra*. As a supplement to that analysis, the Commission provides an analysis of passthroughs between 95 and 105 percent during the PAEA era in Figure II-22 below. As shown in Figure II-22, under the current ratemaking system, the number of workshare discounts with passthroughs between 95 percent and 105 percent has decreased from 27 percent in Docket No. R2008-1 to only 7 percent in Docket No. R2017-1.

³³⁷ Postal Regulatory Commission, Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006, November 14, 2016, at 10 (2016 701 Report).

**Figure II-22
Worksharing Passthroughs**



Source: Library Reference PRC-LR-RM2017-3/1

When workshare discounts are priced at their avoided costs it promotes the productive efficiency of the entire postal sector because the entity (Postal Service or mailer) that can perform the work at the lowest cost will.³³⁸ As shown in Figure II-22, the Postal Service has not set the majority of its workshare discounts so that their passthroughs were close to 100 percent of avoided costs during the PAEA era.

This pricing strategy may have harmed operational efficiency within the postal system because the Postal Service may have processed more mail than it otherwise would have if efficient price signals were sent. This may have led the Postal Service to maintain more mail processing and transportation capacity than necessary because

³³⁸ See the discussion of workshare discounts in Order No. 536 at 41-44, 48-49.

more of the mail it received required additional processing and transportation. Conversely, if the Postal Service sent efficient price signals, it may have increased its own operational efficiency by encouraging more of the mail entered into the system to be prepared in ways that would have allowed it to be processed efficiently by the Postal Service. For workshare discounts that are less than the associated avoided costs, encouraging more efficient mail (*i.e.*, more presorted and dropshipped mail) by setting the discounts equal to avoided costs may have allowed the Postal Service to reduce the size of its mail processing network and increase its operational efficiency.

(c) Commission Precedent

The Commission has generally found that the Postal Service has increased its operational efficiency over the PAEA era, noting a measurable slowdown in efficiency growth in recent years. At times, the Commission has noted the constraints placed on the Postal Service by the price cap system under the PAEA as well as statutory obligations imposed on the Postal Service. The Commission has recognized the limits to operational efficiency gains as a result of those constraints.

As part of its ACDs, the Commission has stated that “[f]rom 2000 to 2010, the Postal Service managed to cut its labor force aggressively as its workload remained flat or declined. As a result, the Postal Service’s efficiency improved dramatically from 2000 through 2007.” FY 2010 ACD at 39. The Commission noted that productivity growth then declined from 2008 to 2009 as a result of the large drop in mail volume due to the Great Recession, but that efficiency rebounded in 2010. *Id.* In 2013, the Commission recognized efficiency gains as a result of the Postal Service efforts since 2010 to increase efficiency. FY 2013 Financial Report at 21. The Commission has continuously recognized Postal Service efforts to improve efficiency, and that it

proposed initiatives in its Five-Year Business Plan to improve delivery efficiency in order to achieve greater cost savings.³³⁹

In more recent years, the Commission has also noted that the pace of efficiency improvement has slowed. In FY 2014, the Commission noted that although TFP grew 0.4 percent, representing the fifth consecutive year of productivity growth, that it was the smallest growth since FY 2006. FY 2014 Financial Report at 17. In its FY 2015 Financial Report, the Commission stated that “[t]he Postal Service has made significant efforts to reduce operating expenses and improve efficiency to ensure that expenses are better aligned with mail volumes.” FY 2015 Financial Report at 1. However, despite these efforts, the Commission noted that the 0.1 percent growth in TFP for FY 2015 represented the slowest growth in the PAEA era. *Id.* at 18. The Commission found that:

For the first time since FY 2005, labor inputs increased, as work hours, employment levels, and the price of labor grew. Much of the increase in materials usage continues to be related to the increased costs for vehicle supplies and maintenance related to the upkeep of the Postal Service’s aging vehicle fleet. Overall, total resource usage grew for the first time since FY 2006.

Id. at 19. Finally, in FY 2016, the Commission stated that “TFP declined slightly for the first time since FY 2009.” FY 2016 Financial Report at 16. The Commission explained

³³⁹ Docket No. ACR2014, Postal Regulatory Commission, Analysis of the Postal Service’s FY 2014 Program Performance Report and FY 2015 Performance Plan, July 7, 2015, at 48.

the decline as follows:

Total workload grew by 1.3 percent in FY 2016. Increases in delivery points and weighted mail volume were the primary contributors. The growth in weighted mail volume was due to the increase in parcel volume, which requires more resources to process than letter and flat-shaped mail. Capital inputs continued to decrease while labor and material inputs increased. The growth in work hours, employment levels, and the price of labor also contributed to the slight TFP decline in FY 2016.

Id.

Accordingly, over the course of the PAEA the Commission has found that efficiency generally increased, but in recent years has begun to slow, with FY 2016 representing the first decline in TFP since implementation of the PAEA ratemaking system.

(3) Maximized Incentives

After analyzing the cost and efficiency data, the Commission next turns to the second step of its analysis to determine whether the incentives to reduce costs and increase operational efficiency have been maximized. In the ANPR, the Commission suggested that the phrase “maximize incentives” could be measured by “determining if the maximum benefit was provided by each incentive mechanism (e.g., price cap, price differentials, and workshare discounts), taking into account associated statutory constraints.” Order No. 3673 at 4.

The Commission determines that the incentive mechanisms in the PAEA have provided the “maximum benefit” if two conditions are met: (1) gains realized through cost reductions and efficiency increases were sufficient to contribute to the overall financial stability of the Postal Service; and (2) the rate of cost reductions and efficiency increases represented an improvement when compared to a relevant time period, in this case, the 10 years immediately preceding implementation of the PAEA.

(a) Contribution to Financial Stability

First, the Commission examines whether the gains from reduced costs and increased operational efficiency during the PAEA era were sufficient to contribute to the financial stability of the Postal Service. As discussed in section II.A.2., *supra*, the price cap limited price increases to the annual change in CPI-U, but allowed the Postal Service to retain any profit resulting from gains from cost reductions and efficiency increases. As the Commission has previously recognized, “[t]he Commission’s rules for applying the price cap and the application of those rules help to achieve several objectives of the PAEA. Enforcing the limitation that price increases for each class of mail do not exceed inflation, for example, incentivizes the Postal Service to reduce costs and increase efficiency (objective 1).” FY 2015 Annual Report at 22.

As shown in the preceding sections, the Postal Service was able to reduce costs and increase operational efficiency during the PAEA era. However, the results were insufficient to achieve overall financial stability for the Postal Service. As demonstrated in section II.C.2.b.(3), *supra*, the Postal Service has not been able to achieve retained earnings during the PAEA era. As a result, despite the decline in costs and improvements in operational efficiency, the Commission finds that the incentives to reduce costs and increase operational efficiency have not been maximized as intended by the PAEA because the reductions and improvements were insufficient to address the Postal Service’s financial instability.

(b) Pace of Cost Reductions and Efficiency Improvements during PAEA era

The Commission determines that the assessment of whether incentives were maximized to reduce costs and increase operational efficiency during the PAEA era necessitates a comparative analysis. For this part of the review, the Commission finds

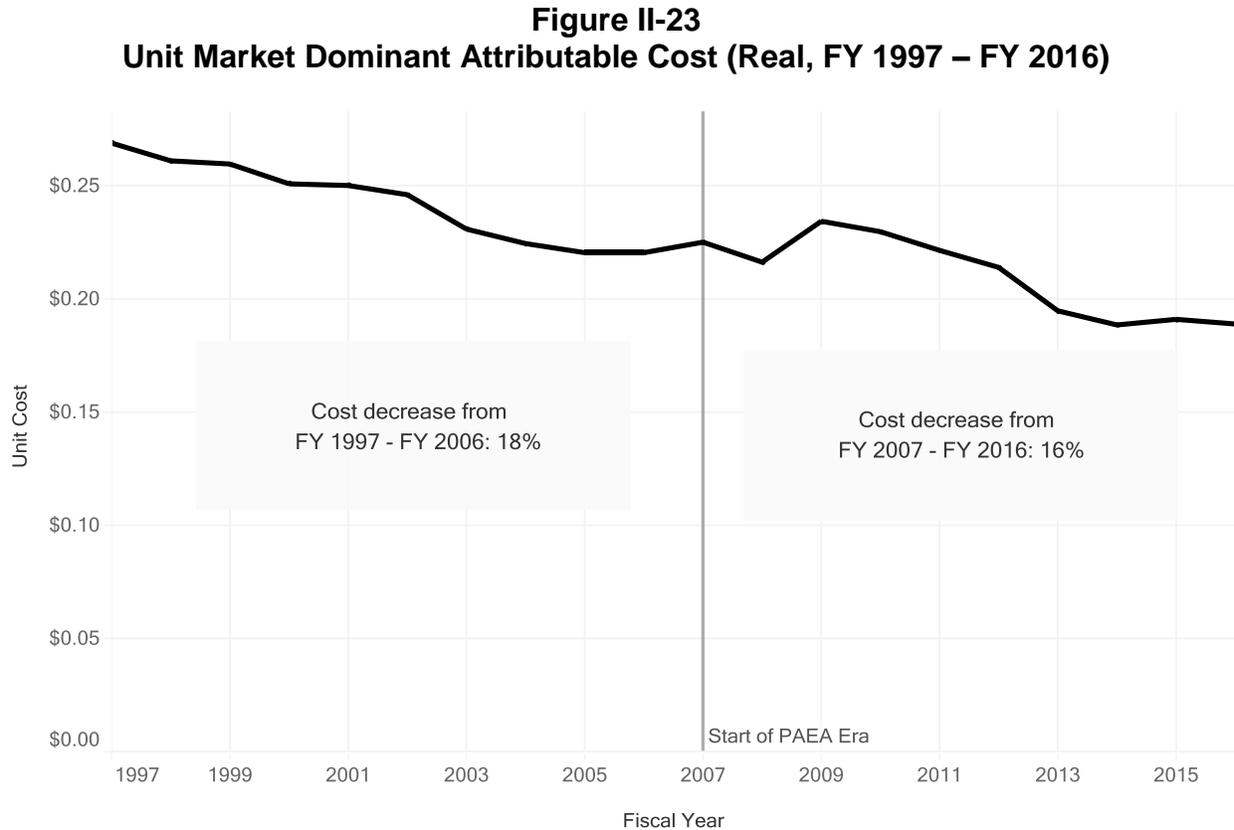
the appropriate time periods to compare are the 10 years of experience in the PAEA era and the 10 years immediately preceding implementation of the PAEA.³⁴⁰ In order for the incentives to have provided the maximum benefit, the Postal Service's cost reductions and efficiency increases in the PAEA era must have exceeded those during the 10 years immediately preceding implementation of the PAEA.

(i) Cost Reductions

As discussed above, the determinative metric for cost reductions is the real unit market dominant attributable cost. The Commission compares cost reductions for real unit market dominant attributable cost in the 10 years immediately preceding implementation of the PAEA and the 10 years following implementation of the PAEA era.

Figure II-23 shows the real unit attributable cost for market dominant mail from FY 1997 to FY 2016.

³⁴⁰ For this review, the Commission chose the two 10 year time periods to compare because it is tasked with reviewing 10 years of experience under PAEA. In order to analyze if the system was successful in reducing costs and increasing efficiency in the PAEA era, the Commission finds the best comparison to be with the 10 years immediately prior to the passage of the PAEA.



Source: Library Reference PRC-LR-RM2017-3/1

As shown in Figure II-23, real unit market dominant attributable cost declined over both time periods. For the 10 years preceding implementation of the PAEA, the real unit market dominant attributable cost declined 18 percent, from \$0.268 to \$0.220.³⁴¹ During the PAEA era, the real unit market dominant attributable cost declined by 16 percent, from \$0.225 to \$0.189. Therefore, the Commission finds that

³⁴¹ In examining the PRA era costs and costs for FY 2007, the Commission uses Priority Mail, Express Mail, and Mailgrams as a proxy for competitive products because the data reported during the PRA and FY 2007 did not have the same distinction between market dominant and competitive products that was used during the PAEA. See United States Postal Service Cost and Revenue Analysis (CRA) Reports, FY 2007 – FY 2016.

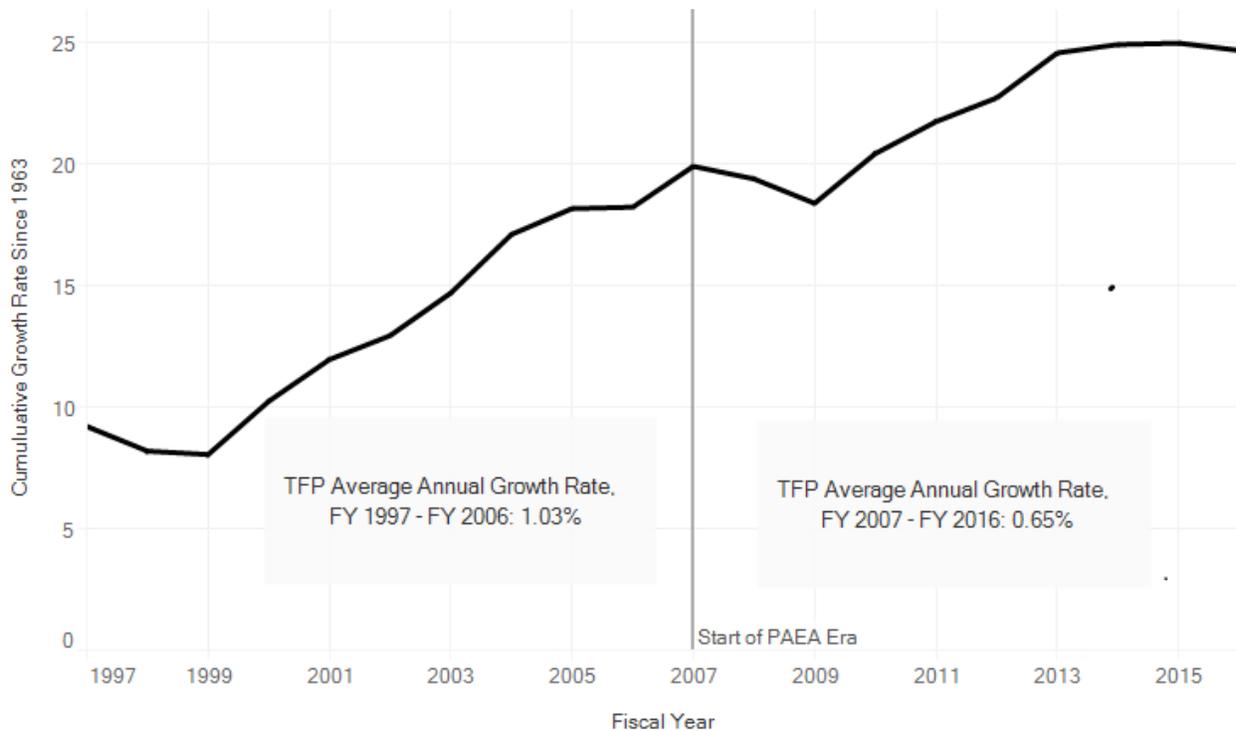
although the Postal Service decreased real unit market dominant attributable cost during the PAEA era, when applying its comparative metric, cost decreased less during the PAEA era than during the preceding 10 years.

(ii) Operational Efficiency Improvements

As discussed above, the determinative metric for increases in operational efficiency is the TFP index. The Commission compares efficiency improvements by examining the TFP index over the 10 years immediately preceding the PAEA and the 10 years of the PAEA era.

Figure II-24 shows the cumulative TFP growth rate from FY 1997 to FY 2016.

Figure II-24
TFP Growth (FY 1997 – FY2016)



Source: Library Reference PRC-LR-RM2017-3/1

As shown in Figure II-24, the average annual TFP growth rate for the PAEA time period (0.65 percent) is much lower than the average annual TFP growth rate for the 10 years immediately preceding the PAEA (1.03 percent). As a result, the Commission finds that although the Postal Service increased operational efficiency during the PAEA era, when applying its comparative metric, operational efficiency increased less during the PAEA era.

Based on the cost reduction, operational efficiency, and maximization analyses, supported by the discussions of additional considerations and Commission precedent, the Commission determines that there were cost reductions and efficiency gains during the PAEA era, but the incentives to achieve cost reductions and efficiency increases were not maximized under the current system.

4. Reasonable Rates

Next, the Commission reviews whether the system has established and maintained reasonable rates as provided by Objective 8 as related to the overall financial health of the Postal Service. 39 U.S.C. § 3622(b)(8). In this analysis, the Commission reviews the reasonable prong of Objective 8 to determine whether the system charged rates that did not “threaten the [] financial integrity” of the Postal Service.³⁴²

a. Comments

Several commenters conclude that the system has not resulted in rates and classifications that are just and reasonable.³⁴³ Comments generally focus on cost

³⁴² Order No. 3673 at 9. For the Commission’s analysis of the just prong of Objective 8, see section II.B.3.c., *supra*.

³⁴³ See, e.g., Postal Service Comments at 83; PR Comments at 21.

coverages for specific products, allocation of institutional costs, and the financial integrity of the Postal Service.³⁴⁴

The Postal Service concludes that the current system has not enabled it to have just and reasonable rates. Postal Service Comments at 83. In particular, the Postal Service states that the “price cap has patently failed to assure adequate revenues to maintain the Postal Service’s financial stability, or to enable rates that are ‘just and reasonable.’” *Id.* at 82-83. Moreover, the Postal Service explains that “the current system’s benefits have been skewed too far toward unsustainably low rates, and too far against the Postal Service’s financial integrity, to be ‘reasonable.’” *Id.* at 108. Similarly, the Public Representative states that the requirement of just and reasonable rates and classifications is not being met because the requirement that the system assure adequate revenue is not being met. PR Comments at 21.

GCA comments specifically on the fact that rates apply at the class-level, which removes discretionary distribution of non-attributable costs. GCA Comments at 26. It notes that the same rule applies to all classes and the cap helps limit any damage. *Id.* However, GCA disapproves of the fact that the price cap system magnifies risks from misallocation of institutional costs. *Id.* With respect to institutional costs, ANM *et al.* agree that the Postal Service should recover its institutional costs, but should not saddle any particular product or class with an unreasonable share of institutional costs. ANM *et al.* at 72.

Certain commenters submit that non-compensatory products prevent rates from being just and reasonable. PSA concludes that rates are not just and reasonable due to the low cost coverage of Periodicals. PSA Comments at 4-5. PSA explains that the Periodicals class is not bearing the direct and indirect postal costs attributable to it. *Id.*

³⁴⁴ See, e.g., GCA Comments at 26; ANM *et al.* Comments at 72.

at 5. ACMA also comments that its members remain concerned by the reported cost coverage results for some postal products. ACMA Comments at 7.

MH and NAAD conclude that the system has achieved the goal of establishing and maintaining a just and reasonable schedule for rate and classifications. MH and NAAD Comments at 9.

b. Application of Measurement

Objective 8 considers just and reasonable rates, requiring that the system “establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.” 39 U.S.C. § 3622(b)(8). In section II.B.3.c.(2), *supra*, the Commission made several modifications and clarifications to the ANPR and separated its analysis into two prongs: just rates and reasonable rates. As explained in section II.B.3.c.(2), *supra*, for the reasonable prong, the Commission looks to whether rates during the PAEA era threatened the financial integrity of the Postal Service. *See also* Order No. 3673 at 9. In section II.B.3.c.(2), *supra*, the Commission finds that rates have been just over the course of the PAEA. As Objective 8 requires rates to be both just *and* reasonable, the Commission also analyzes whether rates have been reasonable (*i.e.*, whether they have threatened the financial integrity of the Postal Service).

As discussed in section II.B.3.c.(2), *supra*, the Commission proposed defining the reasonableness prong of Objective 8 so that a system achieving this objective would charge rates that do not “threaten[] the financial integrity” of the Postal Service. *See* Order No. 3673 at 9. Several commenters address the proposed definition as it relates to reasonable rates. The Postal Service states that the Commission correctly defines “just and reasonable.” Postal Service Comments at 46. MMA, NAPM, and NPPC state that the preliminary definition for a system achieving just and reasonable rates is

unnecessarily broad and that the Commission should adhere to the generally accepted regulatory definition of “reasonable,” which is that rates for a product are reasonable when they cover its costs and make a modest contribution above that. MMA, NAPM, and NPPC Comments at 54-55. Pitney Bowes supports the preliminary definition. Pitney Bowes Comments at 14. The Commission submits that its definition provides for the most comprehensive view of reasonable and therefore adopts the definition as stated in the ANPR as modified and clarified in section II.B.3.c.(2), *supra*. For the reasonable prong, the Commission looks to whether rates threaten the financial integrity of the Postal Service.

For purposes of assessing whether the system maintained reasonable rates during the PAEA era, the Commission proposed measurement methods for reasonable rates in the ANPR. Order No. 3673 at 9-10. In order to determine whether the system has allowed for the maintenance of reasonable rates, the Commission suggested examining the “relationship between price and cost . . . to ensure prices and classifications do not threaten the Postal Service’s financial integrity” and that “total compensation provided by products/services, classes, and all market dominant classes” could be used to measure the concept of “reasonable.” *Id.* at 9-10.

MMA, NAPM, and NPPC suggest using “the generally accepted regulatory definition of ‘reasonable’” to measure reasonableness which they describe as “rates for a product are reasonable when they cover its costs and make a modest contribution above that.” MMA, NAPM, and NPPC Comments at 54-55. The Commission considers this suggestion and submits that the measurement methods proposed in the ANPR encompass a portion of the suggested metric. The Commission also makes a slight modification to one of the proposed measurement methods. Instead of looking at “total compensation” the Commission looks at “total contribution to institutional costs” because it is a publicly available measure. The Commission reviews the relationship between price and cost for the reasonable prong in its analysis of cost coverage below.

Because the system is required to maintain reasonable rates, the Commission also discusses how the system has encouraged the maintenance of reasonable rates during the PAEA era.³⁴⁵

Accordingly, for purposes of this review, in order to determine whether rates have been reasonable throughout the PAEA era, the Commission first reviews the contribution to institutional costs from market dominant products as a whole during the PAEA era. Next, the Commission reviews the total contribution to institutional costs from each market dominant class. The Commission then reviews the contribution to institutional costs from individual market dominant products to determine whether rates have been reasonable. Finally, the Commission discusses how the system has encouraged the maintenance of reasonable rates during the PAEA era. The Commission finds that rates do not threaten the financial integrity of the Postal Service and are reasonable under Objective 8 if market dominant products as a whole are able to make a positive contribution to institutional costs and if each product and class, at a minimum, covers its attributable costs.

(1) Market Dominant Contribution

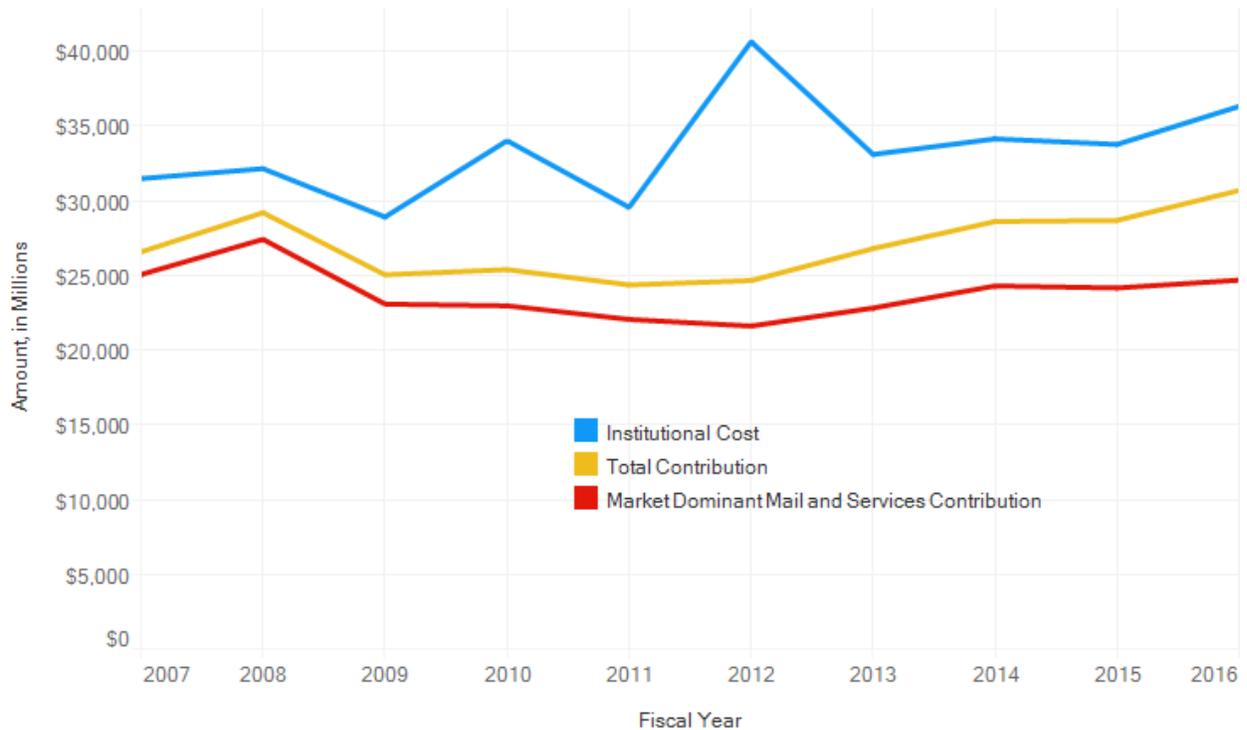
First, the Commission reviews the contribution from market dominant products and total contribution from market dominant and competitive products combined in order to determine whether market dominant products maintained a positive contribution over the PAEA era.

Figure II-25 shows the total institutional costs of the Postal Service, the total contribution to institutional costs of all mail (market dominant and competitive), and the

³⁴⁵ See 39 U.S.C. § 3622(b)(8). See also section II.B.3.c., *supra*, for an assessment of how the system maintained just rates and section II.D., *infra*, for a similar assessment, focusing on whether the system maintained high quality service standards.

contribution from market dominant mail from FY 2007 to FY 2016. Contribution is measured as the difference between revenue and attributable costs.

**Figure II-25
Institutional Costs and Contribution (in \$ Millions)**



Source: Library Reference PRC-LR-RM2017-3/1

As demonstrated by Figure II-25, market dominant products overall were able to provide a positive contribution, but the total contribution was insufficient to cover institutional costs.

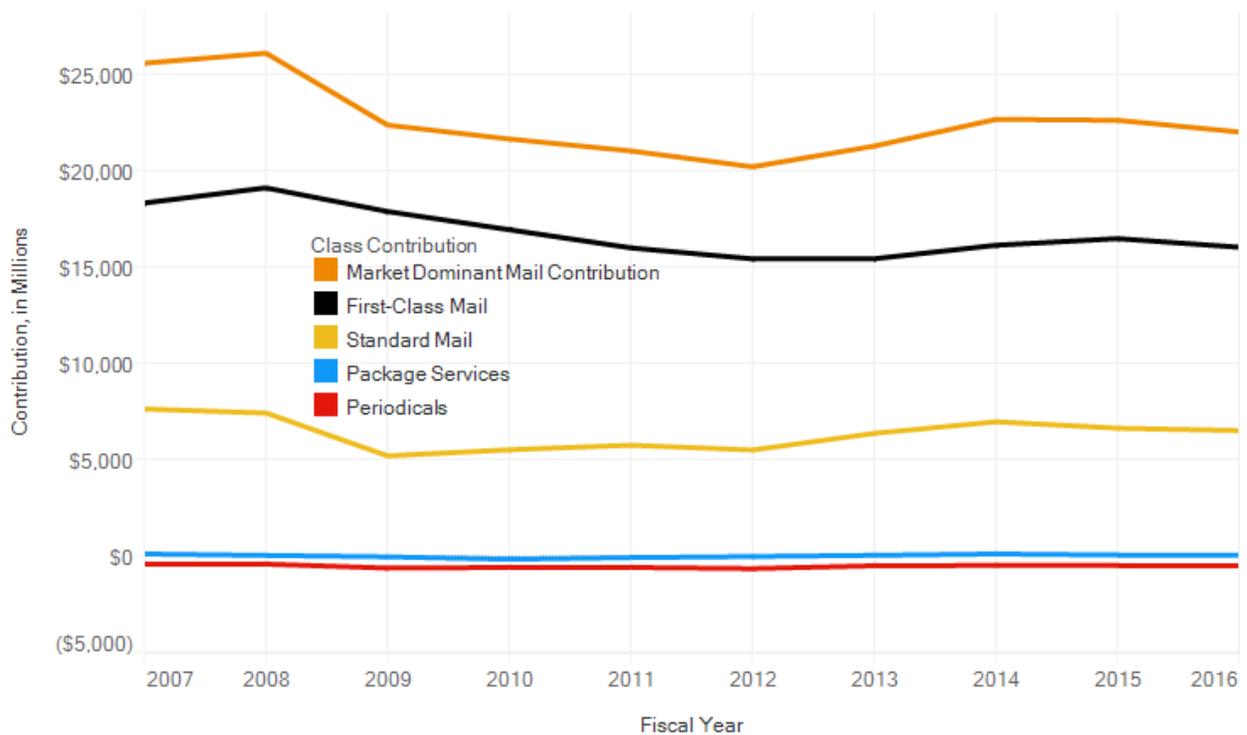
(2) Class-Level Contribution

After reviewing contribution for market dominant mail as a whole, the Commission reviews the contribution for each market dominant class. For classes that have a negative contribution, the rates are not reasonable because they do not provide

enough revenue to cover their attributable costs, let alone a portion of institutional costs. This threatens the Postal Service’s financial integrity.

Figure II-26 represents the contribution for each market dominant class throughout the PAEA era.

**Figure II-26
Contribution by Market Dominant Class (in \$ Millions)**



Source: Library Reference PRC-LR-RM2017-3/1

In Figure II-26, total market dominant contribution decreased during the first half of the PAEA era and then began to slowly increase. First-Class Mail contribution reached a peak of approximately \$19 billion in FY 2008 then declined before increasing slightly after FY 2014. Notably, the contribution for Periodicals has been consistently negative, and the Package Services contribution was negative from FY 2009 to

FY 2012. The negative contributions from the Periodicals and Package Services classes are shown in Table II-14.

Table II-14
Periodicals and Package Services Contribution (in \$ millions)

Fiscal Year	Periodicals Contribution	Package Services Contribution
	(loss)	(loss)
2007	\$ (448)	\$ 89
2008	\$ (437)	\$ 17
2009	\$ (642)	\$ (56)
2010	\$ (611)	\$ (182)
2011	\$ (609)	\$ (97)
2012	\$ (670)	\$ (38)
2013	\$ (521)	\$ 18
2014	\$ (509)	\$ 93
2015	\$ (512)	\$ 37
2016	\$ (531)	\$ 18
Total	\$ (5,489)	\$ (100)

Source: Library Reference PRC-LR-RM2017-3/1

As demonstrated in Table II-14, the Periodicals and Package Services classes had overall negative contributions throughout the PAEA era. Accordingly, as the Periodicals class showed a negative contribution throughout the PAEA era, and the Package Services class demonstrated a negative contribution in 4 of the 10 years that exceeded the positive contribution of the other 6 years, the Commission determines that the rates were not reasonable at the class-level during the PAEA era.

(3) Product-Level Contribution

Finally, the Commission examines the reasonableness of rates at the product-level by examining the total contribution provided by products. As with classes, rates for products that have a negative contribution are not reasonable because they threaten the financial integrity of the Postal Service.

Table II-15 shows all products that had a negative contribution in any fiscal year since FY 2008.³⁴⁶

Table II-15
Non-Compensatory Products
Total Contribution (Loss) per Year (in \$ Millions)

Product/ Fiscal Year	2008	2009	2010	2011	2012	2013	2014	2015	2016
First-Class Mail Parcels	-	-	-	-	(10)	(3)	-	-	-
Inbound Single-Piece Intl Mail	(102)	(105)	(53)	(33)	(93)	(95)	(54)	(75)	(28)
Standard Mail Flats	(227)	(616)	(577)	(643)	(528)	(376)	(411)	(520)	(604)
Standard Mail Parcels	(166)	(205)	(172)	(112)	(49)	(35)	(31)	(24)	(29)
Periodicals Within County	(4)	(13)	(24)	(19)	(28)	(21)	(18)	(22)	(25)
Periodicals Outside County	(434)	(629)	(587)	(590)	(642)	(500)	(490)	(490)	(505)
Bound Printed Matter Parcels	-	(7)	(27)	(4)	-	-	-	-	-
Package Services Media/Library Mail	(60)	(74)	(89)	(98)	(56)	(56)	(20)	(85)	(88)
Package Services Parcel Post	(66)	(61)	(134)	(88)	(66)	(23)	-	-	-
Total Contribution	(1,059)	(1,710)	(1,663)	(1,587)	(1,471)	(1,108)	(1,024)	(1,215)	(1,281)

Source: Library Reference PRC-LR-RM2017-3/1

As demonstrated in Table II-15, numerous products did not cover their attributable cost and had a negative contribution during the PAEA era. Several products, such as Periodicals Outside County and Standard Mail Flats, have consistently made a negative contribution since the PAEA took effect. These non-

³⁴⁶ The Postal Service began reporting product-level data in FY 2008.

compensatory products threatened the financial integrity of the Postal Service because the revenue from these products failed to cover their attributable cost. Accordingly, the Commission determines that the rates were not reasonable because they threatened the financial integrity of the Postal Service during the PAEA era.

(4) Maintenance of Reasonable Rates

The Commission looks to whether the system has encouraged the maintenance of reasonable rates during the PAEA era. As set forth above, rates will be reasonable if market dominant mail, each class, and each product cover their attributable costs and are able to make a sufficient positive contribution to institutional costs.

As discussed previously, section II.B.3.c.(2), *supra*, the Commission conducts an ex-post review of market dominant prices in its ACD proceedings. The provisions of 39 U.S.C. § 3653 provide a mechanism for the Commission to take appropriate action for non-compliance with regard to rates and services. As part of its ACD review during the PAEA, the Commission has repeatedly addressed issues related to non-compliance of rates for non-compensatory products. Since FY 2008, “the Commission has identified seven products that have failed to generate revenue sufficient to cover their attributable costs.”³⁴⁷ As part of its authority to remedy non-compliance with regard to rates under the PAEA, the Commission has directed the Postal Service to increase cost coverage through a combination of above-average price adjustments, subject to the price cap, and cost reductions.³⁴⁸ The Commission consistently encouraged the Postal Service to reduce its costs in order to improve cost coverage.³⁴⁹

³⁴⁷ Order No. 1926 at 137-38 (citing FY 2012 ACD at 15).

³⁴⁸ See, e.g., FY 2016 ACD at 57; FY 2010 ACD at 106.

³⁴⁹ See FY 2016 Financial Report at 32; FY 2015 ACD at 42-69; FY 2014 ACD at 33-57; FY 2013 ACD at 5-61; Revised FY 2012 ACD at 15-22, 88-96, 108-117; FY 2010 ACD at 90-94, 103-108, 116-118.

The mechanism was insufficient to provide for the maintenance of reasonable rates during the PAEA era because, in part, the Postal Service was subject to the price cap limitation.

Based on the cost and contribution analyses, the Commission determines that there was not an adequate mechanism to maintain reasonable rates during the PAEA era because certain products and classes threatened the financial integrity of the Postal Service by failing to cover their attributable costs.

5. Mail Security and Terrorism Deterrence

The Commission reviews Objective 7 and whether the system has “enhance[d] mail security and deter[red] terrorism.” 39 U.S.C. § 3622(b)(7).

a. Comments

Few commenters provide discussion regarding whether the ratemaking system is supporting the development of mail security and terrorism deterrence. The Postal Service asserts that in order to encourage mail security and terrorism deterrence, it must be generating adequate revenue to ensure financial stability, a condition it states is not met. Postal Service Comments at 54. The Postal Service claims that it is inhibited in its ability to meet this objective because of inadequate revenue. *Id.*

MMA, NAPM, and NPPC assert that the current ratemaking system “has had no noticeable effect on enhancing mail security and deterring terrorism.” MMA, NAPM, and NPPC Comments at 52. They express disagreement with the metrics proposed by the Commission in the ANPR (discussed further below) to measure success under this objective, but do not explain their reason for the disagreement. Instead, they suggest that the Postal Service utilize its pricing flexibility to encourage mailers to migrate to more secure forms of mail to further the goals of Objective 7. *Id.*

MH and NAAD also state that the current rate-setting process has not materially affected the Postal Service's ability to safeguard the mail or inhibit its use for terrorist attacks. MH and NAAD Comments at 8. They continue by noting that in the absence of any reason to respond otherwise, the Commission must conclude that the system is encouraging mail security and deterrence of terrorism. *Id.*

Several other commenters discuss mail security and terrorism, but their comments were related to specific operations that are outside the scope of this review.³⁵⁰

b. Application of Measurement

In its review of the financial health of the Postal Service, the Commission also analyzes Objective 7, which looks to whether the system has “enhance[d] mail security and deter[red] terrorism.” 39 U.S.C. § 3622(b)(7). As indicated in the ANPR, “a system achieving Objective 7 encourages methods of safeguarding the mail system from illegal or dangerous use, or terrorism.” Order No. 3673 at 8. Commenters did not oppose the definition, and the Commission adopts the ANPR definition for this review.

The key measurable concepts for Objective 7 include “(1) enhance mail security, and (2) deter terrorism.” Order No. 3673 at 9. Although the Commission listed the key measurable components separately in the ANPR, the Commission considers “enhance mail security” and “deter terrorism” together for purposes of this review. In the ANPR, the Commission suggested the following measurement metrics: reviewing safeguards (and associated available funds) intended to enhance security and deter terrorism, and reviewing the availability of an “exigent-like provision” to ensure funds are available to respond to specific threats. Order No. 3673 at 9. Because commenters did not provide any justifications supporting their opposition to the Commission's proposed

³⁵⁰ See, e.g., Enlightened Connections Comments at 14-16; Yao Statement at 2-4.

measurement metrics, the Commission adopts them in their existing form for this review.³⁵¹ The Commission finds that the system worked to enhance mail security and deter terrorism during the PAEA era because there were sufficient funds available to maintain safeguards and provide for specific and unforeseen security or terrorism emergencies.

In its analysis below, the Commission first reviews the safeguards to enhance mail security and deter terrorism employed by the Postal Service. Next, the Commission reviews the availability of an “exigent-like provision” to ensure funds were available if needed to respond to specific and unforeseen security or terrorism emergencies.

(1) Existing Safeguards

As set forth in the ANPR, the Commission reviews the safeguards enacted by the Postal Service to determine whether there were sufficient funds available to maintain safeguards and provide for specific and unforeseen security or terrorism emergencies during the PAEA era. The existing safeguards employed by the Postal Service included the United States Postal Inspection Service (USPIS) and technology, equipment, and processes that support efforts to secure the mail. These safeguards, discussed in more detail below, were not funded by appropriations, and were considered part of the Postal Service’s operating expenses paid through short-term cash flow.³⁵²

USPIS’ mission is “to support and protect the U.S. Postal Service and its employees, infrastructure, and customers; enforce the laws that defend the nation’s mail

³⁵¹ Although MMA, NAPM and NPPC state that they disagree with the metrics, their comment focuses on suggestions to improve the system rather than disagreement with the measurement metric. See MMA, NAPM, and NPPC Comments at 53.

³⁵² See Joy Leong Consulting, LLC, *The Contribution of the Postal Service in National Emergencies*, February 14, 2011, at 32-33 (Emergency Preparedness Report), available at https://www.prc.gov/sites/default/files/archived/Emergency_Prep_Report.pdf.

system from illegal or dangerous use; and ensure public trust in the mail.”³⁵³ As part of its mission, USPIIS maintains a uniformed force of postal police officers, operates a national forensic crime laboratory, and works with both postal employees and members of the public to ensure secure facilities for the mail.

Annual reports from the USPIIS demonstrate its successful efforts to maintain a secure mail system. For example, the most recent USPIIS annual report described the recent prosecution of a defendant who sent over 400 threatening letters allegedly containing anthrax (the substance was later determined to be non-hazardous), and stated that in FY 2016, inspectors “made a total of 1,850 arrests involving drug trafficking of which 1,571 criminals were convicted.”³⁵⁴ In order to maintain service to the public “in the event of an attack, natural disaster, or other type of incident,” USPIIS undertakes “coordinated protection planning efforts and a thorough evaluation of every vulnerability.” USPIIS FY 2016 Annual Report at 28. These annual risk assessments conducted by the USPIIS ensure security controls are in place at postal facilities in order to protect the mail, employees, and members of the public. *Id.* In addition, as noted by the Department of Homeland Security, the Postal Service has implemented biological detection screening, threat mail identification programs, and aviation mail security programs.³⁵⁵

In addition to the USPIIS, the Postal Service safeguarded the mail system to enhance mail security and deter terrorism through its technology, equipment, and

³⁵³ United States Postal Inspection Service, Mission Statement, (last accessed November 21, 2017), available at <https://postalinspectors.uspis.gov/aboutus/mission.aspx>.

³⁵⁴ United States Postal Inspection Service, Annual Report 2016, at 22 (last accessed November 21, 2017) (USPIIS FY 2016 Annual Report), available at https://postalinspectors.uspis.gov/radDocs/2016%20AR%20FINAL_web.pdf.

³⁵⁵ Department of Homeland Security, National Infrastructure Protection Plan, DHS (last accessed November 21, 2017), available at <https://www.dhs.gov/xlibrary/assets/nppd/nppd-ip-postal-and-shipping-snapshot-2011.pdf>.

processes. IMb services are an example of one of the many technological safeguards enacted by the Postal Service. Although the IMb program was developed to improve operational efficiency, it also has mail security benefits because as mailers registered, there was “an increase in the percentage of known senders using the mail.”³⁵⁶ In addition, the Postal Service learned more about the path of a piece of mail in the event of a law enforcement investigation. *Id.* Accordingly, IMb services enabled the Postal Service “to address identity theft, mail theft, and other abuses.” *Id.*

The Postal Service also utilized equipment safeguards to enhance mail security and deter terrorism during the PAEA era. An example of an equipment safeguard is the Advanced Facer Canceler System biohazard detection screening technology. After the September 11 attacks and the anthrax attacks through the mail system, the Postal Service petitioned Congress for emergency supplemental appropriations to purchase biohazard detection screening technology.³⁵⁷ The funds were used to purchase screening devices to protect the mail system, Postal Service employees, and customers. *Id.* The Postal Service applied its current operating revenue to continue operation of these devices throughout the PAEA era.

In addition to safeguards in technology and equipment, the Postal Service also made continued process improvements in order to enhance mail security and deter terrorism. As identified in the USPIS Annual Reports, the Postal Service continued its efforts to train mail carriers and employees to assess security risks and identify suspicious packages and promote awareness of security concerns through publications and flyers. *See, e.g.*, USPIS FY 2016 Annual Report at 7.

³⁵⁶ See United States Postal Service, Intelligent Mail Usage and Privacy Policy, (last accessed November 21, 2017), available at <http://about.usps.com/who-we-are/privacy-policy/intelligent-mail-privacy.htm>.

³⁵⁷ See Department of Defense and Emergency Supplemental Appropriations for Recovery from and Response to Terrorist Attacks on the United States Act, 2002, Pub. L. 107-117, 115 Stat. 2334-2335, January 10, 2002.

Expenses to maintain the safeguards discussed above were not paid through Congressional appropriations. See Emergency Preparedness Report at 32-33. Accordingly, the Postal Service paid for safeguards through its operating expenses, which were funded by mail revenue. *Id.* The Postal Service was able to cover and pay for all of its operating expenses over the course of the PAEA era, as is demonstrated in the short-term stability analysis in section II.C.2.b.(1), *supra*.

(2) Availability of Exigent Funds

The Commission also reviews the availability of an “exigent-like provision” to ensure funds were available to respond to specific threats. Order No. 3673 at 9. While the Postal Service’s operating revenue (*i.e.*, short-term financial stability, see section II.C.2.b.(1), *supra*) was sufficient to fund existing security and terrorism deterrence efforts, an unexpected mail security emergency or act of terrorism might have presented a problem for the Postal Service based on the instability in its medium and long-term financial instability as described in section II.C.2.b.(1), *supra*.

The exigent provision in section 3622(d)(1)(E) was partially intended to be available to aid the Postal Service in responding to financial difficulties presented by terrorist attacks or other extraordinary mail security emergencies. Although the exigent provision cannot be used as a part of the general funding for the safeguards to secure the mail and deter terrorism, it was designed as an emergency backstop that would allow the Postal Service to recoup extraordinary costs by raising rates above the price cap in case of a specific, unexpected security or terrorism emergency (assuming all other legal requirements of 39 U.S.C. § 3622(d)(1)(E) were met). See S. Rep. 108-318 at 11-12.

In addition, the legislative history of the PAEA contemplated that the exigent provision was intended to provide relief to the Postal Service in cases of “unexpected and extraordinary circumstances.” *Id.* at 11. Specifically Congress intended that the

exigent provision be used in the event the Postal Service had to respond to situations similar to the “the terrorist attacks of September 11, 2001 and the subsequent use of the mail to transmit anthrax.” *Id.* Although the Postal Service has never had to use the exigent provision on the grounds of a terrorist event, the Commission finds that the existence of the provision provided a sufficient source of potential funds and flexibility to adjust to any unexpected security and terrorism demands placed on the system from a specific, unforeseen threat during the PAEA era.

Based on the Commission’s analysis, the Commission determines that there were existing safeguards to protect the mail system and deter terrorism as well as sufficient funds to pay for the safeguards during the PAEA era. In addition, the Commission finds the exigent provision was adequate to address unexpected mail security or terrorism threats.

6. Institutional Cost Allocation

Finally, the Commission reviews Objective 9 and whether the system “allocate[d] the total institutional costs . . . appropriately between market dominant and competitive products.” 39 U.S.C. § 3622(b)(9). For this analysis, the Commission reviews 39 U.S.C. §§ 3633(a)(3) and 3633(b) along with a history of past allocation to determine whether the system had a “mechanism to appropriately divide total institutional costs between market dominant and competitive products in a manner reflecting the relevant statutory considerations.” Order No. 3673 at 10.

a. Comments

With respect to the allocation between market dominant and competitive products, the Postal Service contends that “achievement of Objective 9 is effectuated, from the standpoint of competitive products, through the Commission’s implementation of section 3633(a)(3): so long as the Postal Service’s competitive products are meeting the ‘appropriate share’ provision, institutional costs are being ‘allocated . . .

appropriately' to competitive products for purposes of this Objective.” Postal Service Comments at 79. Other commenters submit that the standards for recovering the institutional costs of the Postal Service are appropriate and should not be changed.³⁵⁸ Additional commenters submitted opinions on whether the actual amount of the allocation is appropriate, as opposed to whether the mechanism to allocate the amount is appropriate.³⁵⁹

b. Application of Measurement

Objective 9 requires that the system “allocate the total institutional costs appropriately between market-dominant and competitive products.” 39 U.S.C. § 3622(b)(9). In the ANPR, the Commission proposed defining Objective 9 as requiring that the system “has a mechanism to appropriately divide total institutional costs between market dominant and competitive products in a manner reflecting the relevant statutory considerations.” Order No. 3673 at 10. The Commission adopts this definition for purposes of this review.³⁶⁰

In the ANPR, the Commission proposed “allocate the total institutional costs appropriately” as the key measurable concepts under Objective 9. Order No. 3673 at 10. As ways to assess Objective 9, the Commission stated the objective is related to 39 U.S.C. §§ 3633(a)(3) and 3633(b) and proposed a “historical review of the allocation of institutional costs between market dominant and competitive products” and “a review of any action the Commission [has taken] to analyze the competitive products’ minimum contribution to institutional costs.” *Id.* Accordingly, in this analysis, the Commission reviews sections 3633(a)(3) and 3633(b) and the history of this allocation together with

³⁵⁸ ANM *et al.* Comments at 10; DMA *et al.* Comments at 4; Enlightened Connections Comments at 20; MH and NAAD Comments at 9; PSA Comments at 8.

³⁵⁹ TPA Comments at 2; UPS Comments at 3.

³⁶⁰ No commenter objected to the Commission’s definition of Objective 9.

past actions taken by the Commission to determine whether the system provides a mechanism to appropriately divide total institutional costs between market dominant and competitive products.

Section 3633(a)(3) provides that the Commission shall promulgate regulations to “ensure that all competitive products cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service.” Section 3633(b) further requires the Commission review the institutional costs contribution requirement every 5 years and “determine whether the institutional costs contribution requirement under subsection (a)(3) should be retained in its current form, modified, or eliminated.” As part of its review of the institutional costs contribution, the Commission is tasked with considering “all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products.” 39 U.S.C. § 3633(b).

In the initial rulemaking promulgating the regulations of the PAEA, the Commission “gave considerable weight to the historical contribution made by items categorized as competitive products by the PAEA and set the minimum contribution level for competitive products at 5.5 percent of total institutional costs.”³⁶¹ The Commission considered numerous factors in setting the appropriate share including: (1) the fact that the PAEA “so thoroughly overhauls the ratemaking process” that the changes in that process should be taken into account; (2) rates for competitive products are no longer predicated on consideration of non-cost factors as they were under the PRA, Pub. L. 91-375 (1970); and (3) under the PAEA, the Postal Service may retain earnings, so it has an incentive to exceed the threshold set by the Commission

³⁶¹ Docket No. RM2017-1, Advance Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, November 22, 2016, at 2 (Order No. 3624); 39 C.F.R. § 3015.7(c); *see also* Order No. 26 at 73-74.

“including reducing rate pressure on market dominant rates, continuation of universal service, and the possibility of bonuses.” Order No. 26 at 71-72.

In setting the allocation, the Commission weighed other considerations, including “the risks of setting it too high” at the outset of a new regulatory system where the Postal Service’s market share was relatively small. *Id.* at 73.

The Commission’s process in setting the appropriate share of institutional costs under sections 3633(a)(3) and 3633(b) involves notice and comment, and the Commission considers input of interested parties prior to determining the allocation. Under the process set forth in section 3633(b) and the relevant regulations, the Commission has determined that the allocation for competitive product’s contribution to institutional costs should be set to 5.5 percent.³⁶² The appropriate share for competitive products has been considered a “minimum contribution.” That is, the Postal Service must cover at least the appropriate share, but may (and, indeed, is expected to) cover more than just the minimum. Conversely, the amount of institutional costs to be allocated to market dominant products has not been specified, although some parties suggest that it is the residual from competitive products’ appropriate share.³⁶³

Table II-16 below shows the institutional cost allocation between market dominant and competitive products over the course of the PAEA era.

³⁶² This share is currently under review by the Commission. See Order No. 3624. The Commission previously reviewed the allocation and determined that the 5.5 percent was to be maintained as the appropriate share. See Docket No. R2013-3, Order No. 1449, Order Reviewing Competitive Products’ Appropriate Share Contribution to Institutional Costs, August 23, 2012.

³⁶³ See *generally*, Docket No. PI2008-2, Initial Comments of the United States Postal Service in Response to Order No. 56 and the Treasury Report, April 1, 2008; Docket No. PI2008-2, Valpak Direct Marketing Systems, Inc. and Valpak Dealers’ Association, Inc. Initial Comments on Report of the U.S. Department of the Treasury on Accounting Principles and Practices for the Operations of the United States Postal Service’s Competitive Products Fund, April 1, 2008.

Table II-16
Contributions to Institutional Costs (FY 2007 – FY 2016)

Year	Competitive Product Contribution (\$ Billions)	Market Dominant Product Contribution (\$ Billions)	Residual Institutional Cost (\$ Billions)
FY 2007	1.52	25.05	4.91
FY 2008	1.78	27.41	2.94
FY 2009	1.96	23.08	3.87
FY 2010	2.42	22.97	8.62
FY 2011	2.31	22.05	5.19
FY 2012	3.04	21.61	15.98
FY 2013	3.86	21.97	7.26
FY 2014	4.31	24.29	5.52
FY 2015	4.52	24.15	5.08
FY 2016	6.00	24.68	5.62

Source: Library Reference PRC-LR-RM2017-3/1

Table II-16 shows the contribution market dominant products and competitive products have made to institutional costs, as well as the residual institutional costs not covered during each fiscal year of the PAEA era. Competitive products have generally contributed an increasing share of total institutional costs each year, while market dominant contributions have decreased during the PAEA era.

The system established under section 3622 of the PAEA does not specify the *amount* to be allocated to market dominant products, rather it only requires that the system have a *mechanism* to appropriately allocate between competitive and market dominant as set forth by Objective 9.

Based on the analysis discussed above, the Commission determines that although the mechanism for allocation is located outside of section 3622, the statutory and regulatory mechanisms to set the allocation of institutional costs required by

sections 3633(a)(3) and 3633(b) provide a mechanism to appropriately allocate institutional costs between competitive and market dominant products.

7. Objectives Relevant to the Postal Service's Financial Health Reviewed in Conjunction with Each Other

The Commission's adoption of a topical approach allows application of the objectives in conjunction with one another as they relate to the Postal Service's finances to determine whether the system has achieved the objectives. In reviewing the financial health of the Postal Service, the Commission analyzes financial stability (Objective 5), cost reduction and operational efficiency gains (Objective 1), reasonable rates (Objective 8), mail security and terrorism deterrence (Objective 7), and institutional cost allocation (Objective 9).

The Postal Service's financial stability is a component of the Postal Service's overall financial health. Although the Commission finds that the short-term financial stability measure was generally achieved, the medium and long-term financial stability measures were not achieved. Therefore, financial stability was not maintained during the PAEA era.

Cost reductions and efficiency contribute to the Postal Service's overall financial health. The Commission uses a two-step analysis of this objective. In the first step, the Commission reviews whether costs were reduced and efficiency increased during the PAEA era. In the second step of this analysis, the Commission reviews whether incentives to reduce costs and increase efficiency have been maximized.

The Commission finds that real unit market dominant attributable cost, the primary measure of cost reduction, has declined during the PAEA era. As discussed, the decline may be the result of multiple influences, including the system of ratemaking, mail mix changes, and the Postal Service's actions.

The Commission finds that TFP, the primary measure of operational efficiency, has increased during the PAEA era.

However, while the Commission finds that during the PAEA era there were cost reductions and efficiency gains, the Commission also finds that the incentives to achieve cost reductions and efficiency increases were not maximized during the same period of time. In the maximization analysis, the Commission determines that: (1) gains were not achieved in cost reductions and operational efficiency sufficient to contribute to the financial stability of the Postal Service; and (2) cost reductions and operational efficiency increases were not achieved at a greater rate when compared to the relevant time period of the 10 years immediately prior to the implementation of the PAEA.

As part of the analysis of the Postal Service's financial health, the Commission analyzes whether rates were reasonable by determining whether rates threatened the financial integrity of the Postal Service. The Commission finds that the system did not maintain reasonable rates because products and classes threatened the financial integrity of the Postal Service by failing to cover their attributable costs.

The analysis of whether rates were reasonable also relates to the Commission's finding in its financial stability analysis that the Postal Service was unable to attain financial stability in the medium-term. Medium-term financial stability requires total revenue to cover total cost, both attributable and institutional. See section II.C.2.b.(2), *supra*. Non-compensatory products were not priced sufficiently to cover attributable costs and make a positive contribution to institutional costs. As a result, non-compensatory products contributed to the Postal Service's inability to cover overall total cost as part of the medium-term financial stability analysis.

The Commission reviews the safeguards in the system and the availability of funds to react to an unexpected mail security or terrorism emergency during the PAEA era in relation to the Postal Service's financial health because the Postal Service's

ability to pay for mail security and terrorism deterrence efforts depends on its financial health. The Commission finds that there were existing safeguards to protect the mail system and deter terrorism, as well as sufficient funds to pay for the safeguards during the PAEA era. The Postal Service's financial stability in the short-term enabled it to continue to fund the existing safeguards, and the exigent provision was adequate to address unexpected mail security or terrorist threats that the Postal Service may not have been able to address due to its medium and long-term financial instability.

After a review of 39 U.S.C. §§ 3633(a)(3) and 3633(b), related Commission action, and a "historical review of the allocation of institutional costs between market dominant and competitive products," the Commission determines that the system contained a mechanism to appropriately allocate total institutional costs between market dominant and competitive products during the PAEA era.

Applying the objectives in conjunction with each other, the overall picture of the Postal Service's financial health is poor. The Commission finds that the system has not maintained the financial health of the Postal Service as intended by the PAEA.

D. Service

The following is a review of the third principal area of the PAEA system, which required the Postal Service to establish and maintain high quality service standards. 39 U.S.C. §§ 3622(b)(3), 3691. In reviewing service during the PAEA era, the Commission analyzes Objective 3, which looks to whether the system has "maintain[ed] high quality service standards established under section 3691." 39 U.S.C. § 3622(b)(3). The ANPR provided that "[a] system achieving Objective 3 is designed for the Postal Service to consistently achieve, for each class of mail, stated days to delivery at a desired target rate." Order No. 3673 at 5. As discussed in detail below, the Commission modifies this definition to focus this review on measuring whether high quality service standards have been maintained, as contemplated in Objective 3.

Accordingly, the Commission finds that a system meeting Objective 3 is one which encourages the maintenance of high quality service standards established pursuant to 39 U.S.C. § 3691, and in which the Postal Service is held accountable for consistently achieving those standards.³⁶⁴ As a result of its review, the Commission determines that the current system does not effectively encourage the maintenance of high quality service standards. Therefore, the goals of the PAEA have not been realized with respect to service.

There are two distinct aspects to service. The first of these, service standards, constitutes the stated days-to-delivery for different types of mail. The second, referred to as service performance, is the measurement of how often the Postal Service meets its stated service standards.

Service standards are determined by two components.³⁶⁵ The first is a “delivery day range,” which comprises the range of days within which all mail eligible for the service standard can be expected to be delivered. For example, the delivery day range for First-Class Mail is between 1 and 5 days. The second component is “business rules,” which determine eligibility for each specific service standard. Using the First-Class Mail example above, there are three separate service standards applicable to First-Class Mail: (1) 1-Day (referred to as “overnight”); (2) 2-Day; and (3) 3-5-Day, and business rules determine whether an individual mailpiece will be delivered overnight, in

³⁶⁴ The Commission reviews service performance, or whether the Postal Service is consistently achieving or meeting service standards, in the Commission’s annual compliance determinations (ACDs), which are conducted pursuant to 39 U.S.C. § 3653.

³⁶⁵ For an in-depth discussion of the components of service standards, including delivery day ranges and business rules, see Proposed Rule, Modern Service Standards for Market-Dominant Products, 72 Fed. Reg. 58946, 58947 (October 17, 2007) (Proposed Initial Service Standards).

2 days, or in 3-5 days. The Postal Service has the authority to adjust service standards.³⁶⁶

Delivery day ranges are based on a mailpiece's classification. The division of mail into "classes" is based upon content (e.g., personal correspondence versus printed advertising), as well as other factors.³⁶⁷ There are four market dominant mail classes which are relevant to this analysis: (1) First-Class Mail; (2) Standard Mail; (3) Periodicals; and (4) Package Services.³⁶⁸ Each class is further subdivided into "products." The subdivision of products is based on the physical characteristics of a mailpiece (e.g., physical characteristics such as shape—letters, parcels, flats), or distinct cost or market characteristics (e.g., In-County Periodicals, Media Mail/Library Mail). See Publication 32 at 183. Finally, the Postal Service reports on each product according to the level of processing required. "Single-Piece," or "End-to-End," service

³⁶⁶ Pursuant to 39 U.S.C. § 3691(a), the Postal Service may revise its service standards from time to time. However, as explained in more detail later in this section, any "change in the nature of postal services which will generally affect service on a nationwide or substantially nationwide basis" requires an advisory opinion by the Commission. 39 U.S.C. § 3661(b).

³⁶⁷ See Publication 32, Glossary of Postal Terms, July, 2013, at 121, available at <https://about.usps.com/publications/pub32.pdf>, (Publication 32).

³⁶⁸ A fifth market dominant class, Special Services, is not considered for purposes of this analysis. For the Special Services class, as of the fourth quarter of FY 2016, the Postal Service reports on 11 products. These products are: (1) Ancillary Services; (2) International Ancillary Services; (3) Address List Services; (4) Caller Services; (5) Change-of-Address Credit Card Authentication; (6) International Reply Coupon Service; (7) International Business Reply Mail Service; (8) Money Orders; (9) Post Office Box Service; (10) Customized Postage; and (11) Stamp Fulfillment Services. Some of these products are measured by the Postal Service's service performance measurement system. Of these 11 products, 7 are designated as either "not required" or "not available" for purposes of reporting. The products that are not measured have been granted semi-permanent exceptions from reporting, either because of their low volume or because measuring them would create increased burden for the Postal Service. See Order No. 531, Docket No. RM2010-11, Order Concerning Postal Service Request for Semi-Permanent Exceptions From Periodic Reporting of Service Performance Measurement, September 3, 2010; Docket No. RM2010-14, Order No. 570, Order Approving Semi-Permanent Exception From Periodic Reporting of Service Performance Measurement for Applications and Mailing Permits, October 27, 2010. For other Special Services products, measurement has not been consistent on an annual basis. For example, the Address List Services product did not report data in FY 2016 due to a lack of orders for the product. See FY 2016 ACD at 145. Similarly, data were not provided for the Stamp Fulfillment Services product in FY 2011. *Id.*

involves the Postal Service handling mail which is not subject to a workshare arrangement and has not received any workshare preparation prior to its point of entry into the mailstream. See Proposed Initial Service Standards, 72 Fed. Reg. 58949-50. “Presorted,” or “Destination-Entry,” service involves mail which has been prepared and/or transported prior to its point of entry into the mailstream by a commercial mailer pursuant to a workshare arrangement. As a result, presorted mail does not require the same level of processing and/or transportation by the Postal Service in order to be delivered. *Id.*

Business rules are based on several factors, such as specific origin-destination 3-digit ZIP Code pairs. See Proposed Initial Service Standards, 72 Fed. Reg. 58947. The entire Postal Service network is divided into service areas and each service area is represented by a unique 3-digit ZIP Code.³⁶⁹ When a mailpiece is entered into the postal network, its origin 3-digit ZIP Code is paired with its destination 3-digit ZIP Code, and the business rules determine, based on the specific ZIP Code pair, the number of delivery days within the applicable service standard for which the mailpiece is eligible. *Id.*

Business rules also include Critical Entry Times (CETs), which are the latest times during a particular day that a mailpiece can be entered into the postal network and still have its service standard calculated based on that day.³⁷⁰ If the mailpiece is entered before the CET on a given day, then its service standard is calculated based on the day of entry. If it is entered after the CET, its service standard is calculated based on the day of entry plus one additional day. *Id.* Hence, CETs determine the start time for calculating the service standard for an individual mailpiece. See Initial Service Standards, 72 Fed. Reg. 72223. Unlike delivery day ranges, business rules are not

³⁶⁹ *Id.* A 3-digit ZIP Code service area contains all traditional 5-digit ZIP Codes that share the same first 3 digits.

³⁷⁰ Proposed Initial Service Standards, 72 Fed. Reg. 58947. Order No. 83 at 3.

published in the Code of Federal Regulations because they vary based on where mail is entered, the mail's level of preparation, and other factors.³⁷¹

In light of its measurement and reporting obligations, the PAEA required the Postal Service to develop a "plan" for meeting service standards, including the establishment of "performance goals" for mail delivery.³⁷² As part of its plan addressing its performance goals, the Postal Service created a set of "performance targets" in order to gauge its success in meeting its service standards.³⁷³ Each year since 2009, the Postal Service has published these performance targets, which are updated annually, on its Rapid Information Bulletin Board System (RIBBS) website.³⁷⁴ Each performance target represents the percentage of mail, for each product category, that the Postal Service has set as a percentage goal for itself to deliver on-time.³⁷⁵ "On-time" is defined as a percentage score in relation to each applicable service standard. Thus, if the service standard is 3-5-Days, and the Postal Service has set a performance target of 90 percent, then in order to meet the target, 90 percent of all mailpieces eligible for that service standard must be delivered within 5 days.

As discussed in section II.A.3., *supra*, under the PAEA, there are three main avenues for the Commission to review service. First, service performance is reviewed annually in the ACD, where the Commission has the authority to order appropriate

³⁷¹ See Revised Service Standards for Market Dominant Mail Products, 77 Fed. Reg. 31190, 31194 (May 25, 2012) (Network Rationalization Revisions); Docket No. N2012-1, Advisory Opinion at 49.

³⁷² Pub. L. 109-435, §§ 302(a), (b)(1), 120 Stat. 3219 (2006).

³⁷³ See United States Postal Service, Postal Accountability and Enhancement Act § 302 Network Plan, June 2008, (Network Plan), available at <https://about.usps.com/postal-act-2006/postal-service-networkplan.pdf>.

³⁷⁴ See United States Postal Service, RIBBS, Targets for Market Dominant Products, available at <https://ribbs.usps.gov/index.cfm?page=targets>.

³⁷⁵ For purposes of measurement, market dominant products are broken down into classes, products, and service standards. Service performance is measured at the service standard level by district. These numbers are then aggregated to obtain product- and class-level scores.

remedies for performance deficits. Second, changes in service standards are reviewed in “nature-of-service” dockets, where the Commission issues non-binding advisory opinions with regard to proposed service changes. The Postal Service is only required to consider these advisory opinions. Third, the Commission may review service through the PAEA’s complaint process, by which parties may file complaints with the Commission regarding service.

Each year, after receiving the Postal Service’s ACR, the Commission reviews the provided information as part of its ACD.³⁷⁶ The Commission determines “whether any service standards in effect during such year were not met,” and, if such is the case, “shall order that the Postal Service take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance”³⁷⁷ In each ACD, the Commission evaluates whether service standards have been met with reference to the performance goals and performance targets established by the Postal Service.³⁷⁸ Although the Postal Service generally establishes its own goals, the Commission may intervene if the

³⁷⁶ 39 U.S.C. § 3653(b)(2). As part of the ACD process, every 2 years the Commission evaluates a special study conducted by a third party contractor on behalf of the Postal Service concerning final delivery service performance to the non-contiguous locations of the Alaska, Honolulu, and Caribbean Districts. These districts serve remote areas less populated than the average continental district, and large portions of these districts are located far from mail processing facilities. See, e.g., FY 2015 ACD at Appendix A.

³⁷⁷ 39 U.S.C. §§ 3653(b)(2), 3653(c), 3662(c). See also Docket No. N2010-1, Advisory Opinion at 8; Docket No. N2012-1, Advisory Opinion at 6; Order No. 465 at 13-14; Order No. 140 at 6-7; Docket No. PI2016-1, Order No. 3490, Order Enhancing Service Performance Reporting Requirements and Closing Docket, at 2-3.

³⁷⁸ The Commission notes that during the years immediately after the PAEA’s enactment, the Postal Service was developing and implementing the performance measurement systems required by the PAEA and it was only after FY 2012 that the service performance data reported by the Postal Service were robust enough for comprehensive analysis. In reviewing the Postal Service’s service performance results therefore, the Commission is limited to essentially 5 years of data, during which a substantial network realignment initiative was underway. The Commission’s method of evaluating compliance with service standards was confirmed in Docket No. C2013-10, Order Granting Motion for Reconsideration and Granting Motion to Dismiss, May 27, 2015, at 12 n.21 (Order No. 2512); *Am. Postal Workers Union, AFL-CIO v. Postal Regulatory Comm’n*, 842 F.3d 711, 718 (D.C. Cir. 2016).

Postal Service's goals are contrary to the objectives of title 39 or significantly change the nature of a postal product. Order No. 2512 at 11 n.20. Moreover, the Commission has "an indirect role in reviewing Postal Service initiated performance standard and target changes . . . as this may affect the nature of the underlying service, or the rates associated with the service in regard to the price cap." Order No. 465 at 26. In addition, the Postal Service is required to notify the Commission prior to the implementation of any change in performance goals.³⁷⁹

The development of service standards and the requirement of service reporting were made necessary by the PAEA's changes to postal ratemaking, as the Commission has previously recognized.³⁸⁰ Under a price cap system, the price cap is only effective if reliable, efficient, and economical service is maintained. Docket No. N2010-1, Advisory Opinion at 7-10. There is "the potential to cut costs by way of service reductions to comply with price cap requirements." 2011 701 Report at 58. The Postal Service cannot be permitted to degrade service in order to comply with the revenue constraints associated with the price cap. Docket No. N2010-1, Advisory Opinion at 7-10. Thus, the price cap and the service requirements are intended to work in conjunction to ensure that cost reductions and efficiency gains are not made at the expense of service quality. *Id.*

1. Relevant Factors

In determining whether the system has achieved the objectives of the PAEA, the Commission considers Factors 1, 4, 9, 12, and 14, as discussed below.

The Commission considers the impact of Factors 1 and 4 together in its review of whether high quality service standards have been maintained during the PAEA era.

³⁷⁹ See 39 C.F.R. § 3055.5; see also Order No. 2512 at 12 n.21.

³⁸⁰ See Docket No. N2010-1, Advisory Opinion at 7-10; FY 2009 ACD at 49.

Factor 1 states that consideration should be given to “the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery.” 39 U.S.C. § 3622(c)(1). Factor 4 states that consideration should be given to “the available alternative means of sending and receiving letters and other mail matter at reasonable costs.” 39 U.S.C. § 3622(c)(4). These factors highlight the importance of maintaining service standards with respect to the value of mail service provided for both the sender and the recipient. A decline in service standards or service performance is, all other things being equal, tantamount to a decline in the overall value of the mail as a service, which makes alternative means of sending and receiving letters and other mail matter more attractive. Moreover, alternatives to mail affect customers’ expectations of service in terms of speed and reliability of delivery.

Factor 9 states that consideration should be given to “the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery.” 39 U.S.C. § 3622(c)(9). Factor 9 contemplates establishing and maintaining separate service standards for different products and recognizes the importance of providing classifications with high degrees of reliability and speed of delivery compared to classifications that do not require high degrees of reliability and speed of delivery. Factor 9, as applied to high quality service, means that service reliability and speed should vary across products, but that the mere existence of such variability does not indicate that service is not high quality.

Factor 12 states that consideration should be given to “the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services.” 39 U.S.C. § 3622(c)(12). Factor 12, impresses the importance of considering the overlap between the goals of Objective 1, on the one hand, and the fact that cost reductions and efficiency gains should not be

made at the expense of service quality. Factor 12 envisions the Postal Service using increases in efficiency and reductions in costs to maintain services which are both affordable *and* high quality.

Factor 14 states that consideration should be given to “the policies of [title 39] as well as such other factors as the Commission determines appropriate.” 39 U.S.C. § 3622(c)(14). Factor 14, allows the Commission to review the policies of title 39 and other factors as it deems appropriate.

2. Comments

Comments that address service performance during the PAEA era and/or Objective 3 fall into three main categories: (1) comments regarding the scope and framework of the Commission’s analysis of high quality service; (2) comments regarding the quality of the Postal Service’s service standards and/or service performance during the PAEA era; and (3) other factors affecting the Postal Service’s ability to maintain high quality service.

Multiple commenters, including the AF&PA and the APWU, stress that service must be considered in conjunction with the other PAEA objectives.³⁸¹ The AF&PA asserts that the current ratemaking system provides the best means of accomplishing all of the PAEA’s objectives in conjunction with each other. AF&PA Comments at 1. The APWU asserts that viewing the objectives in conjunction with each other leads to the conclusion that the current system is failing. APWU Comments at 7.

The Public Representative suggests modifications to the Commission’s definition and measurement of high quality service standards under Objective 3. He suggests that determining whether or not service standards are “high quality” should focus on

³⁸¹ AF&PA Comments at 1; APWU Comments at 7.

more than simply “achiev[ing] . . . stated days to delivery at a desired target rate,” as posited in the preliminary definition for Objective 3 in the ANPR. PR Comments at 24. He notes that one of the potential measurement methods listed in the ANPR is customer satisfaction with the service standards.³⁸² MH and NAAD similarly suggest that the meaning of “high quality service standards” should be ascertained by asking ratepayers and customers what they consider “high quality standards” to constitute. MH and NAAD at 5-6.

In addition to comments regarding the framework for analyzing service under Objective 3, the majority of comments focus on whether the Postal Service’s service standards and/or service performance have been high quality during the PAEA era.

The majority of comments regarding service standards assert that service standards have declined. MH and NAAD, for example, assert that the present standards are not the “high quality” service standards which the PAEA envisioned, considering reductions in overnight service, changes in service standards for Standard Mail, low service performance results for Periodicals, and the reported frequency of

³⁸² *Id.* The Public Representative also contends that the reliance which section 3622(b)(3) places on section 3691 of the PAEA requires the Commission, for purposes of determining whether Objective 3 has been met, to also consider the objectives contained at section 3691(b)(1). *Id.* Specifically, section 3691 of the PAEA, which directs the Postal Service to establish a set of service standards, is structured similarly to section 3622 in that it contains “objectives” to be applied by the Postal Service in establishing service standards. 39 U.S.C. § 3691(b). Section 3622 likewise contains “objectives” to be applied by the Commission in establishing the modern system of rate regulation, as well as in conducting the section 3622 review in which the Commission is presently engaged. 39 U.S.C. §§ 3622(b), (d)(3). The Public Representative asserts that section 3622(b)(3), which posits that the system of modern rate regulation shall “maintain high quality service standards established under section 3691,” incorporates all of section 3691 into section 3622(b)(3) for purposes of determining, pursuant to section 3622(d)(3), whether section 3622(b)(3) has been achieved. PR Comments at 24.

The Public Representative does not provide any example of how the section 3691 objectives should be applied to section 3622(b)(3). The Commission concludes that the section 3691 objectives do not apply to the Commission’s instant review pursuant to section 3622(d)(3). Section 3691 applies to the “establishment” and “revision” of service standards. 39 U.S.C. § 3691(a). The present service standards were established in December 2007. See Initial Service Standards, 72 Fed. Reg. 72216. The relevant inquiry for purposes of the section 3622 review is whether those service standards have been “maintained.” 39 U.S.C. § 3622(b)(3).

service complaints in rural areas. *Id.* The APWU notes that in 2011, 41.2 percent of all First-Class Mail was eligible for overnight delivery, while in 2016 only a small percentage of First-Class Mail Presorted Letters remained eligible for overnight service. APWU Comments at 15. As a result, commenters allege that this reduction in service standards over the course of the PAEA era cannot be considered “high quality” as contemplated by Objective 3.

In addition to comments regarding the degradation in service standards, numerous commenters criticize the Postal Service’s service performance over the past 10 years. The APWU notes that the Postal Service has never attained its service standards for First-Class Mail Flats or First-Class Mail Parcels, and, despite reduced service standards, is still struggling to meet its performance goals, especially for 3-5-Day First-Class Mail.³⁸³ The APWU also notes that the Postal Service has never attained its Periodicals service standards and has consistently failed to attain service standards for most Standard Mail products. APWU Comments at 16. SIIA likewise notes that service performance scores for Periodicals remain well below targets. SIIA Comments at 7.

The Postal Service asserts that its service performance has “significantly rebound[ed]” since FY 2015. Postal Service Comments at 121. This statement is echoed by MH and NAAD, SMC *et al.*, and NNA.³⁸⁴

Numerous commenters provide input on additional factors the Commission should consider when evaluating whether the ratemaking system has maintained high quality service standards during the PAEA era. These factors include the constraints of

³⁸³ APWU Comments at 15-16. *See also* ACI Comments at 4 (“Despite its overall reduced objectives to transport mail in a timely manner, the USPS has further allowed its actual reported metrics for performance to deteriorate . . .”).

³⁸⁴ MH and NAAD Comments at 5; SMC *et al.* Comments at 5; NNA Comments at 18-19.

the price cap system, the tension between cutting costs and reducing service, and volume declines.

Some commenters, including the Public Representative, submit that the price cap's limitation on revenue creates tension with the Postal Service's ability to improve its service performance and provide universal service. Specifically, the Public Representative notes that firms subject to a price cap might be incentivized to maintain profitability by reducing the quality of service provided, thereby reducing costs.³⁸⁵ He and other commenters assert that the inability of the Postal Service to generate sufficient revenue as a result of the price cap has been the primary contributor to service declines.³⁸⁶ In contrast, GCA asserts that there is no empirical support for drawing a connection between the price cap and quality of service, noting that other PAEA provisions provide for oversight of service quality. GCA Comments at 15.

Further, a few commenters note the tension between Objective 1 requiring cost reductions and Objective 3 requiring the Postal Service to maintain high quality service. The Postal Service, in particular, contends that the constraints of the price cap system have left it unable to obtain financial relief through any means other than cost savings, including cutting service. Postal Service Comments at 120. It maintains that financial pressures drove it to escalate operational changes which led to service declines. *Id.* at 121. It asserts that by placing the Postal Service in a state of perpetual financial

³⁸⁵ PR Comments at 25. See also Declaration of John Kwoka, March 20, 2017, at 9-10 (Kwoka Declaration); Declaration of Timothy J. Brennan for the Public Representative, March 20, 2017, at 7 (Brennan Declaration).

³⁸⁶ PR Comments at 24-25. See also Kwoka Declaration at 21-22; APWU Comments at 14; Yao Statement at 3-4.

distress, the price cap could continue to force cuts in service quality.³⁸⁷

In addition to the pressure imposed by the price cap and emphasis on cost reductions, commenters also address the impact of volume declines on service performance. The Postal Service partially attributes reductions in service to the need to adjust its networks in order to account for declining demand for its products, although it maintains that financial pressures exacerbated the cycle of service reductions as a result of lower demand. Postal Service Comments at 120-21. GCA places the blame for service declines on both declining demand and legislatively-imposed payment obligations, such as the RHBf prefunding, but not the price cap system. GCA Comments at 5, 16.

3. Application of Measurement

In analyzing service for purposes of the section 3622 review, the Commission's task is to determine whether high quality service standards have been maintained during the PAEA era. 39 U.S.C. § 3622(b)(3). In the ANPR, the Commission proposed the following definition for Objective 3: "A system achieving Objective 3 is designed for the Postal Service to consistently achieve, for each class of mail, stated days to delivery at a desired target rate." Order No. 3673 at 5. The Commission revises this definition as follows: A system achieving Objective 3 is designed to encourage the maintenance of high quality service standards established pursuant to 39 U.S.C. § 3691, and to hold the Postal Service accountable for consistently achieving those standards.

The Commission makes this change because it determines that the focus of Objective 3 should be on whether the system has encouraged the maintenance of high

³⁸⁷ *Id.* See also DMA *et al.* Comments at 2-3 (citing danger that the Postal Service will reduce service as a means to control costs under the price cap); ARA *et al.* Comments at 1 (expressing concern that should the financial pressure from the rate cap remain unaddressed, the Postal Service will be at risk of even greater service erosion).

quality service standards throughout the PAEA era. The previous definition focused on the analysis that the Commission already performs in its ACDs concerning service performance and was silent as to Objective 3's focus on service standards. See 39 U.S.C. §§ 3653, 3622(b)(3). It is clear that Objective 3 intended there to be a consideration of the substance of the Postal Service's service standards, in order to determine if the "established" standards have been "maintained."

The key measurable concept for Objective 3 suggested in the ANPR was "high quality service standards." Order No. 3673 at 6. Corresponding to the modifications made to Objective 3's definition, the Commission modifies the key measurable concept from "high quality service standards" to "maintenance of high quality service standards." As discussed below, in order to determine whether the system has maintained high quality service standards during the PAEA era, the Commission focuses the majority of its analysis on reviewing changes in service standards made during that time period.

As set forth in the ANPR, the Commission analyzes "changes in service standards over time." Order No. 3673 at 6. In determining whether the ratemaking system has encouraged the Postal Service to maintain high quality service standards, the Commission looks at whether the high quality service standards established under 39 U.S.C. § 3691 have been maintained. In particular, the Commission is concerned with the issue of service standard degradation. Section 3622(b) provides that the ratemaking system "shall be designed to achieve the . . . objective . . ." of "maintain[ing] high quality service standards established under section 3691." 39 U.S.C. §§ 3691(b), 3691(b)(3). Therefore, as part of analyzing changes in service standards over time, the Commission looks at the current system's role in maintaining service standards.

In addition to analyzing whether high quality service standards have been maintained, the Commission finds that Objective 3 implicitly requires consistent achievement of those standards. The service standards mandated by the PAEA would

be of little utility if Congress had not also contemplated the Postal Service regularly meet those standards. Consistent achievement is also implied by the general policy of title 39, as well as the USO.³⁸⁸ Therefore, the Postal Service's service performance, or consistent achievement of service standards, remains an important factor in considering Objective 3.

In the ANPR, the Commission suggested other potential approaches for measurement of Objective 3, including "measuring the Postal Service's performance, both for discrete time periods and since the passage of the PAEA." Order No. 3673 at 6. The Commission noted that some of these measurements were already conducted in the Commission's ACDs. *Id.* With regard to service performance, the PAEA provides a separate mechanism in addition to section 3622(d)(3) for addressing service performance-specific issues—the ACD. Pursuant to 39 U.S.C. § 3653(b)(2), each year the Commission is required to determine "whether any service standards in effect during [the previous year] were not met." In the past 5 years, in particular, the Commission has reviewed a broad array of service performance issues in its ACDs, which have proven to be the appropriate forum for conducting this in-depth review.

The Commission also suggested in the ANPR that customer satisfaction might be utilized as a potential measure for Objective 3. However, given the reliance which section 3622(b)(3) places on maintaining service standards, the Commission has determined that analyzing changes in service standards over time is a better measure for Objective 3. Moreover, as with service performance, the Commission already

³⁸⁸ See, e.g., 39 U.S.C. § 101(a) ("The Postal Service shall . . . provide prompt, reliable, and efficient services . . ."); 39 U.S.C. § 101(b) ("The Postal Service shall provide postal services . . . to residents of both urban and rural communities."); 39 U.S.C. § 403 ("The Postal Service shall . . . provide adequate and efficient postal services . . ."); 39 U.S.C. § 3661(a) ("The Postal Service shall develop and promote adequate and efficient postal services."). Based on these and other statutory provisions, as well as the historical development of postal policy in the United States and other factors, the Commission has identified the Universal Service Obligation (USO) as applying to the Postal Service, which implies a basic level and scope of service which the Postal Service is required to provide. See Universal Service Report.

reviews customer satisfaction each year in its ACDs.³⁸⁹ Therefore, the Commission declines to consider customer satisfaction with service standards, as proposed in the ANPR and suggested by the Public Representative, MH and NAAD.

In the analysis that follows, the Commission first reviews the changes in service standards over time and then summarizes its past ACD findings with respect to service performance. Based on the application of this measurement as set forth below, the Commission finds that during the PAEA era the initial service standards have been reduced and the maintenance of high quality service standards has not been encouraged. At the same time, the Commission finds that the current ratemaking system has proven sufficient for purposes of holding the Postal Service accountable for its service performance.

a. Changes to Quality of Service Standards During the PAEA Era

The Commission looks to whether the Postal Service has “maintain[ed] [the] high quality service standards established under section 3691.” 39 U.S.C. § 3622(b)(3). As set forth in the ANPR, the Commission measures this concept by analyzing “changes in service standards over time.” Order No. 3673 at 6. The Commission determines that the initial service standards set in 2007 were “high quality” service standards. For this analysis, the Commission uses the initial service standards promulgated in 2007 as a baseline, and compares the service standards over the course of the PAEA era to this baseline.

³⁸⁹ See 39 U.S.C. § 3652(a)(2)(B); 39 C.F.R. § 3055.92. The system for measuring customer satisfaction has been evolving throughout the PAEA era and has changed frequently; as a result the Commission has been unable to assess a clear trend. See e.g., FY 2007 ACD at 55-56; FY 2008 ACD at 30-33; FY 2009 ACD at 60-63; FY 2010 ACD at 76-80; FY 2011 ACD at 89-90; Revised FY 2012 ACD at 74-76; FY 2013 ACD at 127-32; FY 2014 ACD at 125-30; FY 2015 ACD at 154-57; FY 2016 ACD at 154-57. The Commission continues to monitor this issue annually in its ACDs.

In determining that the initial service standards set in 2007 were “high quality” for purposes of this analysis, the Commission reviews the criteria for developing the service standards and the goals of the PAEA with respect to their establishment. The requirement to establish service standards was a major change from the PRA.³⁹⁰ Objective 3 states that the ratemaking system shall be designed to “maintain high quality service standards established under section 3691.” 39 U.S.C. § 3622(b)(3). Accordingly, when establishing the initial service standards in 2007, the Postal Service, in consultation with the Commission, designed them to achieve the four objectives of section 3691(b), taking into account the eight factors enumerated in section 3691(c). 39 U.S.C. §§ 3691(b)-(c). By cross-referencing the service standards which were to be established under section 3691 and identifying them as “high quality,” section 3622(b)(3) makes clear that the outcome of the section 3691 process resulted in service standards that were presumably high quality.

The Commission begins its analysis by reviewing Postal Service changes to the service standards which have occurred over the past 10 years. The Commission’s approach is to quantify changes in the quality of service standards by determining the percentage of mail volume eligible to receive various service standards, and to then identify percentage changes in these eligibilities during the PAEA era that resulted from actions taken by the Postal Service.

As initially promulgated, the high quality service standards established in 2007 provided for the vast majority of First-Class Mail to be eligible for delivery within 1-3 days. Initial Service Standards, 72 Fed. Reg. 72224-25. The majority of Standard Mail was eligible for delivery within 2-5 days. *Id.* at 72726. The majority of Periodicals were eligible for delivery within 1-4 days. *Id.* at 72225-26. The majority of Package Services products were eligible for delivery within 1-4 days. *Id.* at 72227.

³⁹⁰ 39 U.S.C. §§ 3691(a), 3622(b)(3).

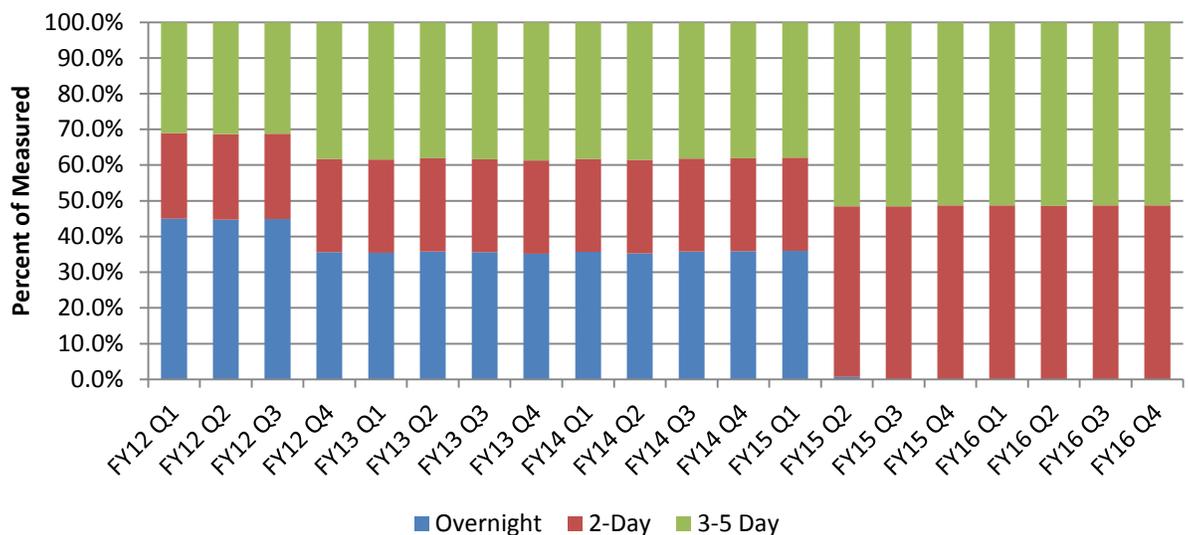
Since December 2007 the Postal Service's service standards have undergone two major revisions. In both instances, the Postal Service filed a nature-of-service case with the Commission. First, in 2012, the Postal Service promulgated revisions to its service standards as a result of its "Mail Processing Network Rationalization" initiative (Network Rationalization). See Network Rationalization Revisions, 77 Fed. Reg. 31190. The Postal Service asserted that the service standards were revised in response to falling mail volume and the resultant excess capacity in the Postal Service's mail processing network. *Id.* at 31191. The Postal Service asserted that addressing this overcapacity required it to cut its total number of processing plants roughly in half and to consolidate its transportation network, which, in turn, required adjustments to its service standards. *Id.* Pursuant to 39 U.S.C. § 3661(b), the Commission issued an advisory opinion. The Commission concluded that it was possible for the Postal Service to undertake significant network rationalization and to realize substantial cost savings while maintaining the majority of the initial service levels set in 2007. Docket No. N2012-1, Advisory Opinion at 45-46. Despite the Commission's opinion that service could be maintained while accommodating network rationalization, the Postal Service went forward with revising its service standards. Network Rationalization was implemented in two phases, with the first phase beginning in 2012, and the second phase beginning in 2015.³⁹¹

The revised service standards had a substantial impact on the level of service for multiple mail classes, including First-Class Mail, Standard Mail, Periodicals, and Package Services. The most significant revision was elimination of overnight service for

³⁹¹ Network Rationalization Revisions, 77 Fed. Reg. 31191; Revised Standards for Market-Dominant Mail Products; Postponement of Implementation Date, 79 Fed. Reg. 4079 (January 24, 2014); Revised Standards for Market-Dominant Mail Products; Designation of Implementation Date, 79 Fed. Reg. 44700 (August 1, 2014). In preparation for the first phase of Network Rationalization, the Postal Service began to consolidate mail processing facilities in May 2012. Docket No. N2012-1, Advisory Opinion at 47.

all First-Class Mail Single-Piece.³⁹² Figure II-27 shows the shift in the proportion of First-Class Mail Single-Piece Letters/Postcards volume eligible for each service standard as a result of the revisions.

Figure II-27
First-Class Mail Single-Piece Letters/Postcards Percent of Volume by Service Standard, FY 2012 - FY 2016 (by Quarter)³⁹³



Source: Library Reference PRC-LR-RM2017-3/1

As shown in Figure II-27, as of the first quarter of FY 2012 nearly 45 percent of the measured volume for this product was eligible for an overnight service standard; approximately 25 percent was eligible for a 2-Day service standard; and approximately

³⁹² Network Rationalization Revisions, 77 Fed. Reg. 31194-95; Docket No. N2012-1, Advisory Opinion at 7.

³⁹³ The Commission analyzes data from FY 2012 through FY 2016 because that is the period for which reliable data are available. Service performance data were not measured or reported under the PRA, and the years immediately after the PAEA’s enactment constituted a transition period as the Postal Service developed and implemented the service performance measurement systems required by the PAEA. As a result, consistent data did not become available until FY 2012.

30 percent was eligible for a 3-5-Day service standard. By the last quarter of FY 2016, no overnight service standard was available for First-Class Mail Single-Piece Letters/Postcards; a little under 50 percent was eligible for a 2-Day service standard; and over 50 percent was eligible for a 3-5-Day service standard. Accordingly, the elimination of overnight service resulted in a reduction in the quality of service for First-Class Mail Single-Piece Letters/Postcards.³⁹⁴

The data in Figure II-27 also show that there was a decrease in mail volume with an overnight service standard and an increase in mail volume with a 3-5-Day service standard prior to the formal elimination of overnight service for First-Class Mail Single-Piece Letters/Postcards. A review of the data prior to overnight elimination reveals a shift in mail volume from overnight service to the lower service standards of 2-Day and 3-5-Days. This trend shows that mail within the overnight service standard was experiencing degradation in service quality prior to the formal elimination of overnight service.

Although overnight service was retained for First-Class Mail Presorted and Periodicals, the Postal Service changed its business rules for these products, including setting more stringent entry requirements in order for these products to continue to be eligible for overnight service.³⁹⁵ In addition, service standards applicable to the Periodicals, Standard Mail, and Package Services classes were revised and lengthened, including service standards applicable to non-contiguous states and territories.³⁹⁶ These changes caused a reduction in the quality of service compared to the initial 2007 service standards.

³⁹⁴ The Commission notes the same trend for First-Class Mail Flats and First-Class Mail Parcels.

³⁹⁵ Network Rationalization Revisions, 77 Fed. Reg. 31194-95; Docket No. N2012-1, Advisory Opinion at 7.

³⁹⁶ Network Rationalization Revisions, 77 Fed. Reg. 31195; Docket No. N2012-1, Advisory Opinion at 51-54.

The second major revision to service standards occurred in 2014 as part of the Postal Service's "Standard Mail Load Leveling" initiative (Load Leveling). The Postal Service explained that the intent in making these changes was to "address the imbalance in the proportion of volume with a Monday delivery expectation . . . and the resulting burden on resources associated with Monday delivery operations" ³⁹⁷ As a result, the Postal Service added an additional day to the specific service standards for certain presorted Standard Mail entered into the Postal Service's network on either a Friday or a Saturday. ³⁹⁸ Hence, a mailpiece that was previously eligible for a 3-Day service standard would instead require 4 days for delivery if it was entered into the Postal Service's network on a Friday or a Saturday. *Id.* This change to the service standard increased the days to delivery compared to the initial 2007 service standards.

In conclusion, a review of the major service standard revisions over the past 10 years demonstrates that service standards were reduced during the PAEA era from the service standards initially established in 2007. As demonstrated by the decline of service standards during the PAEA era, the ratemaking system did not effectively encourage the Postal Service to maintain service quality. This creates a danger that the Postal Service could reduce service standards below a high quality level required by 39 U.S.C. § 3622(b)(3).

b. Review of Service Performance Findings from ACDs

The PAEA provides a specific mechanism for addressing service performance issues in the form of the ACD. Pursuant to 39 U.S.C. § 3653(b)(2), each year the Commission is required to determine "whether any service standards in effect during

³⁹⁷ Service Standards for Destination Sectional Center Facility Rate Standard Mail, 79 Fed. Reg. 12390 (March 5, 2014) (Load Leveling Revisions).

³⁹⁸ Load Leveling Revisions, 79 Fed. Reg. 12393; see also Docket No. N2014-1, Advisory Opinion at 1.

[the previous year] were not met.” If the Commission determines that the Postal Service has failed to meet any of its service standards, then the Commission “shall order the Postal Service to take such action as the Commission considers appropriate in order to achieve compliance with the applicable requirements and to remedy the effects of any noncompliance” 39 U.S.C. §§ 3653(b)(2), 3653(c), 3662(c). This provides the Commission with an annual opportunity to review the Postal Service’s service performance, focusing on problematic areas. Each year since the PAEA was enacted, the Commission has issued findings with regard to service, and the Commission has identified a number of such problematic areas. Three issues, in particular, have been noteworthy.

First and foremost, the Commission has repeatedly addressed the fact that poor service performance for flat-shaped mail products (flats) has been a recurring problem throughout the PAEA era. The Commission has found that the Postal Service struggles more with on-time delivery of flats than it does with either letter-shaped or parcel-shaped mail. See FY 2015 ACD at 160-180. This issue has been addressed extensively in every ACD since FY 2012.³⁹⁹

³⁹⁹ See Revised FY 2012 ACD at 52-53 (First-Class Mail Flats); Revised FY 2012 ACD at 57-58 (Periodicals); Revised FY 2012 ACD at 60 (Bound Printed Matter Flats); FY 2013 ACD at 106 (First-Class Mail Flats); FY 2013 ACD at 109-112 (Standard Mail Flats and Carrier Route); FY 2013 ACD at 112-13 (Periodicals); FY 2013 ACD at 114-15 (Bound Printed Matter Flats); FY 2014 ACD at 100-02 (First-Class Mail Flats); FY 2014 ACD at 107-09 (Standard Mail Flats and Carrier Route); FY 2014 ACD at 110-12 (Periodicals); FY 2014 ACD at 112-14 (Bound Printed Matter Flats); FY 2014 ACD, Appendix A at 3 (directive issued by Commission with respect to flats’ service performance problems); FY 2015 ACD at 102-03 (Postal Service response to FY 2014 flats directive); FY 2015 ACD at 103-09, 131-38 (First-Class Mail Flats); FY 2015 ACD at 109-22, 114-15, 121-22, 138-42 (Standard Mail Flats and Carrier Route); FY 2015 ACD at 122-28, 142-43 (Periodicals); FY 2015 ACD at 128-31, 143-44 (Bound Printed Matter Flats); FY 2015 ACD at 160-180 (analysis of flats issues conducted by Commission as part of FY 2015 ACD); FY 2016 ACD at 129-35 (First-Class Mail Flats); FY 2016 ACD at 135-40 (Standard Mail Flats and Carrier Route); FY 2016 ACD at 140-42 (Periodicals); FY 2016 ACD at 142-44 (Bound Printed Matter Flats); FY 2016 ACD at 170 (follow-up to FY 2015 flats analysis, concluding that Postal Service lacked comprehensive plan to measure, track, and report service performance issues).

In its FY 2014 ACD, the Commission issued a directive to the Postal Service with regard to a number of flats products, ordering the Postal Service to either “improve service for these products in FY 2015 or . . . explain . . . why efforts to improve results have been ineffective and what changes [the Postal Service] plans to make to improve service performance.” FY 2014 ACD at 104, 109, 111-12, 114, Appendix A at 3. In its FY 2015 ACD, the Commission found that the service performance for most of these products had failed to improve, and the Postal Service’s explanations were not adequate. FY 2015 ACD at 108-09, 115, 118-22, 125-28, 130-31.

In its FY 2015 ACD, the Commission conducted a detailed independent analysis of the Postal Service’s difficulties processing and delivering flats. FY 2015 ACD at 160-180. The Commission identified six different “pinch points” in the Postal Service’s processing operations where flats encountered particular difficulty. *Id.* at 165. The Postal Service was directed to submit a report to the Commission “identify[ing] a method to measure, track, and report the cost and service performance issues relating to [each] individual pinch point at the most granular level practicable.” FY 2015 ACD at 181.

This issue was revisited again in the Commission’s FY 2016 ACD, where the Commission concluded that the Postal Service lacked a comprehensive plan to measure, track, and report service performance issues. FY 2016 ACD at 170. At the same time, however, service performance for all flats improved slightly in FY 2016. FY 2016 ACD at 165, Table IV-1. The Commission continues to monitor this issue.

The other two significant issues the Commission has identified include a notable drop in service performance, especially in FY 2015, that appears to have been related

to the Postal Service's network realignment efforts,⁴⁰⁰ and individual areas/districts with recurrent service performance problems.⁴⁰¹

In the Commission's experience, these issues appear to be highly specific to particular products, product components, mail shapes, areas, and operational processes, rather than widespread, systemic issues. The Commission also recognizes that because service performance data for most products were not measured or reported during the PRA era, the Commission lacks any historic baseline against which to compare service performance results. It was only during the second half of the first decade of the PAEA era—FY 2012 through FY 2016—that the service performance data reported by the Postal Service were robust enough for comprehensive analysis. The years immediately after the PAEA's enactment constituted a transition period as the Postal Service developed and implemented the performance measurement systems required by the PAEA. See Order No. 140. The Commission is cognizant; therefore,

⁴⁰⁰ See FY 2015 ACD at 135 (noting large shift from overnight delivery to 2- and 3-5-Day delivery for First-Class Mail following implementation of the second phase of Network Rationalization); *id.* at 136 (concluding Postal Service had failed to quantify the link between the reasons it offered to explain service declines and the rapid severe performance degradation actually experienced in the 3-5-Day standard); FY 2015 ACD at 141 (identifying recurring problems with 6-10-Day component of the service standard for Standard Mail following Postal Service's implementation of Network Rationalization); FY 2016 ACD at 139 (noting that results for 6-10-Day End-to-End Standard Mail components were particularly low).

⁴⁰¹ See FY 2013 ACD at 106 ("The Northeast area, especially for the 3-5-Day service standard category, has been a consistent underperformer and is a partial reason for below-target national scores."); FY 2015 ACD at 107-08, 112, 119-20, 136 (districts which have experienced recurring problems with poor service performance); FY 2015 ACD at 107 ("[E]ight districts have recurring poor performance for First-Class Mail Flats . . . because the same districts demonstrate repeated poor performance, it does not appear that the use of diagnostic tools is leading to improvement."); FY 2015 ACD at 112 ("Standard Mail Carrier Route's service performance is affected by the Postal Service's inability to leverage its diagnostic tools and resolve issues at the district level . . . certain districts have results substantially below the national average."); FY 2015 ACD at 119 ("Another important issue facing Standard Mail Flats is the Postal Service's inability to leverage its diagnostic tools to resolve issues at the district level . . . certain districts have results substantially below the national average."); FY 2016 ACD at 108-09 (districts with highest percentages of collection delays for 3-5-Day EXFC First-Class Mail Single-Piece Letters/Postcards); FY 2016 ACD at 114 (districts with highest percentages of origin processing delays for 3-5-Day EXFC First-Class Mail Single-Piece Letters/Postcards); FY 2016 ACD at 122 (Critically Late Trips by Area, FY 2015 and FY 2016).

that in reviewing the Postal Service's service performance results it is limited to essentially 5 years of data, much of which overlapped with a period of substantial network realignment by the Postal Service. In its most recent ACD, the Commission found that service performance results appear to be improving. FY 2016 ACD at 133, 140, 142.

For the foregoing reasons, the Commission will continue to monitor service performance-related issues in future ACDs, and will offer remedial action when appropriate. Given the highly specific and granular nature of most service performance-related issues, the Commission determines that the ACD has been and continues to be the proper vehicle for addressing issues related to service performance.

4. Conclusion

In summary, with respect to service, the Commission must determine whether high quality service standards have been maintained during the PAEA era. 39 U.S.C. § 3622(b)(3). In order to analyze whether high quality service standards have been maintained, the Commission evaluates whether service standards throughout the PAEA era have remained at the same level as the high quality service standards established in 2007. Based on this analysis, the Commission finds that service standards declined during the PAEA era, because the Postal Service reduced the high quality service standards that were set in 2007. The Commission concludes that the goals of the PAEA with regard to Objective 3 have not been achieved because the current regulatory system did not effectively encourage the Postal Service to maintain service standards quality.

III. CONCLUSION

In accordance with the statutory mandate set forth in 39 U.S.C. § 3622(d)(3), the Commission reviews the market dominant ratemaking system to determine whether it has achieved the objectives of 39 U.S.C. § 3622(b), taking into account the factors of 39 U.S.C. § 3622(c). The Commission applies a topical approach and reviews the structure of the ratemaking system, the financial health of the Postal Service, and service to analyze the objectives in conjunction with each other as set forth by 39 U.S.C. § 3622(b).

In its review of the structure of the ratemaking system, the Commission finds that the system was largely successful in achieving the goals related to the system's structure. With respect to the ratemaking process, the Commission finds that the system has worked well to create rate adjustments that are stable and predictable with regards to timing and that it has reduced the administrative burden and increased the transparency of the ratemaking system. For pricing, the Commission finds that the system allowed the Postal Service pricing flexibility, and achieved just rates that were of a predictable and stable magnitude. However, the Commission concludes that the system has not increased pricing efficiency.

In its review of the financial health of the Postal Service, the Commission finds that the Postal Service's overall financial health is poor. The Commission concludes that financial stability has not been maintained throughout the PAEA era. The Commission finds that the short-term financial stability measure was generally achieved; however, the Postal Service was not financially stable in the medium and long-term timeframes. Although costs were reduced and operational efficiency was increased during the PAEA era, the incentives to reduce costs and increase operational efficiency were not maximized. Non-compensatory products and classes further threatened the financial integrity of the Postal Service, as the system did not generate reasonable rates. On a positive note, the system provided sufficient funds to maintain

safeguards to protect the mail system and deter terrorism and provided a mechanism permitting additional funds for unforeseen security or terrorism emergencies. The system also has an adequate mechanism to ensure the appropriate allocation of total institutional costs.

In its review of service, the Commission finds that the system does not effectively encourage the Postal Service to maintain high quality service standards as intended by the PAEA.

In conclusion, based on its review of the objectives of the PAEA, considering the factors, the Commission finds that the system as a whole has not achieved the objectives of the PAEA.

Stacy L. Ruble
Secretary

Supplemental Views of Commissioner Tony Hammond
Supplemental Views of Commissioner Nanci E. Langley

SUPPLEMENTAL VIEWS OF COMMISSIONER TONY HAMMOND

While I concur with much of the Commission's Order, I disagree in part with its findings.

There are two plausible interpretations of the Commission's mandate in this docket. Section 3622(d)(3) of title 39 instructs the Commission to review "the system for regulating rates and classes for market-dominant products established under this section." The "system" referred to here could be either statutory or regulatory. That is, it may be the price cap framework set forth in section 3622, or it may be the rules and regulations adopted by the Commission to implement the price cap. While this Order focuses on the first interpretation, I believe it is important to consider both.

In the Postal Accountability and Enhancement Act (PAEA), Congress directed the Commission to establish a workable system implementing the objectives and factors of section 3622 within 18 months of the enactment of the law. The Commission established its system in 10 months; 8 months before the statutory deadline, even with two rounds of public comment.

This system has facilitated periodic rate adjustments within the price cap that have been reviewed and approved promptly, while also providing sufficient notice to customers. The system was able to resolve a complicated and contested exigent rate adjustment. The system has also been flexible enough to fairly decide unforeseen questions, such as whether and when changes in mailing standards should trigger the price cap.

Therefore, the Commission's system appears to be working efficiently and transparently, as intended by Congress. We have not been presented with evidence to the contrary. Therefore, the regulatory system has achieved the objectives of section 3622.

With regard to the statutory system -- basically the price cap that replaced the Postal Reorganization Act (PRA's) cost-of-service model -- I believe that the system has mostly achieved Congress's objectives. But, there are exceptions.

The price cap has clearly allowed the Postal Service flexibility to price products within classes as it sees fit for its business objectives, while also assuring customers the intended predictability and stability in rate increases. Those increases have been made through a transparent process that is far less burdensome than the previous cost-of-service system.

The resulting rate schedule has been, I believe, mostly just and reasonable. While I agree with the Commission's Order that the rates have not provided financial stability, and therefore are not fully within the just and reasonable range, I disagree on the degree to which the rates departed from that range. This disagreement stems from my questioning of whether the Retirement Health Benefits Fund (RHBF) prefunding requirement should be considered when assessing the Postal Service's financial stability.

With regard to costs and efficiencies, it is apparent to me that the price cap has made the Postal Service seek ways to reduce costs and increase efficiency across its business, whether in its processing plants, delivery operations, retail network, or in other areas. The price cap prevents the Postal Service from simply increasing prices to match growing costs. As a result, the Postal Service has been forced to focus on reducing costs and making its operations more efficient.

While anyone can disagree with the particular decisions the Postal Service has made pursuing cost reductions and efficiencies, those decisions are ultimately management decisions. For the purpose of this review, I believe the price cap has forced management to focus on cost savings and efficiencies.

Turning to service standards, it is unclear to me whether the system has achieved the objective of maintaining high quality service standards. I believe the service standards the Postal Service adopted immediately after the PAEA met the objective. I also believe that the lengthened standards the Postal Service enacted 5 years later continued to meet the objective, although less so.

However, service performance has been more disappointing. The causes for deficient performance include many factors, such as management decisions, weather, and other contingencies. As a result, the deficiencies cannot be blamed, solely, or even mostly, on the price cap system. Nonetheless, some degradation of service performance is likely linked to the price cap framework, which is why I find it unclear whether the service objective has been met.

Finally, there is the issue of financial stability. The price cap was intended to assure the Postal Service revenue adequate to maintain financial stability. I agree with the Commission's Order that financial stability has not been maintained. However, I disagree on the extent to which the shortfall can be blamed on the price cap system because of the existence of two other factors.

First, much of the Postal Service's financial instability has been caused by the PAEA's imposition of an aggressive RHBF prefunding requirement. Besides constraining the Postal Service's finances, the requirement has spurred cost-cutting efforts that, in retrospect, may have been implemented too hastily, such as the Postal Service's Mail Processing Network Rationalization initiative. I recognize that the prefunding requirement is not up for Commission review. Therefore, I understand why the Commission's Order accepts it as just another cost that must be paid for by the ratemaking system. But I have a different view.

Had Congress known in 2006 what it knows now, it may very well have not adopted such an aggressive prefunding schedule. Indeed, Congress has from time to

time signaled that it may adjust the schedule when it next adopts postal reform legislation. In giving the Commission discretion in this 10-year review, I believe that Congress intended for the Commission to exercise a measure of judgment rather than conduct a simple mathematical exercise. Therefore, I think it is wise to separate out the effects of the prefunding requirement on financial stability from our evaluation of whether the system has assured financial stability.

Second, in 2007, the Postal Service chose not to avail itself of a final cost-of-service rate adjustment, as was authorized by section 3622(f) for the 1-year period following enactment of the PAEA. Had the Postal Service done so, it would have had more of a financial cushion going into the Great Recession. Moreover, because the Commission adopted the new ratemaking system before the 1-year deadline passed, the Postal Service had no uncertainty as to what the new rules would permit and prohibit. Therefore, if it thought the new system was inadequate to its needs, it could have at least sought one more cost-of-service increase.

The Postal Service's financial instability has not been caused solely by these two factors. But, taking these two factors into account certainly reduces the amount of financial instability that can be blamed on the price cap system.

In conclusion, I find that the price cap framework has, for the most part, achieved its objectives. But, it requires some adjustment to address areas where it has fallen short. Such adjustments must be balanced, meaning that the end result must be that all of the objectives continue to be met, rather than sacrificing certain objectives for others. I look forward to the discussion the approval of this review brings about in the subsequent Rulemaking Order.

Tony Hammond

SUPPLEMENTAL VIEWS OF COMMISSIONER NANCI E. LANGLEY

I agree with the Commission's topical approach in reviewing whether the relevant objectives and accompanying factors have been achieved in regard to the market dominant ratemaking system. Required 10 years after enactment of the PAEA, this review is a critical component of the PAEA. However, the achievement of the objectives is not the only determinant of the overall effectiveness of the law, nor is the achievement of the objectives the only determinant of the overall viability of the Postal Service.

Although I agree generally with the findings in the Commission's review, I continue to believe that the PAEA performed as Congress intended – providing the Postal Service with certain pricing flexibilities, the mailers with pricing predictability and stability, and the regulator with enhanced authority. As the Commission has recognized in its annual reports to the President and Congress, there is a tension between the restrictions of an inflation-based price cap on market dominant price increases and the objectives established in section 3622(b), in particular, the objective that the Postal Service have adequate revenues and retained earnings in order to maintain financial stability.¹

Over the past 10 years under the PAEA, the Postal Service has been subject to many outside influences that have tested the Postal Service's ability to operate within the market dominant ratemaking system as originally enacted. These influences – including a recession whose impact on the U.S. economy was second only to the Great

¹ Postal Regulatory Commission Annual Report to the President and Congress Fiscal Year 2016, January 12, 2017, at 24; Postal Regulatory Commission Annual Report to the President and Congress Fiscal Year 2015, January 6, 2016, at 22; Postal Regulatory Commission Annual Report to the President and Congress Fiscal Year 2014, January 5, 2015, at 20.

Depression and the explosive expansion of mobile technology – have impacted on the Postal Service and users of the mail significantly.

Likewise, the statutory requirement that the Postal Service prefund its Retirement Health Benefits Fund (RHBF) within a 10-year period at an annual rate of approximately \$5 billion had a well-acknowledged effect on postal finances. The review of the market dominant ratemaking system notes that the Postal Service's overall liquidity, the combination of the end-of-year cash balance and the Postal Service's remaining borrowing capacity, is significantly lower due to the Postal Service's use of debt to finance operations and the overly ambitious RHBF payments. In addition to the accruals for RHBF prefunding, significant reductions in volume and revenue related to internet diversion and an extensive business downturn in FY 2009 and FY 2010, contributed to net Postal Service losses.² While I agree with the Commission's decision to include the RHBF payments in its calculation of losses, it is important to note that the Postal Service's accumulated deficit of \$59.1 billion includes \$54.8 billion in expenses related to prefunding the RHBF. The non-RHBF deficit is \$4.3 billion.

Moreover, management decisions have impacted whether or not the objectives could be met. The Mail Processing Network Rationalization initiative is an example of where the Postal Service could have potentially realized significant cost savings while preserving most service levels. In the section 3622 review, the Commission observes that the Postal Service's ability to maximize savings from cost reduction initiatives were not accompanied by mechanisms to accurately identify costs, estimate associated savings and/or did not include plans for measuring cost reductions.

² See FY 2013 Financial Report at 1 (“[I]n addition to the RHBF payment requirements, the significant loss of volumes and revenues from internet diversion and extensive business downturns resulted in operating losses for FY 2009 and FY 2010.”).

For these reasons, I believe that some of the objectives, considering the factors, could not be met. I also believe that the Postal Service's revenue shortfall must be addressed. This review and the accompanying proposed rulemaking offers an opportunity to provide the Postal Service with the funds necessary to function in an efficient and effective manner.

Nanci E. Langley

LIST OF COMMENTERS AND COMMENTS

Commenter	Citation	Citation Short Form
Alliance of Nonprofit Mailers, Association for Postal Commerce, and MPA—Association of Magazine Media (ANM <i>et al.</i>)	Comments of Alliance of Nonprofit Mailers, Association for Postal Commerce, and MPA—The Association of Magazine Media, March 20, 2017	ANM <i>et al.</i> Comments
Alliance for Retired Americans; Catholics in Alliance for the Common Good; Center for Community Change Action; Center for Media and Democracy's PR Watch; Center for Study of Responsive Law; Consumer Action; Farm Aid; In the Public Interest; Hightower Lowdown; National Coalition of Black Civic Participation; National Organization for Women; New Progressive Alliance; People Demanding Action; Vote Vets Action Fund (ARA)	Comments of the Alliance for Retired Americans; Catholics in Alliance for the Common Good; Center for Community Change Action; Center for Media and Democracy's PR Watch; Center for Study of Responsive Law; Consumer Action; Farm Aid; In the Public Interest; Hightower Lowdown; National Coalition of Black Civic Participation; National Organization for Women; New Progressive Alliance; People Demanding Action; Vote Vets Action Fund, March 21, 2017	ARA <i>et al.</i> Comments
Alzheimer's Association, Inc. (AA)	Comments of Alzheimer's Association, Inc., March 16, 2017	March 16, 2017 AA Comments
Alzheimer's Association, Inc. (AA)	Comments of Alzheimer's Association, Inc., March 31, 2017	March 31, 2017 AA Comments
American Bankers Association (ABA)	Comments of American Bankers Association, March 20, 2017	ABA Comments
American Catalog Mailers Association (ACMA)	Comments of the American Catalog Mailers Association, March 20, 2017	ACMA Comments
American Consumer Institute Center for Citizen Research (ACI)	Comments of the American Consumer Institute Center for Citizen Research Regarding Docket No. RM2017-3 and Order No. 3673 Submitted to the Postal Regulatory Commission, March 20, 2017	ACI Comments
American Forest & Paper Association (AF&PA)	Comments of the American Forest & Paper Association, March 20, 2017	AF&PA Comments

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American Institute for Cancer Research (AICR)	Comments of the American Institute for Cancer Research, March 14, 2017	AICR Comments
American Lung Association (ALA)	Comments of the American Lung Association, March 28, 2017	ALA Comments
American Postal Workers Union, AFL-CIO (APWU)	Comments of the American Postal Workers Union, AFL-CIO, March 20, 2017	APWU Comments
American Postal Workers Union, AFL-CIO – Local 1459 (APWU)	Comments of Carrie Bieberitz, President, APWU Local 1459, March 15, 2017	Bieberitz Comments
American Postal Workers Union, AFL-CIO – Local 142 (APWU)	Comments of Todd Fawcett, President, APWU Greater Northland Area, March 16, 2017	Fawcett Comments
American Postal Workers Union, AFL-CIO – Local 257 (APWU)	Comments of Mike Landry, President, APWU Central New York Area, March 16, 2017	Landry Comments
American Postal Workers Union, AFL-CIO – Local 230 (APWU)	Comments of Timothy A. Cliche, Clerk Craft Director, March 16, 2017	Cliche Comments
American Postal Workers Union, AFL-CIO – Local 149 (APWU)	Comments of Thomas Athanasakos, Assistant Clerk Craft Director, APWU Local 149, March 17, 2017	Athanasakos Comments
American Postal Workers Union, AFL-CIO – Local 44 (APWU)	Comments of Mike Bates, President, APWU Local 44, March 17, 2017	Bates Comments
American Postal Workers Union, AFL-CIO – Local 89 (APWU)	Comments of Nick Casselli, President, APWU Local 89, March 17, 2017	Casselli Comments
American Postal Workers Union, AFL-CIO – Local 204 (APWU)	Comments of George Collins, President, Mississippi Coast Area, March 17, 2017	Collins Comments
American Postal Workers Union, AFL-CIO – Local 149 (APWU)	Comments of Vito Fallacara, Acting Director, NJI-NDC, March 17, 2017	Fallacara Comments

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American Postal Workers Union, AFL-CIO – Local 44 (APWU)	Comments of Bryon Preminger, Legislative Director, Des Moines Area, March 17, 2017	Preminger Comments
American Postal Workers Union, AFL-CIO – Local 735 (APWU)	Comments of VanScyoc, President, Wichita Area, March 20, 2017	VanScyoc Comments
American Postal Workers Union, AFL-CIO – Local 7139 (APWU)	Comments of Devendra Rathore, President, Fox Valley Area, March 20, 2017	Rathore Comments
American Postal Workers Union, AFL-CIO – Local 44 (APWU)	Comments of Mark Sarcone, Member, Des Moines Area, March 20, 2017	Sarcone Comments
American Postal Workers Union, AFL-CIO – Local 3630 (APWU)	Comments of Nannette J. Corley, President, Montgomery County Area, March 20, 2017	Corley Comments
American Postal Workers Union, AFL-CIO – Local 145 (APWU)	Comments of William Whalen, General President, Wilmington Area, March 20, 2017	Whalen Comments
American Postal Workers Union, AFL-CIO – Local 11 (APWU)	Comments of Philip D. Thomas, President, Omaha Area, March 20, 2017	Thomas Comments
American Postal Workers Union, AFL-CIO – Local 248 (APWU)	Comments of Robert F. Oldt, President, APWU Local 248, March 20, 2017	Oldt Comments
American Postal Workers Union, AFL-CIO – Local 162 (APWU)	Comments of Rufina Pagaduan, National Business Agent, APWU Local 162, March 21, 2017	Pagaduan Comments
America's VetDogs (AVD)	Comments of America's VetDogs, March 27, 2017	AVD Comments
Association of Direct Response Fundraising Counsel (ADRFCO)	Comments of the Association of Direct Response Fundraising Counsel, <i>et al.</i> , March 20, 2017	ADRFCO <i>et al.</i> Comments

Commenter	Citation	Citation Short Form
Catholic Charity Appeal (CCP)	Comments of Catholic Charity Appeal, February 27, 2017	CCP Comments
Compassion International, Inc. (CI)	Comments of Compassion International, Inc., March 16, 2017	CI Comments
Christian Appalachian Project (CAP)	Comments of Christian Appalachian Project, February 21, 2017 and March 14, 2017	CAP Comments
Data & Marketing Association, American Catalog Mailers Association, American Forest & Paper Association, Association for Postal Commerce, Envelope Manufacturers Association, Greeting Card Association, Idealliance, Parcel Shippers Association, and Saturation Mailers Coalition	Comments of the Data & Marketing Association, American Catalog Mailers Association, American Forest & Paper Association, Association for Postal Commerce, Envelope Manufacturers Association, Greeting Card Association, Idealliance, Parcel Shippers Association, and Saturation Mailers Coalition, Pursuant to Commission Order No. 3673, March 20, 2017	DMA <i>et al.</i> Comments
Daughters of St. Paul	Comments of Daughters of St. Paul, November 9, 2017	Daughters of St. Paul Comments
Declaration of Timothy J. Brennan for the Public Representative (Brennan Declaration)	Declaration of Timothy J. Brennan for the Public Representative, March 20, 2017	Brennan Declaration
Declaration of Lyudmila Y. Bzhilyanskaya for the Public Representative (Bzhilyanskaya Declaration)	Declaration of Lyudmila Y. Bzhilyanskaya for the Public Representative, March 20, 2017	Bzhilyanskaya Declaration
Declaration of John Kwoka (Kwoka Declaration)	Declaration of John Kwoka, March 20, 2017	Kwoka Declaration
Declarations Supporting Comments of Alliance of Nonprofit Mailers, Association for Postal Commerce, and MPA—The Association of Magazine Media (Joint Declarations)	Declarations Supporting Comments of Alliance of Nonprofit Mailers, Association for Postal Commerce, and MPA—The Association of Magazine Media, March 20, 2017	Joint Declarations

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eBay Inc. (eBay)	Comments of eBay, Inc., March 21, 2017	eBay Comments
The Elks Magazine	Comments of The Elks Magazine, March 20, 2017	Elks Comments
Enlightened Connections, LLC	Comments of Enlightened Connections, LLC, March 20, 2017	Enlightened Connections Comments
Envelope Manufacturers Association (EMA)	Comments of EMA Foundation's US Mailing Industry Jobs and Revenue Study 2015, February 24, 2017	February 24, 2017 EMA Comments
Envelope Manufacturers Association (EMA)	A National Research Study Among Mail Decision Makers and on Postal Rate Sensitivity on Demand, March 20, 2017	March 20, 2017 EMA Comments
Food for the Poor, Inc. (FFP)	Comments of Food for the Poor, Inc., March 6, 2017	FFP Comments
Franciscan Mission Associates (FMA)	Comments of Franciscan Mission Associates, March 8, 2017	FMA Comments
Greeting Card Association (GCA)	Initial Comments of the Greeting Card Association, March 20, 2017	GCA Comments
Guide Dog Foundation (GDF)	Comments of the Guide Dog Foundation, March 27, 2017	GDF Comments
The Honorable Jason Chaffetz and the Honorable Mark Meadows of the U.S. House of Representatives Committee on Oversight and Government Reform	Comments of the Honorable Jason Chaffetz and the Honorable Mark Meadows of the U.S. House of Representatives Committee on Oversight and Government Reform, March 20, 2017	Chairman Chaffetz and Chairman Meadows Comments
Jewish Voice Ministries International (JVMI)	Comments of Jewish Voice Ministries International, March 20, 2017	JVMI Comments
LSC Communications (LSC)	Comments of LSC Communications, March 20, 2017	LSC Comments

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Mailers Hub, LLC (MH) and the National Association of Advertising Distributors (NAAD)	Comments of Mailers Hub LLC and the National Association of Advertising Distributors, March 20, 2017	MH and NAAD Comments
Major Mailers Association (MMA), National Association of Presort Mailers (NAPM), National Postal Policy Council (NPPC) (collectively, MMA <i>et al.</i>)	Comments of the Major Mailers Association, the National Association of Presort Mailers, and the National Postal Policy Council, March 20, 2017	MMA <i>et al.</i> Comments
March of Dimes	Comments of the March of Dimes, March 17, 2017	March of Dimes Comments
Marine Toys For Tots Foundation	Comments of the Marine Toys For Tots Foundation, March 13, 2017	Marine Toys For Tots Comments
Minnesota Power	Comments of Minnesota Power, March 20, 2017	Minnesota Power Comments
National Association of Letter Carriers, AFL-CIO (NALC)	Comments of the National Association of Letter Carriers, AFL-CIO, March 20, 2017	NALC Comments
National Catholic Development Conference (NCDC)	Comments of the National Catholic Development Conference, March 10, 2017	NCDC Comments
The National Children's Cancer Society (NCCS)	Comments of The National Children's Cancer Society, March 9, 2017	NCCS Comments
National Newspaper Association (NNA)	Comments of National Newspaper Association, March 20, 2017	NNA Comments
National Postal Mail Handlers Union (NPMHU)	Comments of the National Postal Mail Handlers Union, March 21, 2017	NPMHU Comments
Netflix, Inc. (Netflix)	Initial Comments of Netflix, Inc., March 20, 2017	Netflix Comments
News Media Alliance (NMA)	Comments of News Media Alliance, March 17, 2017	NMA Comments

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Oblate Missions, Missionary Association of Mary Immaculate (OMI)	Comments of Oblate Missions, February 27, 2017	OMI Comments
Parcel Shippers Association (PSA)	Comments of the Parcel Shippers Association Pursuant to Commission Order No. 3673, March 20, 2017	PSA Comments
Statement of John C. Panzar (Panzar Statement)	Statement of John C. Panzar on Behalf of Pitney Bowes Inc., March 20, 2017	Panzar Statement
PESI, Inc (PESI)	Comments of PESI, April 4, 2017	PESI Comments
Pitney Bowes Inc. (Pitney Bowes)	Comments of Pitney Bowes Inc., March 20, 2017	Pitney Bowes Comments
Poor Handmaids of Jesus Christ Foundation, Inc. (PHJC)	Comments of Poor Handmaids of Jesus Christ Foundation, Inc., March 17, 2017	PHJC Comments
Public Representative (PR)	Comments of the Public Representative, March 21, 2017	PR Comments
Salesian Missions (SM)	Comments of Salesian Missions, February 27, 2017	SM Comments
Saturation Mailers Coalition (SMC); Association of Free Community Papers; Independent Free Papers of America; Community Papers of Florida; Midwest Free Community Papers Association; Community Papers of Michigan; Southeastern Advertising Publishers Association; Mid Atlantic Community Papers Association; Free Community Papers of New York; Wisconsin Community Papers; Small Business Legislative Council; Community Papers of New England	Comments of the Saturation Mailers Coalition; Association of Free Community Papers; Independent Free Papers of America; Community Papers of Florida; Midwest Free Community Papers Association; Community Papers of Michigan; Southeastern Advertising Publishers Association; Mid Atlantic Community Papers Association; Free Community Papers of New York; Wisconsin Community Papers; Small Business Legislative Council; Community Papers of New England, March 20, 2017	SMC <i>et al.</i> Comments

Commenter	Citation	Citation Short Form
The Honorable Ron Johnson of the Senate Committee on Homeland Security and Governmental Affairs	Comments of Senator Ron Johnson, Chairman of the Senate Committee on Homeland Security and Governmental Affairs, March 20, 2017	Chairman Johnson Comments
Software & Information Industry Association (SIIA)	Comments of Connectiv, a division of the Software & Information Industry Association, March 20, 2017	SIIA Comments
Taxpayers Protection Alliance (TPA)	Comments of Taxpayers Protection Alliance, March 20, 2017	TPA Comments
Trinity Missions, Missionary Servants of the Most Holy Trinity (Missionary Servants)	Comments of Trinity Missions, March 2, 2017	Missionary Servants Comments
United Parcel Service, Inc. (UPS)	Comments of United Parcel Service, Inc. on Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market-Dominant Products, March 20, 2017	UPS Comments
United States Postal Service (Postal Service)	Comments of the United States Postal Service, March 20, 2017	Postal Service Comments
WETA Television (WETA)	Comments of WETA Television, March 8, 2017	WETA Comments
Wounded Warrior Project (WWP)	Comments of Wounded Warrior Project, March 20, 2017	WWP Comments
Statement of David Yao (Yao Statement)	Statement of David Yao, March 20, 2017	Yao Statement