REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
IN RESPONSE TO ORDER NO. 4258

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I. INTRODUCTION

As the Commission correctly concluded, the current price cap system for regulating market-dominant rates is not working. Now that the Commission has made that determination, the Commission is statutorily authorized and obligated to modify the current system or adopt an alternative system. The Commission must make a legal determination as to what pricing authority is necessary to confer on the Postal Service to achieve the statutory objectives, including to ensure financial stability. The Commission is not tasked with determining what actual price increases would appropriately balance market realities and other relevant considerations, including the financial needs of the Postal Service. That business judgment is reserved to the Postal Service’s Governors. Many participants fail to account for this crucial distinction in their initial comments.

The best option for achieving the statutory objectives is a system that eliminates the price cap, and that gives the Postal Service the discretion to make prudent pricing decisions based on market pressures and other business considerations. Under such a system, the Commission would reserve the authority to monitor the Postal Service’s financial, operational, pricing, and service performance and the power to intervene if necessary. As explained in the Postal Service’s comments from March 20, 2017, and March 1, 2018, such a system is the best way to achieve the statutory objectives.

Neither of the Commission’s December 1, 2018, orders, nor the comments filed by other participants, undermines this position. If the Commission is nevertheless unwilling to adopt such a system at this time, then the Commission should incorporate into any price cap the recommendations in the Postal Service’s March 1 comments (as elaborated
upon herein). Nothing in the comments filed by other participants meaningfully changes the validity of these recommendations.

As discussed in section II, the Commission is authorized and obligated to change or replace the current price cap system. Congress appropriately delegated to the Commission the responsibility to review the current price-cap system after 10 years, and to modify or adopt an alternative rate-regulation system as necessary to achieve the statutory objectives. Congress’s intent, as reflected in Section 3622’s language, structure, and legislative history, is clear. Moreover, even if the statute were ambiguous as to the scope of the Commission’s authority (which it is not), the Commission’s interpretation that it has the authority to replace the price cap is clearly reasonable. The Commission properly aimed to fulfill the statutory directive by proposing a reformed price-cap system after concluding that the current system is not achieving the objectives (although the system it proposed would likewise fall short of achieving the objectives). The contrary arguments raised by various commenters fail to overcome the Commission’s reasoned analysis and the Postal Service’s comments from March 20, 2017, regarding this authority.

As discussed in section III, many of the commenters take positions to justify continuation of the current system that essentially advocate that the Commission should not take steps to “assure adequate revenues, including retained earnings, to maintain financial stability” or to achieve “just and reasonable” rates, despite a clear statutory mandate to do so. Some commenters advocate that the Commission should wait to act until Congress enacts legislative reform, especially with respect to the Postal Service’s retiree health benefits (RHB) prefunding requirement. While the Postal Service certainly
agrees that such reform is necessary, its enactment is not a guarantee, and, as the Commission has previously and appropriately recognized, speculation about possible legislative action is not a legally acceptable basis to shirk the Commission’s statutory obligations. In addition, even if legislative reform were enacted, it would not unilaterally provide the Postal Service with financial stability. As such, regulatory reform of the pricing system would remain necessary.

Many commenters assert that an increase in rates will lead to a “death spiral” of accelerated volume loss and further financial instability. Not only does this hypothesis lack any solid empirical support, it actually bolsters the Postal Service’s position that a price cap is not necessary. The “death spiral” hypothesis holds that market-dominant volume is now fundamentally price-elastic: that customers will leave the mail for alternative delivery options if prices are set too high. If the hypothesis is true, customers are not truly “captive” and alternatives exist that are adequate to check the Postal Service’s ability to raise prices significantly. Even though the commenters provide no empirical basis for the Commission to accept this argument over the calculated elasticities, it is nevertheless true that the Postal Service must be sensitive to the possibility of unanticipated demand responses to rate increases in the current environment, meaning the Postal Service still has strong incentives not to pursue a pricing policy that risks its longer-term viability by potentially driving away needed mail volume. Therefore, a price cap is not needed at all.

Other commenters suggest that the failures of the current price cap system are necessary to encourage cost-cutting by the Postal Service. However, these arguments essentially boil down to the proposition that the Commission must ensure the Postal
Service’s continued financial instability in order to induce efficiency incentives. That position lacks any factual or legal foundation and ultimately reads critical statutory objectives out of the statute. The Commission has recognized the statutory constraints on the Postal Service’s ability to reduce costs, which mailing-industry commenters uniformly ignore. Indeed, these commenters fail to identify any meaningful cost-cutting opportunities to mitigate the Postal Service’s record evidence about the insufficiency of available opportunities under current law. The few would-be cost-cutting opportunities that commenters do identify are inaccurate, unreliable, or ambiguous, and they would be far from enough to vitiate the need for reform of the ratemaking system in any case.

Each of these arguments essentially urges the Commission to do nothing and to leave the Postal Service on its current path. This is not a viable option, nor is it statutorily permitted. Instead, the Commission should provide the Postal Service with enough pricing flexibility to permit a meaningful opportunity for financial stability under current law. Given prevailing market conditions, the Postal Service will have ample incentives to restrain price increases and achieve available cost savings and efficiency improvement. No price cap is needed.

As discussed more fully in the Postal Service’s March 1 comments, if the Commission is committed to proceeding with a price cap model, there are certain modifications the Commission should make to its proposal. Such modifications would allow the new system to meet the Commission’s own articulated goals, such as providing the Postal Service with a meaningful opportunity to progress toward and ultimately achieve financial stability. Supplemental rate authority should reset rates going into the new system to a level that reasonably reflects total costs, without
factoring random, non-cash events into the baseline. To avoid perpetuating the central cause of the current system’s failure, a mechanism must be provided to compensate for exogenous factors that would otherwise soon render the initial rate levels non-compensatory, such as declining economies of density and changes in the Postal Service’s RHB and pension expenses. Beyond breaking even in the average year, financial stability requires income above the breakeven point in order to ensure that the Postal Service has adequate liquidity to make capital investments, service its liabilities, and maintain adequate reserves to account for contingencies. Therefore, any additional rate authority should be unconditional and subject to review in the next Section 3622(d)(3) proceeding, or at least unconditional in the initial years; to the extent that that additional rate authority is made conditional, it should be framed in such a way as to make it realistically achievable in the near term. And all forms of rate authority should be bankable, in order to preserve the Postal Service’s pricing flexibility in a high-pressure market environment.

Section IV explains that the premise for the Commission’s supplemental rate authority – resetting rates to total costs going into a new price cap – is on solid footing as a matter of price-cap regulation, particularly because the Postal Service’s shortfall derives from volume declines and other factors beyond its control. However, the Commission’s specific proposal is inadequate because it is based on an unrepresentative baseline. The Postal Service’s proposal of an alternative baseline level that better reflects recent and expected net losses resonates with a handful of other commenters’ proposed baselines, which are in the same range. While still other commenters provide alternative approaches to calculating various baselines, these
arguments are either inconsistent with the purpose of the supplemental rate authority or would flout Commission precedent (and the proponents’ own past positions) about the appropriate allocation of responsibility to cover institutional costs between market-dominant and competitive products.

Section V reinforces that the Commission’s conclusion that additional rate authority is necessary, because financial stability requires more than the “breakeven” goal of the supplemental authority. The Postal Service needs more liquidity for true financial stability, and an unconditional 1 percentage point of authority beyond the supplemental authority would contribute to that goal. The alternative approaches recommended by other commenters do not constitute improvements to the proposal.

Consistent with the Postal Service’s March 1 comments, sections VI and VII discuss some of the more technical issues associated with the Commission’s proposals regarding underwater classes and products and workshare discounts, respectively.\(^1\) As discussed in section VI, the Postal Service recognizes that, while Order No. 4258 does not explain the underlying basis for why the Commission choose an additional 2 percentage points of rate authority in particular for underwater classes, such an approach may strike the right balance until the situation can be re-evaluated in the next Section 3622(d)(3) review. Section VI also reemphasizes the need for pricing flexibility with respect to individual underwater products (as opposed to classes), consistent with longstanding Commission practice.

\(^1\) As in the Postal Service’s initial comments, these comments will use the term “underwater” as shorthand for more precise but awkward phrases like “having attributable costs that exceed product/class revenues.” See Initial Comments of the United States Postal Service in Response to Order No. 4258, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “USPS March 1 Comments”], at 7 fn.1. “Above-water” will denote positive attributable cost coverage.
Finally, section VII rebuts recommendations by commenters in favor of more rigid workshare discount rules. While the Postal Service understands the Commission’s intent with respect to the proposed workshare rules, it is important that the final rules provide enough flexibility to account for the realities of the workshare pricing structure.

As articulated in the Postal Service’s March 1 comments, the Postal Service is requesting additional legal authority and flexibility. The Commission’s responsibility is to determine the level of such authority, in order to achieve the objectives. No matter the approach ultimately taken by the Commission regarding the design of the regulatory system, however, the Postal Service’s use of this authority and flexibility will be constrained by market conditions and business realities. The Postal Service’s responsibility to make appropriate business decisions regarding price levels requires the Postal Service to assess and balance market risks, customers’ short-term pricing needs, and customers’ long-term need for a sustainable universal postal service.

II. THE COMMISSION CLEARLY HAS THE POWER AND DUTY TO CHANGE OR REPLACE THE CURRENT PRICE CAP

Some commenters continue to advocate for an exceedingly narrow interpretation of Section 3622(d)(3) that would reduce the 10-year review to the same sort of regulatory updating that the Commission has routinely undertaken throughout the period. Yet this position has no basis in Congressional intent, as set forth in the

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language of the statute and its legislative history, and it has been sufficiently addressed in Order No. 4258 and the Postal Service’s March 20, 2017, comments. While the commenters do not back up their position with any substantially new or “well-reasoned legal analysis,” this section responds to a few points raised in the latest round of comments.

Regarding NPPC et al.’s constitutional arguments, the commenters offer no answer to the Commission’s reasoned rejection of those arguments. With respect to non-delegation in particular, NPPC et al. continue to rely on the only two cases where the Supreme Court found that Congress’s delegation to an administrative body impermissibly lacked any guiding principles whatsoever. But NPPC et al. still fail to contend with the eighty years of intervening cases (as well as earlier case-law) upholding delegations on the basis of guiding principles with substantially less specificity than Section 3622’s 9 objectives and 14 factors. That more extensive body


4 Order No. 4258, Supp. Views of Vice Chairman Mark Acton, at 1-2.

5 Compare Order No. 4258 at 24-25 with NPPC et al. Comments at 31-40.

6 NPPC et al. Comments at 35-40. ANM et al. are downright minimalistic in their invocation of this theme. See ANM et al. Comments at 18 fn.5.

7 NPPC et al. are no strangers to the very Supreme Court opinions that downplay the precedential value of the two cases on which NPPC et al. rely here. Compare USPS March 20 Comments, app. A at 12 & fn.43 (citing, among other cases, Whitman v. Am. Trucking Ass’ns, 531 U.S. 457, 474 (2001) (“In the history of the Court we have found the requisite ‘intelligible principle’ lacking in only two statutes, one of which provided literally no guidance for the exercise of discretion, and the other of which conferred authority to regulate the entire economy on the basis of no more precise a standard than stimulating the economy by assuring ‘fair competition.’” (citations omitted)); Clinton v. City of New York, 524 U.S. 417, 485-86 (1998) (Breyer, J., dissenting) (same); Mistretta v. United States, 488 U.S. 361, 373 (1989) (“Until 1935, this Court never struck down a challenged statute on delegation grounds. After invalidating in 1935 two statutes as excessive delegations, we have upheld, again without deviation, Congress’ ability to delegate power under broad standards.” (citations omitted))), with NPPC et al. Comments at 26, 31-32, 40 (citing the same cases for other purposes).
of case-law requires nothing more than a “bottom-line principle that should guide administrative action.” Section 3622’s objectives and factors provide a host of guiding principles consistent with, and, if anything, more detailed than, previously upheld delegations. And ultimately, NPPC et al.’s arguments are pointless, since the Commission lacks jurisdiction to rule on the statute’s constitutionality and cannot cure a constitutional defect through self-restraint.

With respect to statutory-interpretation arguments, the commenters have to demonstrate that the statute unambiguously forecloses the Commission’s interpretation, such that it is unreasonable and thus not deserving of “Chevron step two” deference. In attempting to devise a coherent plain-language argument, however, the commenters advance an overly formalistic and unsustainable interpretation. In their view, Section 3622(d)(1)’s requirements, including that of a CPI-only price cap, apply to any “system,” including any “alternative system” established under Section 3622(d)(3). This, they claim, relegates the Section 3622(d)(3) exercise to a mere mandatory checkpoint, at

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8 NPPC et al. Comments at 35-36 (citing Am. Power & Light Co. v. SEC, 329 U.S. 90, 104 (1946)). See, e.g., Whitman, 531 U.S. at 474-75 (citing cases in which the Court upheld broad legislative standards for regulatory authority, including those where the relevant standards were merely that rates, prices, or regulations be “in the public interest,” or “generally fair and equitable”).

9 USPS March 20 Comments, app. A at 12-13. The Commission’s role is to therefore fulfill the statutory role that Congress clearly conferred on it: designing a regulatory system to achieve the objectives. Ultimately, it is the court’s role to decide whether Congress’s decision to confer that authority on the Commission is constitutional.

10 Chevron refers to a two-step analysis whereby a court determines whether to defer to an agency’s interpretation of a law that it is charged with administering: the statute must be ambiguous (“step one”), and the agency’s interpretation must be reasonable (“step two”). Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842-44 (1984). In fact, as discussed below, the statute unambiguously gives the Commission the authority to replace the price cap, meaning this issue is most appropriately resolved at “step one” (though with the opposite result urged by the commenters). At most, the statute is ambiguous, and the Commission’s interpretation is reasonable.

11 See ANM et al. Comments at 10-13, 17-18, 23; ABA Comments at 5; NPPC et al. Comments at 23-25.
which the Commission must review its implementing regulations if it has not already
done so in the preceding ten years, pursuant to Section 3622(a).\textsuperscript{12}

But “Chevron step one” analysis is not limited to such literalism. Rather, “a court
must exhaust the traditional tools of statutory construction to determine whether
Congress has spoken to the precise question at issue. The traditional tools include
examination of the statute’s text, legislative history, and structure, as well as its
purpose.”\textsuperscript{13} While the analysis must “start with the statute’s text,” “the meaning . . .
ascribe[d] to statutory text must reflect the statute’s context,” including, “among other
things, the problem Congress sought to solve” in enacting the statute in the first
place.”\textsuperscript{14} As it happens, the commenters’ interpretation is inconsistent with the plain
language and structure of the statute and as well as its purpose. This is further
explained in relevant and reliable legislative history.

In their argument, the commenters rely almost entirely on the so-called “uniform
usage” presumption. However,

the presumption that identical words used in different parts of the same
act are intended to have the same meaning . . . is not rigid and readily
yields whenever there is such variation in the connection in which the
words are used as reasonably to warrant the conclusion that they were
employed in different parts of the act with different intent. The
presumption of uniform usage thus relents when a word used has several
commonly understood meanings among which a speaker can alternate in

\textsuperscript{12} ANM et al. Comments at 19 & fn.6; ABA Comments at 5-6; NPPC et al. Comments at 26-27.

\textsuperscript{13} Petit v. U.S. Dep’t of Educ., 675 F.3d 769, 781 (D.C. Cir. 2012) (internal quotation marks omitted)
(quoting Bell Atl. Tel. Co. v. FCC, 131 F.3d 1044, 1047 (D.C. Cir. 1997), and citing Gen. Dynamics Land
Sys., Inc. v. Cline, 540 U.S. 581, 600 (2004)).

\textsuperscript{14} Petit, 675 F.3d at 781-82 (internal quotation marks and citations omitted).
the course of an ordinary conversation, without being confused or getting confusing.\textsuperscript{15}

The Court also pointed to a second flaw in over-reliance on the canon, to the extent that such reliance “ignores the cardinal rule that statutory language must be read in context since a phrase gathers meaning from the words around it.”\textsuperscript{16} In that case, the Court found that the same word (“age”) could have exactly opposite meanings (“old age” versus “youth”) in two subsections of the same statutory provision, based on the differing contexts: this formal paradox “tells us that the presumption of uniformity cannot sensibly operate here.”\textsuperscript{17}

Section 3622 calls for a similarly chary approach to the “uniform usage” presumption. In the context of Section 3622, the word “system” can plausibly be interpreted as referring to the framework for regulating market-dominant rates. In its initial post-PAEA incarnation, that framework is embodied in both statutory parameters and implementing regulations. The PAEA’s framers themselves used the term “system”

\textsuperscript{15} Gen. Dynamics Land Sys., Inc. v. Cline, 540 U.S. 581, 595-96 (2004) (internal quotation marks and citations omitted) (quoting, among other cited authorities, Atl. Cleaners & Dyers, Inc. v. United States, 286 U.S. 427, 433 (1932)). ANM et al. selectively cite a single sentence from Atlantic Cleaners about the presumption’s “natural[ness],” while ignoring the opinion’s more significant discussion preceding and following that sentence about how that “natural[ness]” does not end the inquiry. Compare ANM et al. Comments at 13 & app. A at 10, with Atl. Cleaners, 286 U.S. at 433 (“Most words have different shades of meaning, and consequently may be variously construed . . . when used more than once in the same statute or even in the same section. Undoubtedly, there is a natural presumption that identical words used in different parts of the same act are intended to have the same meaning. But the presumption is not rigid[.] . . . Where . . . the conditions [in which the word is used] are different, or the scope of the legislative power exercised in one case is broader than that exercised in another, the meaning well may vary to meet the purposes of the law . . . .” (citations omitted)).

\textsuperscript{16} Gen. Dynamics Land Sys., 540 U.S. at 596 (internal quotation marks and brackets omitted) (quoting Jones v. United States, 527 U.S. 373, 389 (1999)).

\textsuperscript{17} Id. at 596-97. Cf., e.g., Moreland v. Fed. Bureau of Prisons, 431 F.3d 180, 187-88 & fn.38 (5th Cir. 2005) (holding that the phrase “term of imprisonment” has two different meanings (“time served” versus “sentence imposed”) within the same statutory section and collecting consonant holdings by other federal appellate courts).
in both senses.\textsuperscript{18} The dictionary definitions of “system” are certainly broad enough to accommodate a range of interpretations.\textsuperscript{19} It is clear that Section 3622(a) is referring to the “system” that the Commission must “by regulation establish” and that, at least for the first decade, that “system” must conform to Section 3622(d)(1)’s requirements and Section 3622(d)(2)’s limitations. But those legal facts do not mean that the “system” under review and potential modification or replacement in Section 3622(d)(3) must be confined to the Commission’s implementing regulations. What matters is context.

The structural context of Section 3622(d)(3) is materially different from that of Section 3622(a) and (d)(1)(A). If the point of Section 3622(d)(3) were merely to make the Commission conduct a Section 3622(a) revision exercise after ten years, then it would have made far more sense for Congress to place that directive in Section 3622(a). Instead, Congress placed the provision at the end of subsection (d), leading an ordinary reader to understand that the requirements and limitations enumerated in the immediately preceding subsection (d) provisions are what are subject to review, rather than merely the regulations called for back in subsection (a). Far from “read[ing] Section 3622(d)(3) in isolation from the preceding parts of Section 3622(d),”\textsuperscript{20} the

\textsuperscript{18} Compare H.R. REP. NO. 108-672, pt. 1, at 5 (2004) (“Section 201 of the bill establishes a new, modern system for regulation of Market Dominant products[,]”), with id. at 7 (referring to the “system established by the Postal Regulatory Commission”); compare S. REP. NO. 108-318, at 3-4 (2004) (referring to “the rate and classification system created in the 1970 Postal Reorganization Act”), with id. at 8 (discussing the Senate Committee’s choice to allow the Commission, rather than Congress, to “establish the details of the regulatory system”).

\textsuperscript{19} “System,” Merriam-Webster.com, https://www.merriam-webster.com/dictionary/system (last visited Mar. 29, 2018) (defining “system” as, among other things, “a regularly interacting or interdependent group of items forming a unified whole,” “an organized set of doctrines, ideas, or principles usually intended to explain the arrangement or working of a systematic whole,” “an organized or established procedure,” and a “harmonious arrangement or pattern; order”).

\textsuperscript{20} ANM et al. Comments at 21.
statutory context places those “preceding parts” squarely at the center of Section 3622(d)(3)’s review exercise.

Moreover, the breadth of the review authority provided to the Commission in Section 3622(d)(3) – to “adopt [an] alternative system” as well as to “modify” – confirms that Congress envisioned this review authority as materially broader than merely revising its regulations as under Section 3622(a). To be sure, “modify” might fairly be characterized as synonymous with “revise,” and both terms indicate a limited degree of change. However, considering the specificity of Section 3622(d)(1) and (2), even this conferral of authority would suggest at least some ability on the part of the Commission to create a system that deviates from those parameters. Ultimately, however, the precise scope of the Commission’s “modification” authority is irrelevant, because Congress did not stop there. “Alternative” denotes a far more fundamental degree of change, from one model to another wholly different one.

The CPI-only price cap simply does not leave a wide enough range of unresolved issues for the Commission to make changes fundamental enough to qualify as being between “alternative systems.” ANM et al.’s attempt to shoehorn adoption of an “alternative” system into the scope of “revising” and “modifying” proves too much: if that were true, then it would have been superfluous for Congress to have specified the

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21 Id. at 16-17.
22 See Order No. 4258 at 15 fn.25 & 16 fn.29 (quoting dictionary definitions of “modification” and “revise,” as well as MCI Telecomms. Corp. v. AT&T Co., 512 U.S. 218, 224 (1994)).
23 “Alternative,” Merriam-Webster.com, https://www.merriam-webster.com/dictionary/alternative (last visited Mar. 29, 2018) (defining “alternative” as, among other things, “offering or expressing a choice,” such as between “several alternative plans,” or “different from the usual or conventional: such as . . . existing or functioning outside the established cultural, social, or economic system”).
24 ANM et al. Comments at 17.
“adopt [an] alternative system” option.\textsuperscript{25} By juxtaposing the Commission’s “modification” option against the more sweeping possibility of an “alternative system,” Congress plainly intended to propel the Commission into the very arena of “wholesale abandonment or elimination of a requirement” that would otherwise be denied it.\textsuperscript{26} Therefore, the plain language of the statute clearly confers on the Commission the authority to adopt a new “system” – that is, a new framework for regulating market-dominant rates – that need not include the parameters initially set forth by Congress in Section 3622(d)(1) and (2). Rather, as the statute makes clear, the principles to guide the Commission are the objectives and factors.

Even if the text and context of Section 3622(d)(3) were ambiguous about the scope of the Commission’s authority to “adopt [an] alternative system,” which it is not, legislative history confirms the above analysis of Section 3622’s text and structure.\textsuperscript{27} Senator Susan Collins’s floor statement is far more significant than the commenters would like to believe. It is the sole pre-enactment explanation of the intent of Section 3622(d)(3)’s Congressional framers. Far from warranting dismissal as a lone Senator’s

\textsuperscript{25} Cf. id. at 60 & fn.37 (invoking “the anti-surplusage canon of construction, which presumes that every word in a phrase must be given effect if possible” (citation omitted)).


\textsuperscript{27} Legal Authority of the Department of the Treasury to Issue Regulations Indexing Capital for Inflation, 16 Op. Off. Legal Counsel 136, 151 & fn.24 (1992) (“Thus, even if we were to conclude that the plain language and the structure of the [statute] did not provide a clear meaning for [the word in question], we would be compelled to search the legislative record of the [relevant Act of Congress] to determine if that record could provide such meaning. . . . A court undertakes a Chevron inquiry employing traditional tools of statutory construction, of which legislative history is generally one.” (citations omitted)). In Chevron itself, the Court sought (unsuccessfully) an expression of Congress’s intent in legislative history after finding it lacking in the statute’s text. Chevron, U.S.A., 467 U.S. at 862-64. For a discussion of the legislative history at issue here, see Order No. 4258 at 22-23; USPS March 20 Comments at 5-6.
statement of personal views,\textsuperscript{28} “a sponsor’s statement to the full Senate,” such as Senator Collins’s statement, “carries considerable weight.”\textsuperscript{29} Moreover, it is not a self-serving effort to advance Senator Collins’s preferred view of the statute, but rather something akin to a declaration against interest by Senator Collins, and therefore more reliable:\textsuperscript{30} in characterizing the statute as allowing the Commission to replace the CPI-only price cap after ten years, Senator Collins was frank about how that was not “the preferable approach” to her.\textsuperscript{31} It is not rational to conclude that Senator Collins and Senator Thomas Carper would describe the outcome in such grumbling terms as “not perfect,” “a delicate compromise,” and “a difficult compromise” if their vision of a perpetual CPI-only price cap had prevailed in the final version of the PAEA negotiated between the House and Senate.\textsuperscript{32}

Senator Collins’s floor statement does not evince ambiguity; it eschews it, and clearly rules out the commenters’ proposed interpretation. It therefore confirms that Congress has unambiguously conferred on the Commission the authority to revise or eliminate the current price cap. Even if Section 3622(d)(3) were somehow considered ambiguous for purposes of\textit{ Chevron} step one (which it is not),\textsuperscript{33} the legislative history supports the reasonableness of the Commission’s interpretation, which would therefore

\begin{footnotesize}
\begin{enumerate}
\item See ABA Comments at 6; NPPC\textit{ et al.} Comments at 28.
\item\textit{Cf.} FED. R. EVID. 804(b)(3) cmt. (1972) (“The circumstantial guaranty of reliability for declarations against interest is the assumption that persons do not make statements which are damaging to themselves unless satisfied for good reason that they are true.” (citation omitted)).
\item\textit{Id.} (statements of Senators Collins and Carper).
\item See ANM\textit{ et al.} Comments at 17 fn.4.
\end{enumerate}
\end{footnotesize}
be upheld at *Chevron* step two.\(^{34}\) For all of these reasons, the Commission is entitled to rely, as it did in Order No. 4258, on the highly probative explanation of legislative intent by the PAEA’s Senate sponsors.

Contrary to NPPC et al.’s lament that Congress has somehow “abdicated its longstanding role as the body that sets the benchmark for postal rates,”\(^{35}\) Section 3622 fits within a history of Congressional delegations of decision-making authority concerning postal matters, including ratemaking. Congress’s historical role in setting postage rates “is not constitutionally scripted”:\(^{36}\) the Constitution charges Congress only with establishing post offices and post roads.\(^{37}\) Even in those areas, an express constitutional grant of authority did not prevent Congress from breaking with almost two centuries of Congressional prerogative by shifting discretion over post offices to the Executive Branch.\(^{38}\) Congress also delegated other types of decisions in which it had maintained “direct involvement . . . ever since the Nation’s Founding,”\(^{39}\) such as the selection of postmasters and the fixing of compensation, when it established the Postal Service in 1970.\(^{40}\) It did the same thing regarding rates, by delegating the authority to

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\(^{35}\) NPPC *et al.* Comments at 30.


\(^{37}\) U.S. CONST. art. I, § 8, cl. 7.

\(^{38}\) 39 U.S.C. §§ 404(a)(3), 406(a), 413(a)-(b) (authorizing the Postal Service to establish post offices). The establishment of post roads remains governed by statute. See 39 U.S.C. § 5003. Notably, the delegation of post office authority is based on guiding principles no more specific than the objectives and factors that the Commission must apply. See 39 U.S.C. § 101(b), 404(a)(3), 404(d)(2)(A).

\(^{39}\) NPPC *et al.* Comments at 29.

\(^{40}\) See generally 39 U.S.C. chap. 10.
set rates to the Postal Rate Commission and the Postal Service, pursuant to various policy principles (the “breakeven” standard and the factors of then-Section 3622). It is hardly remarkable to think that Congress might have done so again in establishing the Postal Regulatory Commission in 2006, and giving the Commission the authority to design a regulatory system to achieve revised policy parameters (in particular, the objectives).

Moreover, there is nothing unusual about Congress’s choice. Section 3622 fits a broader pattern of Congress establishing an initial, default framework and allowing a regulatory agency to amend that framework as circumstances change. For example, that is what Congress did with the Federal Communications Commission’s (FCC’s) Schedule of Regulatory Fees: 47 U.S.C. § 159(g) establishes an exhaustive fee schedule, subject to periodic adjustment.41 But the FCC may also amend the schedule at any time, based on its balancing of agency headcount (i.e., personnel expense) against such “factors that are reasonably related to the benefits provided to the payor of the fee by the Commission’s activities [and] that the Commission determines are necessary in the public interest.”42 In a somewhat different but related vein, Congress required the Secretary of Transportation to prescribe standards (based on an array of requirements and factors) regarding gas and hazardous liquid pipelines in high-density and environmentally-sensitive areas.43 At the same time, Congress established default risk-analysis and integrity-management requirements that would apply directly to

42 Id. at (b)(1)(A), (3).
pipeline operators, until the Secretary of Transportation exercised his or her statutory discretion.\textsuperscript{44} By the same token, Congress provided in the PAEA that the CPI-only price cap would be the default regulatory model unless and until the Commission, at least ten years later, found that changes were necessary in order to meet the criteria in Section 3622(b) and (c).

On a different point, and contrary to the view of NPPC et al., Congress’s failure to specify a sunset date for the CPI-only price cap is not dispositive.\textsuperscript{45} Section 3622(d)(3) makes clear that the CPI-only price cap could persist beyond the ten-year review, if the Commission found that it was still meeting the objectives and factors. Senator Collins’s floor statement likewise indicates that the CPI-only price cap in Section 3622(d)(1)(A) would be effective for “at least . . . a decade,” and she allowed that “the Postal Rate [sic] Commission, at the end of that decade, may well decide that it is best to continue with a CPI rate cap in place.”\textsuperscript{46} There was no need for Congress to set an expiration date, given Section 3622(d)(3)’s purpose of leaving that decision to the Commission’s judgment after the first decade.

Finally, the Commission has not made an “unexplained departure” from some past position on its Section 3622(d)(3) authority or the policy value of a CPI-only price cap compared to other means of regulating market-dominant rates to achieve the objectives,\textsuperscript{47} because it had no reason to take a considered position on those issues during the ten-year period when it had no discretion over that cap. The Commission’s

\textsuperscript{44} 49 U.S.C. § 60109(c)(8).

\textsuperscript{45} See NPPC et al., Comments at 25-26.


\textsuperscript{47} See ANM et al. Comments at 28-29; ABA Comments at 4-5; NPPC et al. Comments at 26.
past statements about the importance of the price cap reflected Congress’s policy decision to impose the price cap in effect at the time, not a policy judgment about whether the same price cap would remain good policy in all circumstances going forward. While the Commission must support a change in regulatory approach with reasoned explanation, Order Nos. 4257 and 4258 exhaustively explain how the CPI-only price cap failed to achieve objectives 5 and 8 (among other things) in the past decade’s market conditions. Moreover, even if “rigorous enforcement of the CPI cap” was thought to be appropriate in 2006, circumstances since 2006 make clear that this initial policy choice is no longer appropriate. Rather, as the Postal Service has detailed at length, such market conditions make a CPI-only price cap untenable.

III. THE COMMISSION MUST REMEDIATE THE CURRENT SYSTEM’S FAILURE TO ACHIEVE OBJECTIVES 5 AND 8

Several commenters assert that, even assuming that the Postal Service has not achieved financial stability under the existing price-cap system and even if the Commission has the authority to change the system by modifying or eliminating the price cap, the Commission should not exercise that authority in these proceedings. These arguments fall into several broad categories, which are addressed in turn below, and none of them provide a legitimate basis to maintain the status quo.

48 Order No. 4258 at 18; USPS March 20 Comments, app. A at 3 fn.13.
49 ANM et al. Comments at 28.
A. A Desire for Legislative Reform Is No Excuse to Shirk the Commission’s Statutory Duty

As a means of achieving the objectives, Congress gave the Commission only one tool: reform of the ratemaking system. Congress specifically declined to give the Commission other tools, such as the power to set postal employees’ compensation or to change the scope of the universal service obligation. Those powers remain reserved to Congress or, in the case of wages, certain benefits, and terms and conditions of employment, to third-party labor arbitrators. No one, including the Commission, can predict whether and how Congress will exercise its policy judgment to make changes to the statutory structure under which the Postal Service must operate. As the Commission and its predecessor have long recognized, our constitutional system does not allow an administrative agency “to ignore statutory mandates and prohibitions based on agency speculation about future congressional action”; to do so “would gravely upset the balance of powers between the Branches and represent a major and unwarranted

51 Order No. 4258, Supp. Views of Vice Chairman Mark Acton, at 1 (distinguishing the Commission’s “lawful responsibility to review and, if necessary, propose and implement regulations to address flaws in the market dominant ratemaking system” from Congress’s exclusive ability “to allow the Postal Service to re-amortize unfunded liabilities, administer employee benefits differently, change the frequency of delivery, or deliver profitable items restricted by statute”).

52 The delegation of both powers to a "Postal Regulatory Board" was recommended by the President’s Commission on the United States Postal Service. PRESIDENT'S COMM’N ON THE U.S. POSTAL SERV., EMBRACING THE FUTURE: MAKING THE TOUGH CHOICES TO PRESERVE UNIVERSAL MAIL SERVICE 63, 69 (2003). Contrary to those recommendations, Congress abjured the exercise of any PAEA-derived authority, including the Commission’s powers, to “restrict, expand, or otherwise affect” employee and labor rights. PAEA § 505(b). With respect to universal service, Congress charged the Commission only with studying the subject and making recommendations for Congress to consider, clearly reserving such matters to Congress’s policymaking discretion. PAEA § 702; see also S. Rep. No. 108-318, at 39 (2004) (“From the perspective of the Committee, both the postal monopoly and universal service are issues of broad public policy – not regulatory issues. For that reason, the Committee decided that the power to refine either the monopoly or the universal service obligation should remain in the hands of Congress.”).
expansion of the Executive’s power at the expense of Congress.” The Commission’s “responsibility is to uphold the law as it is written, not as some would like it to be.”

Therefore, just as the Commission cannot speculate about legislative actions, the Commission cannot shirk its statutory duty or handicap itself in the hope of sharpening Congress’s incentive to act. Section 3622(d)(3) does not allow the Commission to tolerate non-achievement of the objectives in a gambit to influence Congress. To the contrary, it expressly charges the Commission with repairing or replacing the system as necessary to ensure achievement of the objectives.

Our constitutional system requires Congress to lead and the Commission to follow. In this context, Congress has dictated certain policy priorities to the Commission, and the Commission must design a system that achieves those priorities (that is, the statutory objectives, taking into account the statutory factors). By that token, the Postal Service agrees with commenters who recommend that the new system should accommodate the possibility of legislative changes that materially affect the assumptions underlying the system. The adjustment factor that the Postal Service has proposed for this purpose would automatically and symmetrically adjust available rate authority for legislative (and other) changes to RHB and pension expenses, without


54 Order No. 1926, Separate Views of Comm’r Mark Acton, at 3.

prejudice to the direction or source of changes.\textsuperscript{56} Because the adjustment factor would track externally generated invoices from the Office of Personnel Management (OPM), it would not rely on estimation or the application of judgment, and there would be no need for litigation. As such, the Postal Service’s proposed solution would allow for more predictable and stable expectations (objective 2), as well as greater transparency and less administrative burden (objective 6), than proposals to litigate such changes through “exigency”-type proceedings or a pre-term Section 3622(d)(3) review.\textsuperscript{57}

B. Nor Are the Postal Service’s Statutory Obligations a Basis to Avoid Reforming the Ratemaking System

In a variant of the above argument, several commenters recognize that the Postal Service has had insufficient revenues to allow it to cover its total costs during the PAEA era, but attribute that failure not to the price cap but instead to the RHB prefunding schedule that the PAEA also imposed.\textsuperscript{58} If the RHB prefunding obligations

\textsuperscript{56} USPS March 1 Comments at 74-77.

\textsuperscript{57} Cf. Comment of the National Association of Letter Carriers, AFL-CIO, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “NALC Comments"], at 25-27 (“exigency”-type proceedings); Initial Comments of Netflix in Response to Order No. 4258, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “Netflix Comments"], at 7-12 (“exigency”-type proceedings and three-year review); Initial Comments of the Public Representative, PRC Docket No. RM2017-3 (as refiled Mar. 7, 2018) [hereinafter “Public Representative Comments"], at 61-63 (three-year review). Similarly, the Postal Service’s proposed automatic adjustment factor for volume and delivery-point changes would be far simpler and less controversial to apply than NALC’s proposal to make such adjustments through Section 3622(d)(1)(E)-type proceedings. Compare USPS March 1 Comments at 71-74 with NALC Comments at 25-27 (including “increasing delivery points and volume-depressing technological change” among the potential bases for price cap adjustments to be litigated). That said, the Postal Service agrees with NALC’s proposal to expand or clarify Section 3622(d)(1)(E)’s applicability to changes in statute or regulation that impose significant new cost burdens on the Postal Service in areas not covered by a built-in adjustment mechanism. NALC Comments at 26 (discussing the possibilities of legislation mandating the prefunding of workers’ compensation benefits, or requiring the Postal Service to take actions that result in “hundreds of millions of dollars in new fees on international shipments”). At the same time, the Postal Service disagrees with Netflix’s suggestion that non-cash accounting changes, such as the FY2017 adjustment to the workers’ compensation liability, should be a basis for adjusting rates and reducing the Postal Service’s expected cash flow. See Netflix Comments at 7-8, 12.

\textsuperscript{58} See Comments of the American Forest & Paper Ass’n, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “AFPA Comments"], at 5; Comments of the American Mail Alliance, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “AMA Comments"], at 3-4; Comments of the News Media Alliance,
were disregarded, the argument goes, the Postal Service would have nearly broken
even over the first eleven years of the price-cap regime. But this argument does not
justify a failure to alter or replace the ratemaking system.

The PAEA introduced both the price cap and the RHB-prefunding schedule,
reflecting Congress’s expectation that the price-cap regime would allow the Postal
Service to generate adequate revenues to cover its total costs (including RHB
prefunding) and generate retained earnings so long as it operated in a responsible
manner. While this expectation did not come to fruition, the fundamental reason was
not the prefunding requirement, but the failed assumption that mail volume would
continue along its then-current trend. As the Commission found in Order No. 4258, mail
volume fell dramatically, which deprived the Postal Service of the ability to cover its
institutional costs (including, but not limited to, its statutory RHB prefunding

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59 See Quad/Graphics Comments at 3. On a related point, ANM et al. argue against finding a failure to
achieve objective 5 because the Postal Service did make some RHB prefunding payments when it had
the liquidity to do so, because the Postal Service somehow ought to have “foresee[n] that [it] could stop
making the prefunding payments without a penalty.” ANM et al. Comments at 47. This argument is
cynical in the extreme. The prospect of a penalty has no relevance to the fact that the RHB payment
obligation is a legislative mandate with which the Postal Service must comply. Businesses are normally
expected to satisfy their payment obligations in good faith, and government entities are expected to
adhere to Congress’s policy choices. While the Board of Governors subsequently determined that the
Postal Service had to default on certain payments in order to ensure the achievement of its primary
statutory mission (providing universal service), there is certainly no basis to conclude that the Board’s
prior decision to make payments was improper.

60 Postal Regulatory Comm’n, Section 701 Report, Analysis of the Postal Accountability and
Enhancement Act of 2006 (Sep. 22, 2011) [hereinafter “2011 Section 701 Report”], at 21; Public
Representative Comments at 2.
obligations). So, while it is true that the Postal Service’s cumulative net losses in the 
PAEA era happen to resemble the amount of RHB prefunding payments that the Postal 
Service was obligated to make during that period, it is inappropriate to attribute the 
failure of the PAEA solely to the existence of the prefunding obligations and to avoid 
changing the ratemaking system on that basis. It is just as possible to highlight the 
other costs that the Postal Service has been required to incur during the same period as 
being the reason that the PAEA failed.

More important, as noted above, the Commission does not have the authority in 
these proceedings to relieve the Postal Service of the obligation to make statutory 
benefits payments, any more than it has the authority to repeal or disregard any other 
distinct statutory obligation that drives Postal Service costs, from the federal defined-
benefit pension and workers’ compensation programs to the universal service 
obligation. The sole authority that the Commission has is to modify or replace the rate-
regulation system in a manner that will give the Postal Service the ability to cover the 
cost structure rooted in Congress’s policy choices. This is why the Postal Service has 
proposed that the Commission, if it chooses to keep a price-cap system, authorize rates 
to be reset at compensatory levels (in accordance with regulatory best practices) to

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61 Order No. 4258 at 35-38 (recounting Congress’s expectation that a CPI-only price cap would be 
sufficient to cover costs and guard against contingencies, based on then-current volume trends and 
financial performance, and explaining how the Great Recession undermined that expectation).

62 For corroboration that the resemblance between the total RHB prefunding payments and the post-
PAEA-decade net losses is coincidental, “[r]emember that market-dominant mailers already pay a 
surcharge for retiree health care benefits, in the form of the $3.1 billion rate increase embedded in the 
R2005-1 rate case to fund the former escrow obligation.” Comments of the Major Mailers Association, the 
National Association of Presort Mailers, and the National Postal Policy Council, PRC Docket No. 
RM2017-3 (Mar. 20, 2017), at 48. Thus, if volumes had remained constant, market-dominant rates would 
have funded a substantial portion of the RHB payments every year. That did not happen, because 
volumes declined and rates could not be raised to maintain the same level of contribution toward RHB 
costs. Importantly, the steep and sustained volume declines occurred too late for the Postal Service or 
the Commission to have accounted for them in a transitional rate case under 39 U.S.C. § 3622(f).
correct the fundamental deficiencies of the original regulatory model, and further that the Commission adopt the proposed adjustment factors going forward to account for circumstances outside the Postal Service’s control that cause rates to become non-compensatory in the future.

Some commenters cry foul, claiming that the Commission should not allow the Postal Service to recover those RHB prefunding payments that it defaulted upon in order to continue operations.\textsuperscript{63} This misunderstands the Commission’s proposal. The Commission’s supplemental rate authority proposal is designed to mitigate the design flaws of the earlier system in order to give the Postal Service an opportunity to cover its total costs – to achieve “medium-term financial stability” – going forward. Although the Commission’s proposal falls short in that regard,\textsuperscript{64} nothing in either the supplemental rate authority proposed in Order No. 4258 or the modifications to that authority proposed in the Postal Service’s March 1 comments is designed to allow the Postal Service to recover past losses, including those liabilities incurred by defaulting on RHB and pension payments.\textsuperscript{65}

\textsuperscript{63} See ANM et al. Comments at 76-77; Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Ass’n, Inc. Initial Comments on the Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “Valpak Comments”], at 12; AMA Comments at 5-6; Netflix Comments at 6 fn.15 & 7 fn. 17; DMA Comments at 2.

\textsuperscript{64} See USPS March 1 Comments at 48-77.

\textsuperscript{65} Another source of confusion might be the Commission’s invocation of “retained earnings” to justify its proposal of an additional 1 percentage point of rate authority. Order No. 4258 at 46-48. Retained earnings are the accumulation of net income over time. The Postal Service will not have true retained earnings until it has achieved future net incomes greater than its accumulated deficit of $61.9 billion, including $40.8 billion in unpaid RHB and pension obligations. Despite its imprecise use of the term “retained earnings,” the proposal in Order No. 4258 is not aimed directly at reducing the accumulated deficit and thereby restoring retained earnings. Rather, it provides the opportunity to generate net income in the near term and rebuild liquidity that can be invested in the Postal Service’s business, the returns from which would assist in generating net incomes farther into the future and hence eventually restoring retained earnings. See id. at 46-47, 53.
In a variation on the same theme, Netflix argues that future rate authority should be reduced to the extent that the Postal Service defaults on future RHB and pension obligations. But expenses do not disappear upon default; they continue to require payment as current liabilities. To provide medium-term financial stability (as the Commission has defined the term), the supplemental rate authority must allow coverage of all expenses, regardless of when the Postal Service determines that those expenses can be paid as a matter of responsible financial management. As a practical matter, Netflix’s proposal would also be out of step with how the Commission’s proposed phasing approach would work. Even assuming that the Commission adopts a more reasonable baseline and adjustment mechanisms, the phasing approach would not provide the full amount of intended revenue until Year 5. It would make no sense to use interim defaults as a basis to truncate that revenue stream prematurely, or at all.

C. Predictions of a “Death Spiral” Are Largely Unsupported And Only Prove That the Current Business Environment Makes a Price Cap Unnecessary and Counterproductive

A separate refrain echoed by many commenters is that any loosening of the CPI-based price cap will ultimately be self-defeating because rate increases will lead to a “death spiral.” Under that hypothesis, any increase in inflation-adjusted market-dominant rates will accelerate volume declines, which in turn will deprive the Postal Service of the contribution that the rate increases were intended to produce, which will then require greater rate increases, which will trigger additional volume declines, and so

66 See Netflix Comments at 9, 12.
67 See id. at 14-18.
on. In effect, these commenters contend that market-dominant mail volume is now price-elastic: that is, that demand has become sufficiently sensitive to price that customers will leave the mail for alternative delivery channels if prices rise faster than consumer inflation.

This is not a new contention. The Commission has rejected arguments that the elasticities are invalid, finding in its decision approving the exigent price increase that “the Postal Service’s model provides the most reliable available estimate of the likely impact on volume of the proposed rate increase.”

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68 See ANM et al. Comments at 79-82; Comments of Mailers Hub LLC and the National Association of Advertising Distributors, Inc., PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “MH-NAAD Comments”], at 6; NMA Comments at 7; NPPC et al. Comments at 63; Comments of the American Catalog Mailers Ass’n, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “ACMA Comments”], at 6; Comments of the EMA, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “EMA Comments”], at 3; ABA Comments at 3-4; AMA Comments at 7-8.

69 One commenter, EMA, attaches a research paper that goes even farther, suggesting that the mere authority to raise rates above the price cap will drive away mail volume, even if the Postal Service does not actually use that authority. See Infotrends, Exploring Mail Volume Impact from the PRC’s Proposed Rate Structure (Feb. 2018), at 12 (“Although the U.S. Postal Service may not exercise its authority to raise rates each year, many mailers will likely factor this risk into their future communication strategies and investment priorities.”) (attached to EMA Comments). But neither EMA’s comments nor the survey it commissioned cites any evidence in support of that claim: the commissioned survey asks respondents only about how they would respond to actual “rate increases,” not to the provision of rate authority. See generally id. at 8-11.

70 See, e.g., Comments of the National Postal Policy Council et al. in Opposition to Exigent Rate Increase, PRC Docket No. R2013-11 (Nov. 26, 2013), at 36-38 (arguing that the Postal Service’s price-elasticity estimates “do not provide useful insights of how volume would change in response to larger real price changes” under current circumstances, considering that the “market in which [the Postal Service] operates today differs greatly from that of 2006 or earlier years” due to the “rapid improvements in alternative means of communication since 2006 or 2007”). See also Order No. 1926 at 148-154 (describing mailer arguments against exigent case on the ground that, because ample alternatives to the mail exist, rate increases by the Postal Service could simply exacerbate the Postal Service’s financial problems by driving more volume away than the Postal Service’s elasticities would indicate). The mailers presented the same arguments in Docket No. RM2014-5.

71 Order No. 1926 at 156-57. Accord Ofcom, Review of the Regulation of Royal Mail (Mar. 1, 2017), at ¶ 3.124, http://tiny.cc/Ofcom-03-17-review (expressing skepticism that a postal pricing decision could trigger a significant acceleration of electronic substitution among business mailers, given the incentive to substitute inherent in the existing marginal price differential between physical and electronic communication). The Commission also closed the recent mailer-initiated proceeding to consider elasticity issues without issuing a notice of proposed rulemaking. In doing so, the Commission observed that “neither the commenters nor respondents to the [Notice of Inquiry] provided a new postal demand model to replace the current Postal Service’s demand model,” and that “there is no indication that issuing a
While several commenters again question the validity of the current elasticities, the only support for their position comes from opinion surveys in which market-dominant mailers claim that they will leave the mail in response to postal price increases.\textsuperscript{72} And such claims are undercut by real-world experience, notably the response to the exigent rate increase, which supports the continued validity of the current elasticities. The exigent increase raised prices of market-dominant products by an average of 4.3 percent above CPI-U and remained in effect for more than two years, but mail-volume declines did not accelerate during that period or decelerate when the increase was terminated in April 2016.\textsuperscript{73} This indicates that price elasticities have not changed appreciably over time on account of either increased electronic diversion or the Great Recession, and that reduced demand for the mail continues to be due to non-price factors (such as changing demographics and technological innovation), rather than increased sensitivity to postal rate increases.\textsuperscript{74}

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\begin{itemize}
  \item \textsuperscript{72} See EMA Comments (attaching Infotrends, Exploring Mail Volume Impact from the PRC’s Proposed Rate Structure (Feb. 2018)); ACMA Comments at 4-5; DMA Comments at 5-6; AFPA Comments at 6; ANM et al. Comments at 65-66; letter of Idealliance, PRC Docket No. RM2017-3 (dated Feb. 28, 2018), at 1-2.
  
  \item \textsuperscript{73} Some commenters speculate that the muted demand response to the exigent increase was because mailers knew the exigent increase would be temporary, not permanent. Comments of the Software & Information Industry Ass’n, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “SIIA Comments”], at 5; AFPA Comments at 6; DMA Comments at 5. But none of these commenters offer evidence to support their hypothesis. Moreover, the amount of revenue recoverable by the exigent surcharge, and therefore the length of time the surcharge would be in effect, was the subject of considerable dispute and uncertainty for years. See Comments of the Major Mailers Ass’n et al., PRC Docket No. RM2017-3 (Mar. 20, 2017), at 22-23 (arguing that “mailers operated from July 2010 until December 2016 under the cloud of either a request for or an actual exigent surcharge,” which “made mailers wary of committing to the mail, and has encouraged them to seek electronic alternatives more aggressively”).
  
  \item \textsuperscript{74} Similarly, in the United Kingdom, Royal Mail was able to achieve revenue growth and dramatic profit growth, notwithstanding an 8-percent drop in addressed letter volumes, after prices were increased
\end{itemize}
Moreover, even if the postal marketplace has changed since 2016 such that demand for market-dominant products is now price-elastic, then that proves that a price cap is not needed at all. Price cap systems were introduced to mimic competitive forces. The logical conclusion of the commenters’ “death spiral” argument is that, notwithstanding the Postal Service’s statutory monopoly and the lack of physical-delivery substitutes, market-dominant products have essentially become “competitive” products within the meaning of 39 U.S.C. § 3642(b)(1): that is, the Postal Service can no longer raise prices significantly without fearing substantial volume loss. Regardless of whether market-dominant products technically possess “market power” or would be ineligible for a product transfer under Section 3642, the existence of alternatives indicates that a price cap is unnecessary to protect ratepayers in such a market dynamic. If, as mailers would have it, rate increases will ultimately be significantly in the 2012-2013 fiscal year (e.g., a base rate increase of approximately 30-40 percent for the subset of single-piece letters, and 6-8 percent above inflation for the minimum prices of certain business mail categories). Ofcom, Annual Monitoring Update on the Postal Market, Financial Year 2016-17 (Nov. 23, 2017), at 3, 5, http://tiny.cc/Ofcom-2016-17-ann-rept; id., Interactive Data – Raw Data, http://tiny.cc/Ofcom-2017-report-data, tab “Business prices”, cells D16-D17, D71-D72, D82-D83, D93-D94; see also Ofcom, Review of the Regulation of Royal Mail (Mar. 1, 2017), at ¶ 3.111-.112, http://tiny.cc/Ofcom-03-17-review. After the year of the significant price increases, the rate of volume decline slowed to an average of 3 percent per year. See Ofcom, Annual Monitoring Update on the Postal Market, Financial Year 2016-17 (Nov. 23, 2017), at 3.

See, e.g., In the Matter of Price Cap Performance Review for Local Exchange Carriers, 10 F.C.C. Rcd. 8961, 8965 (1995) (FCC’s price cap plan “is designed to mirror the efficiency incentives found in competitive markets, thus acting as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary”).

While any absence of market power renders a price cap unnecessary, this does not mean that the mere presence of market power requires or supports imposition of a price cap. As the Postal Service argued at length in its comments of March 20, 2017, the Commission need not find that the Postal Service lacks market power over its market-dominant products for purposes of Section 3642 in order to conclude that a price cap is unnecessary. Nor is the Postal Service suggesting that it do so. The shrinking size of the market due to the existence of non-mail substitutes means that the Postal Service has no incentive to seek to exploit any nominal market power it may have. See USPS March 20 Comments at 177-89.

Id. at 178-80.
pointless and self-defeating because they will cause mailers to leave the system for alternatives, then that fact alone will prevent the Postal Service from raising rates in an excessive manner. As noted in the Postal Service’s March 20, 2017, comments, a party cannot claim on the one hand that it will use alternative communications channels if the Postal Service’s raises rates, while on the other hand claim that a price cap is needed to protect “captive” customers who would have no choice but to accept excessive rate increases.\textsuperscript{78}

In any event, the Postal Service itself must contend with the possibility that its elasticities may not accurately predict the demand response to very significant rate increases under current circumstances,\textsuperscript{79} and that excessive rate increases could lead to significant level shifts in volumes that could be detrimental to the Postal Service.\textsuperscript{80} It is equally aware of the risk that an unexpected demand response could be asymmetric, in that any volume that leaves the postal system as a result of an excessive price increase would not necessarily return even if the increase were thereafter reversed.\textsuperscript{81} This uncertainty will inherently incent the Postal Service to increase prices only to the extent necessary to ensure its financial stability. That inherent pricing restraint, in turn, forces the Postal Service to maximize financial returns from efficiency rather than

\textsuperscript{78} Id. at 189-90.

\textsuperscript{79} The elasticities are calculated on the basis of historic data, and are also calculated at a relatively broad level.

\textsuperscript{80} See USPS March 20 Comments at 185.

\textsuperscript{81} See id. at 185-86.
pricing, to the extent possible, with the goal of avoiding the need for greater price increases.\textsuperscript{82}

But the proper market-based pricing strategy is ultimately the Postal Service’s decision to make, in an exercise of its business judgment. Just as the Commission’s authority and responsibility in this proceeding are distinct from those of Congress, they are also distinct from those of the Postal Service Governors. The Governors’ role in the statutory scheme is to make business decisions about pricing levels, based on holistic consideration of the Postal Service’s needs, best practices of efficient management, and fairness to customers.\textsuperscript{83} Through daily contact with mailers, the Postal Service is in the best position to assess demand and other market forces.

The Commission’s greater remove from the market is critical to its oversight role, but it necessarily leaves the Commission in a poorer position to assume ultimate responsibility for setting price levels. Particularly under the PAEA, the Commission’s role is to determine the outer bounds of available rate authority within which the Postal Service exercises its pricing discretion. For the past ten years, Section 3622(d)(1)’s

\textsuperscript{82} Even if the Commission adopts a price cap with a mechanism to compensate for the effect of volume declines on the price cap’s intended contribution toward institutional costs (as proposed by the Postal Service and the Public Representative), volumes will continue to drive the Postal Service’s efficiency incentives. For one thing, volume declines do not automatically eliminate volume-variable costs: they create the potential to do so, which the Postal Service must then work to realize (e.g., by realigning its network or taking measures to scale back its workforce). For another thing, the proposed adjustments account only for the effect of volumes, delivery points, and pension and RHB costs on institutional costs. If the Postal Service is to live within a CPI constraint (after rates are reset via the supplemental rate authority), then it must continue working to restrain growth in the institutional cost base. That is the point of the adjustment mechanism, after all: to adjust out costs and trends beyond the Postal Service’s control and thereby to focus the Postal Service’s incentives to keep costs within its control from growing faster than inflation.

\textsuperscript{83} 39 U.S.C. § 404(c) (charging the Governors with establishing rates and classes that are “reasonable and equitable and sufficient 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.”).
requirements, such as the CPI-only price cap, did most of that boundary-placing work.\textsuperscript{84} Now, the Commission’s task is to determine how the objectives and factors translate into a new outer bound in its proposed system.

In the current market environment, regardless of the rate-regulation system in place, persistent, rapid volume declines inherently restrain the Postal Service’s pricing decisions and maximize its efficiency incentives. If, in an effort to respond to hypothetical “death spiral” concerns, the regulatory outer bound were set so low that the Postal Service lacked the authority to raise needed revenue through pricing (after accounting for available cost-reduction opportunities), then the Commission would be in the position of perpetuating the current system’s failures, rather than giving the Postal Service the appropriate tools to make it potentially succeed in a challenging marketplace. Even trying to guess the perfectly balanced outer-bound level via a revised price cap brings a substantial risk that circumstances will diverge from expectations before the next Section 3622(d)(3) review. The Commission would be assuming the risk of error, but the Postal Service and the entire mailing community would bear the fallout from any such error. As U.K. postal regulator Ofcom found, in such a market environment, the regulator’s best option is to stand back and, with a watchful eye and a readiness to intervene if necessary, let market discipline do its work.\textsuperscript{85}

\textsuperscript{84} Order No. 1926, Separate Views of Comm’r Mark Acton, at 2-3 (distinguishing the Governors’ responsibility for “approving management approaches within [their] control in an effort to move the Postal Service forward” from the Commission’s then-operative role to administer the more restrictive CPI-only price cap).

\textsuperscript{85} For more on the reasons why the risk of regulatory error is to be avoided in this business environment, see USPS March 20 Comments at 216-18.
In short, the Commission’s role in these proceedings is to give the Postal Service the authority to price its products in a manner that will achieve the purposes of the statute, including providing for “just and reasonable” rates and financial stability for the Postal Service. It may well be that market conditions will prevent the Postal Service from exercising that authority, but that question is one for the Postal Service and not the ratemaking system.

D. There Remains No Quantitative Evidence of Cost-Cutting Opportunities Sufficient to Achieve Financial Stability Without Additional Pricing Authority

Several commenters assert that the Commission should refrain from altering the existing price-cap model because increased pricing authority will reduce the Postal Service’s incentive to engage in cost-cutting efforts.86 This argument is contrary to the theory underlying incentive regulation, and ultimately reads objectives 5 and half of objective 8 out of the statute. Moreover, although several commenters stress the importance of forcing the Postal Service to act more efficiently, those comments do not identify any reasonable cost-cutting proposals within the Postal Service’s control that would come close to closing the net-income gap that the Commission’s proposal, let alone a continued CPI-only price cap, would leave.

In one sense, it could always be argued that any increase in a firm’s revenues will reduce its incentive to cut costs, on the premise that basic survival is a more

86 See ACMA Comments at 3, 8; Comments of American Consumer Institute Center for Citizen Research Regarding Docket No. RM2017-3, PRC Docket No. RM2017-3 (Feb. 23, 2018) [hereinafter “ACI Comments”], at 5; ABA Comments at 4, 9; ANM et al. Comments at 39, 48-52; DMA Comments at 3; LSC Comments at 3; Quad/Graphics Comments at 3; Comments of United Parcel Service, Inc., PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “UPS Comments”], at 4; cf. NPPC et al. Comments at 10.
powerful motivator than stability, profitability, or success. But while such an argument is being used here to justify maintaining the status quo, it could just as easily be used to advocate for a reduction in, or an outright elimination of, a firm’s ability to raise revenue. Taken to its logical conclusion, if keeping real prices flat provides incentives to control costs, then reducing prices will provide even greater incentives. After all, as the U.S. Court of Appeals for the D.C. Circuit noted, “[t]he prospect of imminent bankruptcy surely concentrates the mind.” However, the court immediately added that, if that is the justification for the choice of a particular price-cap index, “it amounts to no more than the principle that ‘lower is better’ – an argument that seems to have no end and little connection to any stated purpose” of a price-cap system.

No form of rate regulation is designed to drive a firm to the precipice of insolvency. Instead, rate regulation necessarily is designed to achieve reasonable prices for consumers and a reasonable rate of return (and thus financial stability) for providers. The fundamental purpose of price-cap regulation is to encourage efficiency by providing a firm with the opportunity to earn a higher rate of return (and thus greater profits) if it succeeds in reducing costs and operating more efficiently than expected. That expresses the core regulatory bargain inherent in any rate-regulation system: rates should be compensatory but not excessive. These goals are reflected in the PAEA’s


88 Ass’n of Oil Pipe Lines v. FERC, 281 F.3d 239, 244 (D.C. Cir. 2002).

89 Id.


objectives, which require the system to enable the Postal Service to set “just and reasonable” rates that give it the opportunity to generate adequate revenues to maintain “financial stability,” while at the same time ensuring that the Postal Service has “maximum incentives to reduce costs and increase efficiency.” The commenters arguing for the continuation of non-compensatory rate levels as a means of incentivizing cost-cutting are, in effect, reading the “financial stability” and “just and reasonable” objectives out of the statute. Nothing in price-cap theory generally – or the PAEA specifically – permits the Commission to force the Postal Service into financial ruin as a means of inducing it to cut costs.

It would perhaps be another matter if there were a supportable argument that the Postal Service could cut its way to financial stability: that is, if the Postal Service could cover its costs within the price cap by availing itself of cost-cutting opportunities within its control. But the commenters speaking broadly of incentivizing cost-cutting offer little by way of cost-cutting opportunities available or forgone, and they fail to address the statutory constraints under which the Postal Service operates. For example, no commenters specifically rebut the evidence in the record, in the form of the expert report prepared by Alvarez and Marsal (A&M), that any cost-cutting opportunities within the Postal Service’s control are relatively limited and dwindling. As noted in the Postal

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92 The Commission has held that the “just and reasonable” rates objective means that rates must neither be “excessive to the mailer nor threaten the financial integrity of the Postal Service,” including in light of the “total contribution to institutional costs” provided by market-dominant products as a whole. Order No. 4257 at 113 fn.213, 229. As the Commission has noted, id. at 113 fn.213, this understanding is consistent with the widely understood interpretation of “just and reasonable” standards as requiring that rates be fully compensatory but not excessive. See, e.g., Farmers Union Cent. Exch. v. FERC, 734 F.2d 1486, 1502 (D.C. Cir. 1984); see also USPS March 20 Comments, app. A at 5 fn.6.

93 This silence is particularly telling in the case of ANM et al., whose counsel sought and obtained access to the A&M report. See generally Order Granting Motion for Access to Non-Public Material Filed Under Seal, PRC Docket No. RM2017-3 (Apr. 5, 2017).
Service’s earlier comments, A&M’s report shows that, while the Postal Service has been aggressive in pursuing opportunities to achieve cost reductions and efficiency gains, the opportunities for further cost savings within the Postal Service’s control come nowhere close to filling the net-income gap left by either the existing system or Order No. 4258’s proposal.\textsuperscript{94} In short, the cost-cutting challenge that the Postal Service faces is caused not by insufficient incentives, but by insufficient opportunities under existing law.

Instead of pointing to cost-cutting opportunities within the Postal Service’s control that might somehow allow the Postal Service to achieve financial stability without additional pricing authority, some commenters point to potential cost-cutting measures that are outside the Postal Service’s exclusive control (and thus beyond the scope of the Commission’s authority in these proceedings). Specifically, some commenters focus on labor costs, suggesting that giving the Postal Service insufficient pricing authority may induce the Postal Service to address the longstanding wage premium.\textsuperscript{95} This argument ignores the reality that the wage premium has persisted despite, not because of, the Postal Service’s decades-long advocacy on the issue before the binding arbitration panels that resolve collective bargaining in cases of impasse.\textsuperscript{96} Moreover, the Commission cannot use its authority under the PAEA to influence or dictate the outcome of the collective bargaining process.\textsuperscript{97} For purposes of designing a ratemaking

\textsuperscript{94} See USPS March 1 Comments at 65-67; USPS March 20 Comments at 145-47.
\textsuperscript{95} DMA Comments at 2-3; ACMA Comments at 3; Comments of Business Extension Bureau, PRC Docket No. RM2017-3 (Feb. 28, 2018), at 1; Comments of Citizens Against Government Waste, PRC Docket No. RM2017-3 (Mar. 1, 2018), at 1; NPPC et al. Comments at 71; cf. ANM et al. Comments at 34.
\textsuperscript{96} See USPS March 20 Comments at 69-70; see also 39 U.S.C. § 1207. As an employer subject to the National Labor Relations Act, the Postal Service cannot unilaterally modify wages, hours, working conditions, or other mandatory subjects for bargaining. \textit{E.g.}, \textit{NLRB v. Katz}, 369 U.S. 736 (1962).
\textsuperscript{97} Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, § 505(b), 120 Stat. 3198, 3236 (“Nothing in this Act[, including Section 3622(d)(3),] shall restrict, expand, or otherwise affect any of
system that will achieve the statutory objectives, the Commission must take labor costs resulting from the collective bargaining agreements as they are, and not how it or any other party (including the Postal Service) might wish them to be.

Other proposals either seek to relitigate long-past business decisions, which have no bearing on the Postal Service’s current or future financial-stability needs, or are not as clear-cut as their proponents would like the Commission to believe. For example, as discussed further in section IV.B.4 below, arguments that the contribution from competitive products will continue to grow perpetually at the recent-historical rate is undermined by the same commenters’ apt warnings against such rosy assumptions in Docket No. RM2017-1. As discussed in section VI.A below, ANM et al. have failed to make their case about the Postal Service’s alleged inefficiencies with respect to flats: the Postal Service has actually kept flats’ unit carrier and mail processing costs below CPI since the Great Recession, and unit transportation costs only moderately above it. And with respect to claims that deeper workshare discounts would have a uniformly beneficial effect on Postal Service costs or volumes, section VII below explains why the situation is actually far more ambiguous. In any case, the opportunities for greater cost reduction or volume stimulation that might exist are not consequential enough, on their own, to allow the Postal Service to achieve financial stability and avert the need for substantial rate-regulation reform.

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the rights, privileges, or benefits of either employees of or labor organizations representing employees of the United States Postal Service under chapter 12 of title 39, United States Code, the National Labor Relations Act, any handbook or manual affecting employee labor relations within the United States Postal Service, or any collective bargaining agreement.”). See also USPS March 20 Comments at 70-73; USPS March 1 Comments at 21 fn.47 (recounting history of the Postal Rate Commission’s efforts to avoid exercising ratemaking authority, particularly with regard to cost-growth assumptions, in a way that might prejudice labor negotiations).
E. The Commission Should Reject the Argument that Objective 2 Somehow Precludes the Commission from Modifying or Replacing the Existing System

Finally, ANM et al. contend that allowing rates to rise above CPI-U inherently violates the rate “stability” component of objective 2. As discussed below, however, ANM et al.’s cramped reading of the word “stability” is not required by the statute’s plain language, is inconsistent with Congressional intent as indicated in the statute’s structure and legislative history, and flies in the face of Commission precedent and common sense. Indeed, reading objective 2 in such a manner – as requiring a CPI cap no matter the circumstances – would read other objectives out of the statute.

As an initial matter, despite ANM et al.’s suggestion that “stability” has a plain meaning, their own comments appear to support three somewhat different interpretations of what the word means in the context of pricing authority. Their central contention is that “rate stability” means that rates cannot rise faster than CPI. But they also rely on a dictionary definition of “stability” as meaning “immutability,” which would suggest that rates cannot change at all, and further rely on the usage of the term by economists as meaning “a rate of inflation under two percent,” suggesting either that rates can track inflation but only when inflation is low or that rates must increase by less than two percent above the baseline trend.

While the Postal Service agrees that the word “stability” is subject to a range of possible meanings, that range is much broader than ANM et al.’s comments suggest.

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98 ANM et al. Comments at 57-62.
99 Id. at 58.
100 Id. at 59 & fn.36.
101 Id. at 60.
For example, the word “stability” is certainly capable of connoting resistance to sudden change, deterioration, or fluctuation.\textsuperscript{102} That interpretation is the most logical in the context of the statute as a whole, and the Commission has already incorporated it into its interpretation of objective 2.\textsuperscript{103} As the Commission already noted, the House version of the PAEA, which included the “rate stability” objective, contemplated that several different systems could achieve the statutory objectives, including “incentive regulation (e.g., price caps, revenue targets); cost-of-service regulation; or any other form of regulation that the Commission considered appropriate to achieve the objectives, consistent with the factors.”\textsuperscript{104} The House bill also contemplated above-CPI price increases, without a specified limit, whenever “reasonable, equitable, and necessary.”\textsuperscript{105} Even the Senate bill, which would have imposed a permanent CPI-only cap, considered it necessary to specify the stability condition expressly, rather than assuming it as implied within objective 2, and allowed above-inflation increases in certain circumstances.\textsuperscript{106} If Congress had believed that “stability” can be achieved only when

\textsuperscript{102} See WEBSTER’S NEW UNIVERSAL UNABRIDGED DICTIONARY 1852 (2003) (definitions of “stability” include “firmness of position” and “resistance to change, esp[ecially] sudden change or deterioration”); “Stability,” Merriam-Webster.com, https://www.merriam-webster.com/dictionary/stability (last visited Mar. 29, 2018) (defining “stability” as, among other things, “the property of a body that causes it when disturbed from a condition of equilibrium or steady motion to develop forces or moments that restore the original condition”).

\textsuperscript{103} Order No. 4257 at 55 (interpreting objective 2 to mean, among other things, that the system must “foster 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” (emphasis added)).


\textsuperscript{105} Order No. 4258 at 20.

\textsuperscript{106} S. 2468, 108th Cong. § 201(a) (2004).
rates strictly adhere to inflation, it would have said so expressly. It would not have allowed rates for individual market-dominant products to rise above inflation, or allowed the Postal Service to “bank” rate authority for use in subsequent years. And it would not have authorized the Commission to alter the CPI-only price cap (but not objective 2) after ten years.

Nor does Commission precedent support the unreasonably narrow reading that ANM et al. now advance. To be sure, the Commission has previously stated that the CPI-only price cap achieved rate stability, a point on which virtually no one disagrees. But it has never stated that a CPI-only constraint is necessary to achieving such stability. To the contrary, the Commission has previously acknowledged that significantly above-CPI rate increases for individual products and rate categories are “commonplace” without raising objective 2 concerns, and also held that an across-the-board rate increase of 4.3 percent above inflation is consistent with rate stability.

In short, the Commission has long recognized that rate “stability” should be construed as restricting extreme volatility in rate changes, not as prohibiting any change at all.

107 *Whitman*, 531 U.S. at 468 (“Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions – it does not, one might say, hide elephants in mouseholes.” (citations omitted)).


109 Order No. 1926 at 157 (noting that, in January 2013, “the Postal Service implemented rates (approved in Docket No. R2013-1) that increased rates for First-Class Mail Parcels by 5.0 percent and First-Class Mail Non-automation Presort and Mixed ADC Automation flats by 7.5 percent”).

110 See Order No. 1926 at 167-68 (rejecting argument that exigent rate increase, by allowing rates for market-dominant classes to rise above the price cap, would run afoul of objective 2).

111 See Order No. 4257 at 55 (interpreting objective 2 as referring, among other things, to rates “that do not include sudden or extreme fluctuations”); Order No. 3673, Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products, PRC Docket No. RM2017-3 (Dec. 20, 2016), at 5 (same); 2011 Section 701 Report at 31 (noting that the use of 12-month CPI averages to compute the price cap “removes some of the volatility present when a point-to-point comparison is done with monthly CPI-U values,” and thereby “creates peaks that are not as
At the same time, none of the Postal Service’s proposals, including the removal of the price cap, run afoul of the “stability” objective. As the Postal Service stated in its earlier comments, “stability” can also be achieved through a regulatory monitoring approach, which would allow the Postal Service to provide more detailed forward guidance to mailers and would recognize that demand pressures inherently restrain the Postal Service from shocking the system through sudden or extreme price fluctuations. 112 In the event that those demand pressures become ineffective as a restraint, objective 2 would support re-entry by the Commission to restrain volatility. Objective 2 does not itself require rates to be artificially fixed at CPI or any other particular level, and the Commission should reject such an interpretation.

IV. IF THE COMMISSION KEEPS A PRICE-CAP SYSTEM, ITS SUPPLEMENTAL RATE AUTHORITY IS CONCEPTUALLY SOUND, ALTHOUGH IT SHOULD BE CORRECTED

A. Alternative Proposals for Correcting the Net-Loss Baseline Largely Validate the Postal Service’s Net Loss Computation

In its initial comments, the Postal Service explained why the unadjusted FY2017 net loss is an unreasonable baseline to use in setting the supplemental rate authority: a $2.2 billion non-cash accounting adjustment to the workers’ compensation liability places the putative net loss far outside both the historical mainstream and the bounds of realistic forward-looking expectations. 113 The most reasonable baseline would be $6.0

112 USPS March 20 Comments at 201-04.
113 USPS March 1 Comments at 48-60.
billion, which represents the five-year average net loss, adjusted to remove the impact of exigent surcharge revenue and of non-cash adjustments to the liability for postage in the hands of the public (PIHOP). 114 While other net-loss calculations are available that would still be more supportable than the Commission’s proposed figure, none of those calculations would yield a baseline less than $5.0 billion. 115

Of the commenters that correctly understand that the proposed supplemental rate authority is based on the net-income gap and not on past-due payment obligations, all of those commenters identify the same problem with the Commission’s use of a single-year snapshot that is unrepresentatively low, due to a non-cash accounting accrual. 116 While the commenters’ proposals differ, they tend to align with the range of corrected baselines outlined in the Postal Service’s initial comments. One computes a ten-year average annual net loss (FY2007-FY2016) of $6.2 billion, 117 while another cites an eleven-year average (FY2007-FY2017) of $5.9 billion as a reference point. 118 Another proposes to use either the FY2017 net loss, adjusted as discussed in the

114 Id. at 63-64, 68-69.
115 Id. at 60-62.
116 Public Representative Comments at 19; Comments of the American Postal Workers Union, AFL-CIO on the Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market-Dominant Products, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “APWU Comments”], at 7-8; NALC Comments at 11-14; see also Comments of the National Postal Mail Handlers Union, PRC Docket No. RM2017-3 (Mar. 1, 2018) [hereinafter “NPMHU Comments”], at 3-4 (identifying $2.7 billion as an unrepresentatively low single-year net loss, without attributing that to the non-cash accounting change). As NALC points out, the FY2017 non-cash workers’ compensation liability adjustment was unprecedented in the post-PAEA era: eight of the eleven annual non-cash adjustments were negative, in three cases by an absolute value greater than the $2.2 billion FY2017 adjustment, and the two other positive adjustments were only $0.1 billion and $0.3 billion. NALC Comments at 12-13.

117 APWU Comments at 13. While APWU also remarks that this average could be adjusted for borrowing authority available in some of the relevant years, the resulting $4.8 billion figure would still approximate the FY2017 adjusted net loss. Id.
118 NPMHU Comments at 3-4.
Postal Service’s initial comments ($5.0 billion),\footnote{119} or else the $5.2 billion net loss projected in the Postal Service’s FY2018 Integrated Financial Plan.\footnote{120} All of these alternative baselines drive home the conclusion that the appropriate baseline is around $6.0 billion, and in no case appreciably less than $5.0 billion.

The Public Representative’s proposal is materially lower than the others, but that is because of an apparent disconnect within his comments. He starts out in a manner consistent with the other proposals. In particular, while he does challenge the Commission’s finding of short-term stability, he appears to have no issue with the Commission’s measurement of medium-term stability according to net income or losses (i.e., total revenue minus total costs), its finding that the current system failed to provide medium-term stability due to persistent net losses, or its view that the new system must remedy that failure.\footnote{121} From mid-2016 up to the declarations accompanying his March 1 comments, the Public Representative and his experts have attested that well-established regulatory practice requires periodically resetting the price cap so that prices collectively cover total costs.\footnote{122}
With that background, the Public Representative correctly identifies the problems that lead the Commission’s proposal to fall short of “offer[ing] the Postal Service the opportunity for these ‘reset’ rates to recover the target costs.”\footnote{Brennan, PRC Docket No. RM2017-3 (Mar. 20, 2017) [hereinafter “Brennan 2017 Declaration”], at 5 (“To ensure that the regulated firm is able to cover costs at the start, the initial price may be based on [cost-of-service regulation].”); see also Public Representative Comments, PRC Docket No. PI2016-3 (June 15, 2016), at 42-43 (summarizing academic literature to the effect that “a price cap must operate with a breakeven constraint” in order to “extract[ ] more rents for consumers in the long run,” hence a “need to provide periodic revenue reset adjustments” (citation, internal quotation marks, and capitalization omitted)).} His expert declarants likewise conclude that the Commission’s proposal “does not correctly reflect either [the Postal Service’s] longer-term average loss or its likely future revenue shortfalls.”\footnote{Kwoka & Wilson Declaration at 11.} Like the Public Representative, their problem is not with the concept of correcting for medium-term stability through a net-loss-based reset; their problem is with the lack of adjustment for volume declines and the need for an acceleration of recovery in the interest of short-term stability.\footnote{\textit{Id.} at 11-12.} From that background, the logical next step would be to propose an alternative baseline that would more likely allow prices to cover total (or average) costs, as the Postal Service and all of the other parties discussed in this section have done.\footnote{See USPS March 1 Comments at 49 fn.130, 50 fn.132, 78 fn.197 (establishing a similar foundation in regulatory practice for the Postal Service’s net-loss-based alternative baseline calculations).}

As a separate matter, the Public Representative’s declarant criticizes Order No. 4258 for not including “Z factors” to pass RHB and pension expenses through directly to ratepayers, in light of the Postal Service’s inability to control those expenses.\footnote{Kwoka & Wilson Declaration at 12-13.} Such
adjustment factors during a price-cap period are a regulatory concept distinct from the need to reset rates to costs at the beginning of a price-cap period, and the declaration appropriately distinguishes between these concepts. In essence, the declaration mirrors the Postal Service’s own proposal to (1) use a more representative net-loss baseline to reset rates to costs and (2) include mechanisms to adjust the reset rates for declining economies of density and changes to RHB and pension expenses.128

Yet the Public Representative does not follow through with such a proposal. To the contrary, the Public Representative would abandon the use of the supplemental rate authority baseline to reset rates to cover total costs, and would instead set it at a level equal to the FY2017 value of certain “exogenous” RHB and pension expenses.129 This solution confounds the two problems without solving either of them. Whatever the cause of confusion, the fact remains that the “exogenous” FY2017 RHB and pension expenses are, in fact, included within reported net losses and, therefore, within the Commission’s, the Postal Service’s, and the unions’ proposed supplemental rate authority baselines.130 Even if that were not the case, the Public Representative does not establish why the supplemental rate authority should serve as only a partial gap-filler, rather than a full reset to compensatory levels, consistent with the regulatory best practice that his own declarants attest. Meanwhile, the Public Representative’s use of a static one-year

128 See USPS March 1 Comments at 56-77.
129 Public Representative Comments at 43.
130 See USPS FY2017 Form 10-K at 17 (adjusting those expenses out of the FY2017 net loss to derive controllable income); Order No. 4258 at 38 (using the top-line FY2017 net loss as the basis for the proposed $2.7 billion baseline). When considering expenses for the purposes of rate regulation, it is important to note that, although normal costs are tied to some factors partially within the Postal Service’s control (e.g., headcount), they remain extremely sensitive to actuarial changes completely beyond the Postal Service’s control, and the Postal Service has no power to reform the pension model that gives rise to those costs, as other employers can. See USPS March 1 Comments at 74-76.
snapshot of RHB and pension expenses still would not meet the need, identified by his own declarants (and the Postal Service), to adjust for changes in those expenses after the initial reset.

The Public Representative’s concept is ultimately out of sync with the task at hand. The Commission has defined objectives 5 and 8 in terms of ensuring that revenues cover total costs and provide a reasonable, but not excessive, amount of positive earnings. The Public Representative’s focus on covering certain expense items, without regard to net losses, is untethered to the objectives at issue, regulatory best practice, and his own experts’ supporting declaration. While the Commission’s proposed baseline level is in need of correction, the Commission should retain its proper orientation around a net-loss solution for a net-loss problem.

**B. There Is No Valid Reason to Adjust the Net Loss Baseline Downward**

While most of the proposed upward adjustments to the Commission’s proposed baseline are well-founded and consistent with the Commission’s articulated goals, the downward adjustments suggested by other commenters are not.

1. **Proposed adjustments for hypothetical property asset values and for pension and RHB fund assets are unwarranted**

Proponents of an adjustment for the hypothetical market value of property assets advance no new arguments that the Commission and the Postal Service have not already addressed.\(^{131}\) As for the argument that the net-loss baseline should be

\(^{131}\) DMA Comments at 2; NPPC *et al.* Comments at 46-47, 55-57; see also NMA Comments at 5 fn.3 (posing the argument in the broader context of the Commission’s finding of a lack of medium-term financial stability). *But see* Order No. 4258 at 155; USPS March 1 Comments at 8 fn.5; USPS March 20 Comments at 150-51. Regarding NPPC *et al.*’s argument about hypothetical sale/leaseback arrangements, NPPC *et al.* Comments at 56-57, see Opposition of the United States Postal Service to Motion for Reconsideration of Order No. 3763, PRC Docket No. RM2017-3 (Feb. 10, 2017), at 16 & fn.37.
adjusted for the off-balance-sheet assets in the Postal Service’s pension and RHB accounts, the logical corollary is that a simultaneous adjustment would be needed to incorporate the far greater liabilities in those same accounts. That would be necessary to be consistent with basic principles of double-entry bookkeeping. That exercise is unwarranted in any event, however, because the annual financial impacts of the Postal Service’s net pension and RHB liabilities are already reflected on the Postal Service’s income statement, in the form of annual expenses for amortization of the unfunded RHB, CSRS, and FERS liabilities (that is, the difference between total liabilities and total assets in each account).

2. The proposed supplemental rate authority already accounts for competitive products

GCA and NPPC et al. find fault in the fact that the proposed net-loss baseline supposedly does not account for competitive products’ contribution to institutional costs, and they propose, at the very least, to allocate responsibility for recovering the net loss between market-dominant and competitive products, in proportion to their shares of total revenue.\textsuperscript{132} However, competitive products’ contribution to institutional costs is already accounted for in the net loss that would be used to set the supplemental rate authority baseline under the Commission’s proposal. Net income or loss is composed of total revenue minus total expenses. Competitive product revenue is included in total revenue; competitive product attributable costs are included in total expenses. Thus, any surplus of competitive product revenue above competitive product attributable costs – in short, competitive product contribution – is embedded within the organization-wide

net income/loss calculation. The Commission’s proposed baseline (as well as alternative baselines offered by the Postal Service and postal labor organizations) would essentially allocate to competitive products the entirety of actual competitive product contribution in the baseline period (e.g., FY2017, in the Commission’s proposal). In FY2017, competitive products provided a contribution of approximately 23 percent of institutional costs.

The Commission’s proposed use of a net-loss figure to set the supplemental rate authority baseline – as well as the alternative net-loss baselines proposed by the Postal Service and postal labor organizations – therefore already accounts for a level of competitive contribution that is far in excess of the “appropriate share” requirement, which underlies objective 9.133 In other words, market-dominant products would not be held responsible for the share of institutional costs that the Commission has (implicitly) found appropriate to “allocate” to them for purposes of objective 9, but rather a lesser share, discounted by the amount by which competitive products overachieved their share. Making market-dominant products responsible for the net loss amount is appropriate: the net loss is not due to a failure on competitive products’ part, but due to

133 In Order No. 4257, the Commission concluded that objective 9 is to be measured by reference to the process for establishing the “appropriate share” of institutional costs that competitive products must cover, in accordance with Section 3633(a)(3) and (b). Order No. 4257 at 243-47. This appropriately recognizes the congruency that Congress built into Sections 3622(b)(9) and 3633(a)(3). See USPS March 20 Comments at 79. To GCA’s alternative argument that objective 9 should have some import beyond cross-referencing Section 3633(a)(3) and (b), GCA Comments at 14-19, the Commission could easily rectify that issue by finding that, while Section 3633 requires competitive products to contribute at least their appropriate share of institutional costs, Section 3622(b)(9) requires the market-dominant ratemaking system to provide enough revenue for market-dominant products to cover any additional amount necessary to ensure financial stability. USPS March 20 Comments at 80. Thus construed, the current system has clearly failed objective 9, but that failure could be remedied through adoption of supplemental rate authority based on a proper net-loss baseline and adjusted for future changes in economies of densities and exogenous costs.
the current market-dominant ratemaking system’s failure to enable market-dominant products to provide sufficient contribution.\footnote{134}

3. A proportional allocation of the net loss would set the very sort of dangerously high contribution requirement that its proponents recently opposed

Rather than appreciate the extraordinary extent to which competitive products would already be assisting market-dominant products under this approach, GCA asks the Commission to make competitive products do even more. By proposing that market-dominant products cover less than the full shortfall in institutional costs after competitive products’ contribution, GCA effectively demands that competitive products continue to furnish not only their actual revenue level (rather than the appropriate share level) from the baseline period, but an additional amount to cover the net loss, in direct proportion to their share of total revenue. GCA computes competitive products’ share of total revenue at 29 percent in FY2017.\footnote{135} Thus, assuming constant volumes and mail mix for simplicity’s sake, competitive products would be responsible for providing approximately $7 billion each year (their actual contribution level in FY2017) plus at

\footnote{134} UPS’s comments, which aim almost entirely at the relationship between market-dominant and competitive products, are unfounded and at times self-contradictory. UPS begins by finding that the current system somehow “failed,” not in terms of any relevant statutory objective, but in “protect[ing] against” alleged cross-subsidization of competitive products. UPS Comments at 1, despite the fact that the Commission’s incremental cost test already “prevent[ed] market dominant products from cross-subsidizing competitive products.” Order No. 4402, Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, PRC Docket No. RM2017-1 (Feb. 8, 2018), at 75; see, e.g., Postal Regulatory Comm’n, Annual Compliance Determination Report, PRC Docket No. ACR2017 (Mar. 29, 2018) [hereinafter “FY2017 ACD”], at 82, 94 (finding that market-dominant products did not unlawfully cross-subsidize competitive products, and rejecting as “not actionable” criticisms of the cost models used to evaluate cross-subsidization). At any rate, UPS’s criticism is undermined by the lack of any proposed solution, perhaps because such costing issues are outside the scope of this proceeding.

\footnote{135} GCA Comments at 10. NPPC \textit{et al.} use a factor of 30 percent, which produces a substantially similar result. NPPC \textit{et al.} Comments at 54-55.
least another approximately $0.8 billion (29 percent of the $2.7 billion FY2017 net loss).\textsuperscript{136}

This would be wrong, and arbitrary and capricious, as a matter of regulatory procedure, policy, and precedent. On a procedural level, it would render moot the entire process for deliberating over the “appropriate share” – the same process that the Commission found to embody objective 9 – by setting a competitive-product contribution requirement far above any minimum contribution level that the Commission has ever considered appropriate. And GCA’s proposed setting of a new, higher competitive-product contribution requirement would be based solely on equity arguments in the context of Section 3622(d)(3), rather than on consideration of the specific factors that Congress expressly required the Commission to account for in setting the appropriate share.\textsuperscript{137} While Congress clearly intended Section 3622(d)(3) to allow the Commission to modify or replace parameters of the market-dominant ratemaking system established under Section 3622, Congress did not intend for the Commission to use Section 3622(d)(3) to sweep aside Section 3633 and the attending body of regulatory practice. Rather, as the Commission found, Congress intended objective 9 and Section 3633 to be read in a congruent manner.

\textsuperscript{136} The latter figure would be even larger if a higher supplemental rate authority baseline were used, as proposed by the Postal Service and other commenters discussed in section IV.A above.

\textsuperscript{137} 39 U.S.C. § 3633(b) (“In making its determination, the Commission shall consider 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.”); Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, § 703(d), 120 Stat. 3198, 3244 (requiring the Commission to “take into account the recommendations of the Federal Trade Commission [regarding Federal and State laws that apply differently to the Postal Service’s competitive products and to private providers of similar products], and subsequent events that affect the continuing validity of the estimate of the net economic effect, in promulgating or revising the regulations required under section 3633 of title 39, United States Code”).
On a policy level, it would be counterproductive to set an unduly high contribution requirement for competitive products. In a separate, ongoing proceeding (Docket No. RM2017-1), the Postal Service has explained why potential future growth is uncertain, given various trends in the marketplace, and why raising the minimum contribution requirement could force the Postal Service to raise prices artificially, triggering a volume decline that only makes it harder to achieve the required contribution level.\(^{138}\) (By definition, competitive products are much more price-elastic than market-dominant products, making the “death spiral” concern far more relevant in the competitive-product arena.) Incredibly, GCA itself, along with many other proponents of a competitive-contribution discount to the baseline in this proceeding, cited the same concerns in opposition to making competitive products responsible for an appropriate share at or above recent actual contribution levels.\(^ {139}\) What is more, GCA and its allies specifically


\(^{139}\) Reply Comments of the Greeting Card Association, PRC Docket No. RM2017-1 (Mar. 9, 2017), at 2 (“[A minimum share requirement] far exceeding any historically achieved result seems almost certain not to [be achievable]. In this connection, GCA, like a number of other commenters, believes that the Commission must take care to avoid forcing the Service into traffic-killing price increases.”); Reply Comments of the National Postal Policy Council, PRC Docket No. RM2017-1 (Mar. 9, 2017), at 5 (“NPPC agrees with commenters that observed that trying to force the Postal Service to recover more in institutional costs from Competitive Products than the market allows would be unsuccessful. . . . Choking off business in the Competitive Products area from a too aggressive target contribution is not in the interests of market-dominant mailers generally, including NPPC members.”); Comments of the National Association of Presort Mailers, PRC Docket No. RM2017-1 (Mar. 9, 2017), at 2 (“We are particularly concerned [that] UPS’s proposal to substantially increase the requirement . . . would compel the Postal Service to raise competitive product prices substantially, jeopardizing the Postal Service’s competitive position in the package delivery market and the substantial contribution that these products make to the Postal Service’s financial position.” (emphasis in original)); Comments of the Association for Postal Commerce, PRC Docket No. RM2017-1 (Jan. 23, 2017), at 6 (“A sudden large change in [the minimum-contribution] requirement could prove disruptive. For instance, if the USPS were to see a sudden decline in shipping volumes due to some exogenous factor, it may feel compelled to increase prices beyond the point where it can compete effectively. Such an outcome would be harmful, not only to users of the USPS[s] competitive products, but it would indirectly harm users of market dominant products as well.”); Comments of Parcel Shippers Association, Alliance of Nonprofit Mailers, American Catalog Mailers Association, Continuity Shippers Association, Data & Marketing Association, Envelope Manufacturer Association, National Association of Presort Mailers, National Newspaper Association, PSI Systems, and
objected to a proposal to allocate institutional costs according to the proportion of revenue: the very proposal that GCA has advanced in this proceeding.\footnote{Reply Comments of the Greeting Card Association, PRC Docket No. RM2017-1 (Mar. 9, 2017), at 2-3 (opposing UPS’s proposal to require competitive products to contribute to institutional costs in proportion to their revenue, and characterizing it as “a fundamental methodological error” and the sort of “a priori pricing rule . . . which is usually thought to produce inefficient prices and which the Commission has repeatedly criticized”); Comments of the Association for Postal Commerce, PRC Docket No. RM2017-1 (Jan. 23, 2017), at 6 (“While use of proportionality based on current contribution or revenue may appear intuitively appealing, PostCom cautions against using such an approach.”); see also Comments of Parcel Shippers Association, American Catalog Mailers Association, Continuity Shippers Association, Data & Marketing Association, Envelope Manufacturers Association, Idealliance + Epicom, PSI Systems, and Stamps.Com, PRC Docket No. RM2017-1 (Mar. 9, 2017), at 2 (agreeing with PostCom and criticizing the proposed proportionality approach as “smack[ing] of fully distributed costing, a method that . . . the Commission, and others, have repeatedly rejected”).}

The Commission only last month expressed the same concern about demanding too much contribution from competitive products.

If the appropriate share level were set too high, the Postal Service would be forced to raise its prices to non-competitive levels in order to meet the minimum contribution required by the appropriate share. At these higher prices, consumers would likely stop using the Postal Service and transfer their volume to cheaper competitors. Depending on the scale of the volume exodus and other factors, the Postal Service may be unable to meet the minimum contribution. If the Postal Service were forced to exit the competitive market, competition in the market would decline, harming consumers and benefiting the Postal Service’s competitors, who would be able to absorb the remaining volume and then set prices higher than the Postal Service had previously charged.\footnote{Order No. 4402 at 50.}

Perhaps most important of all, the Commission agreed with GCA, NPPC, and others in Docket No. RM2017-1 and rejected a proposal to allocate institutional costs according to revenue shares. Such a proposal would be “inherently arbitrary,” “violate[ ] the Commission’s long-standing approach to cost attribution [codified in Section 3622(c)(2)]

Stamps.Com, PRC Docket No. RM2017-1 (Jan. 23, 2017), at 2, 6-7 (“Even leaving the required minimum contribution in place at its current level would be a needless invitation to mischief. . . . Raising the minimum contribution requirement to a level that affects prices is not just unnecessary, it could be harmful. . . . The losers would include the Postal Service’s customers, ultimate consumers, and the Postal Service itself.”).
that necessitates attribution be established through reliably identified causal relationships," and “fail[ ] to maximize economic efficiency because it is not based on marginal cost and does not yield prices reflecting market demand.” Moreover, “[t]he substantial impact that unrelated factors (e.g., a decline in market dominant revenue) can have on the appropriate share under this approach demonstrates the major flaw with this and other approaches that assign costs based on non-causation factors.”

The Commission’s reasoning in Order No. 4402 – which was applied in the course of employing the “mechanism to appropriately allocate between competitive and market-dominant [product categories] as set forth by Objective 9” – is well-founded and directly relevant here. In addition to subverting that objective 9 mechanism as a procedural and statutory matter, GCA and NPPC et al.’s proposal here would be as inconsistent with factor 2 as UPS’s proposal was in Docket No. RM2017-1. Whatever the reason why GCA, NPPC, and other opponents of revenue-based institutional cost allocation appear to have changed their tune in the past year, there is no basis for the Commission to backtrack on its recent rejection, at those same parties’ behest, of just such a proposal.

142 Id. at 81-82 (citations omitted). While the Commission made these remarks in connection with a separate proposal to set the appropriate share level according to competitive products’ share of attributable costs, the criticisms apply equally to the revenue-share proposal, which the Commission found “suffers from similar weaknesses.” Id. at 82.

143 Id. at 82.

144 Order No. 4257 at 246 (emphasis omitted).
4. Predictions about competitive product growth provide no basis to truncate the supplemental rate authority baseline

Nor is there any basis to discount the net-loss baseline on the basis of an arbitrary and dubious forecast of competitive products’ revenue growth, as GCA also proposes.\textsuperscript{145} The point of the proposed supplemental rate authority is to reset rates to total costs going into the new system, in keeping with established regulatory practices of price-cap calibration. (The fact that the Commission proposes to distribute this reset across multiple years, rather than in a one-time true-up, does not alter the underlying principle.) Future changes in the assumptions underlying the rate-resetting baseline tend to be dealt with through adjustment factors that pick up those changes after they are known, similar to what the Postal Service and Public Representative have proposed.\textsuperscript{146} If the intent were not to establish a starting point based on the actual financial situation in the baseline year or period, but to set the baseline according to a reasonable expectation of performance during the new-system period, then the Commission would have to forecast a number of factors that will influence market-dominant products’ future contribution to institutional costs: volume changes, mail mix changes, network growth, operating expenses, and so forth, in addition to competitive-

\textsuperscript{145} GCA Comments at 10. ANM \textit{et al.} and NMA also advance arguments based on competitive products’ past growth trend, although their conclusion is that the supplemental rate authority should be abolished, rather than discounted. Because of the similarity to GCA’s position, this section will also address ANM \textit{et al.}’s more detailed argument.

\textsuperscript{146} They may also be addressed through a reopening of the price cap, as NALC and Netflix have proposed, although an adjustment mechanism avoids the uncertainty and litigation burden involved in a reopening of the ratemaking system. See footnote 58 \textit{supra}. 
product revenue growth. There is no reason why the Commission should go down the path of predicking the regulatory system on forecasts.

GCA, ANM et al., and NMA misleadingly characterize the Commission’s proposed net-loss baseline as setting an assumption of zero competitive product growth. But the point of the supplemental rate authority is not to prescribe a vision of financial performance for the next several years. Rather, the point is to reset rates to compensatory levels going into the new system (in a phased manner), while remaining neutral as to the future trajectory of competitive product growth and other variables. And that trajectory is substantially uncertain.

The sponsors of the ANM et al. comments should be well aware of these circumstances: indeed, ANM and ACMA previously urged the Commission not to allocate to competitive products even a level of institutional costs “comfortably below current levels,” because

[market conditions – such as the state of the economy, pricing strategies of private carriers, and customer needs (e.g., volumes, service requirements, package characteristics) – change, often without warning and with a potential effect on the Postal Service’s ability to generate contribution. Indeed, because private carriers are major users of Postal Service competitive products for last-mile delivery, these companies have the power to reduce the share of institutional costs paid for by competitive products. For strategic or operational reasons, a competitor could simply

147 While some foreign postal regulators have used cost and volume forecasts to set their price cap formulas, those forecasts inhere a significant risk of error and may require ongoing adjustment to the price cap, which can be complex and controversial. See USPS March 20 Comments, app. E at 19, 21-23, 28.

148 ANM et al. Comments at 67, 73-75; GCA Comments at 6-7, 9-10, 33; NMA Comments at 5.

149 Initial Comments of the United States Postal Service, PRC Docket No. RM2017-1 (Jan. 23, 2017), at 12-17. GCA’s consultant NDP Analytics mistakenly quotes a remark about future competitive product revenue growth from the Postal Service’s FY2017 Annual Report to Congress. GCA Comments, app. A at 3 (quoting United States Postal Serv., FY2017 Annual Report to Congress (2017), at 23). But that remark’s context extends no farther than the next year’s financial plan, not the five-year period of NDP Analytics’ “simulation” or the more generic “coming years” that NDP Analytics evokes. Id. at 3-5.
shift a portion of its package volumes from Postal Service delivery to its own delivery networks.\(^{150}\)

Given this acknowledgment of competitive products' future headwinds in opposing a higher minimum contribution requirement for competitive products, it is disingenuous for these parties now to claim that the recent trend line alone is "the best evidence of record available today" as to what Commission should expect from competitive products in the coming years, or that speculative overall growth in the e-commerce market will boost the Postal Service commensurately with other providers.\(^{151}\) Indeed, the rate of competitive product growth has been trending down in recent years, which demonstrates that the market is becoming even more competitive.\(^{152}\) As such, the Commission cannot assume that even the levels of contribution from competitive

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\(^{151}\) ANM et al. Comments at 72-74. ANM et al. misleadingly tie the continuation of "these" competitive product contribution trends to predictions of growth in the overall e-commerce market, id. at 72, but such a causal link cannot be taken for granted. As for ANM et al.'s citations to railroad-regulation cases, those references are inapposite. First, the cases cited involve federal railroad regulators' application of a stand-alone cost test and have no direct relevance in this proceeding: in evaluating and modifying or replacing the market-dominant ratemaking system, the Commission has never articulated its task in terms of "simulat[ing] a competitive rate standard for non-competitive [mail] movements by determining the rate that would be available to shippers in a contestable market environment." Bituminous Coal–Hiawatha, Utah to Moapa, Nevada ("Hiawatha"), 10 I.C.C. 2d 259, 266 (1994); \textit{but see} Order No. 4257 at 243-47 (holding that objective 9 is to be measured according to the process for setting competitive products' "appropriate share" level); Order No. 4402 at 80-81 (rejecting a proposal to set the appropriate share level according to a stand-alone cost test). Second, while ANM et al.'s summary of the relevant portion of \textit{Burlington Northern Railroad Co. v. Surface Transportation Board}, 115 F.3d 206 (D.C. Cir. 1997), is correct as far as it goes, \textit{see} ANM et al. Comments at 74 fn.43, the commenters neglect to mention that the regulator rejected the railroad’s competitive revenue projections in that case for lack of "evidence of [customers'] alleged competitive options." \textit{Burlington Northern}, 115 F.3d at 213. And in \textit{Hiawatha}, the railroad’s customer presented competing volume forecasts, which the regulator ultimately found to be more reliable. 10 I.C.C.2d at 269-71. By contrast, the headwinds facing the Postal Service's competitive products are not merely conjunctural, but uniformly attested in media reports and stipulated by mailers, including ANM et al., and the Postal Service alike in Docket No. RM2017-1.

\(^{152}\) ANM et al.'s own data indicates that the annual growth rate in competitive product contribution dropped from 33 percent in FY2016 to 19 percent in FY2017 and suggests that it will drop still further, to 15 percent, in FY2018. \textit{See} Library Reference ANM et al.-LR-RM2017-3/4, Microsoft Excel file "ANM et al.-LR-RM2017-3-4.xlsx", tab "Figures 6 & 7", cells D4-D7. Meanwhile, the growth rate in competitive product volumes fell from 14 percent in FY2015 to 13 percent in FY2016 and 11 percent in FY2017. \textit{See} USPS FY2017 Form 10-K at 21; USPS FY2015 Form 10-K at 18.
products previously achieved will continue, much less assume continued growth in contribution levels.

In this environment of uncertainty, any attempt to forecast competitive product growth is necessarily arbitrary. An assumption that competitive product revenue will continue to grow at the recent-historical rate is no less arbitrary than a “conservative” assumption that they will grow at only half that rate. As the history of the current system shows, to establish a forward-looking ratemaking system on the basis of historical volume growth trends is to invite folly. The stakes – the Postal Service’s financial stability, the balance of ratepayers’ short- and long-term interests, and the Postal Service’s opportunity to compete fairly – are simply too high for the Commission to engage in such guessing games.

5. The Postal Service’s proposed adjustment mechanism accounts for changes in competitive product contribution

While competitive products’ future trajectory cannot be predicted with certainty at this time, it is understandable that the Commission, going forward, might want to account for how “growth of Competitive Product revenue could significantly reduce the

153 GCA Comments at 10 & app. A at 5. GCA oversells its own consultant’s study as reflective of “probable growth in the competitive sector” and “a good basis [to] redesign” the proposed supplemental rate authority; the consultant describes the study as merely an “illustrative” “simulation.” Compare id. at 10-11 with id., app. A at 1. It also bears noting that GCA and its consultant fail to account for the effect of product transfers on reported competitive product revenue and contribution during the FY2010-FY2017 period that they study.

154 Order No. 4258 at 35-38 (“Given this environment [of rising overall mail volume and a stable financial condition], 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. . . . The sudden divergence in total Postal Service expenses and revenues and the CPI index [during the Great Recession] made it extremely challenging for the Postal Service to manage retained earnings through sustained net income.”); see also Order No. 4402 at 49 (deeming it “important” for an allocation of institutional cost to competitive products “to incorporate such changes” as the “significant innovative developments and changes in e-commerce and the delivery industry” that have arisen in recent years).
amount needed” to break even in future years.\textsuperscript{155} Of course, any such accounting should be symmetrical, in the event that market conditions cause competitive-product revenue to fall below the level reflected in the net-loss baseline. And it should be based on actual, publicly reported results, not on guesses about the future.

That is one more reason to adopt the Postal Service’s proposed mechanism to adjust available rate authority for economies of density.\textsuperscript{156} The organization-wide variable for revenue-weighted volume picks up changes in the mail mix between competitive and market-dominant products, as well as within each category. And by multiplying that variable by the ratio of institutional costs to total costs, the formula would home in on the change in the two categories’ relative contributions to institutional costs. As noted in section III.A above, the Postal Service’s proposed adjustment mechanism applies objectively and automatically, on the basis of actual data reported months, or even a year or more, in advance of any price change based on the rate-authority adjustment. As such, it would be designed to achieve objectives 2 and 6 far better than Netflix’s proposal of continual litigation over the impact of competitive product growth.\textsuperscript{157} Under the Postal Service’s formula, competitive product growth would have a moderating effect on any upward price-authority adjustment resulting from the mechanism, thereby allowing market-dominant mailers to share directly in the benefits from that growth.

\textsuperscript{155} Netflix Comments at 6. Netflix does not account for the possibility that the goal of financial stability should not necessarily be limited to breakeven: that is, that competitive product growth should be allowed to result in profits.

\textsuperscript{156} See USPS March 1 Comments at 71-74.

\textsuperscript{157} See Initial Comments of Netflix in Response to Order No. 4258, PRC Docket No. RM2017-3 (Mar. 1, 2018), at 11-12.
C. Calls to Tie the Supplemental Rate Authority to Productivity Miss the Point

Several commenters argue that the Commission’s proposed supplemental rate authority should not be granted unconditionally. Instead, they argue all new forms of rate authority should be tied to productivity gains that the Postal Service achieves in order to incentivize the Postal Service to increase efficiency.\textsuperscript{158} Leaving aside the already-established problems with the Commission’s proposed approach to TFP benchmarking,\textsuperscript{159} this argument misunderstands the nature of the proposed supplemental rate authority and is inconsistent with regulatory best practices.

The Commission’s proposal to authorize supplemental rate authority of 2 percentage points above CPI is not akin to a productivity offset, or an “X-factor,” that modifies the CPI-based price cap. Instead, the 2 percentage points of authority is the Commission’s proposed solution to the fact that existing rates are – and have been – non-compensatory. In other words, the supplemental rate authority is simply a rate recalibration typical of price-cap systems. Unlike other rate resets, however, the Commission decided to phase it in over a five-year period rather than authorizing it as a one-time rate adjustment. If anything, regulatory practice supports calibrating rates not merely to breakeven, but to a level reflecting a reasonable income level above breakeven. That is the point of the additional 1 percentage point of proposed rate authority. Apart from those two forms of rate-resetting (and other adjustments to bring

\textsuperscript{158} See ANM \textit{et al.} Comments at 3, 5, 33-34, 36-40; Comments of the Consumer Postal Council, PRC Docket No. RM2017-3 (Mar. 1, 2018), at 2; DMA Comments at 6; Infotrends, \textit{Exploring Mail Volume Impact from the PRC’s Proposed Rate Structure} (Feb. 2018), at 4 (attached to EMA Comments); NMA Comments at 9-10; NPPC \textit{et al.} Comments at 15-18, 70-76; Quad/Graphics Comments at 2; UPS Comments at 4-5 (proposing to make half of all above-CPI pricing authority conditional on above-benchmark TFP improvement); Valpak Comments at 8-11.

\textsuperscript{159} See USPS March 1 Comments at 86-89, 96-112.
other non-compensatory rates for “underwater” classes up to compensatory levels), the Commission’s fundamental proposal is to retain the CPI-based cap going forward. While the level of the rate reset is deficient for the reasons set forth in the Postal Service’s March 1 comments, the “+2%” in the proposed “CPI+2%” is not intended as a productivity-adjusting X-factor.

Because the supplemental rate authority is not designed as a going-forward adjustment to the price cap, there is no basis for the commenters’ claim that it should somehow be tied to the Postal Service’s productivity. Price-cap regulatory models, whether containing a productivity offset or not, work only when the going-in rate level is compensatory. This is often not an issue, as price-cap systems generally succeed cost-of-service regulation, in which existing rates have already been set to fully compensatory levels. That is why it is common to see statements that price-cap regimes use “existing” rate levels as a starting point. However, where, as here, the existing rate level is non-compensatory, a cost-based reset at the beginning of the new regulatory period is needed in order for the system to achieve its purposes. There is nothing particularly controversial about that approach as a matter of price-cap theory and practice. Because a reasonable going-in rate level is a cornerstone of any price-cap regime, there is no basis for an argument that the Postal Service must be somehow “incentivized” to achieve it or that setting such a level should be conditioned on future productivity gains. If anything, an unconditional rate-reset is especially warranted here, where all evidence and the Commission’s own findings indicate that the shortfall results not from Postal Service inaction or extravagance, but from exogenous legal constraints
and market trends that overwhelmed the Postal Service’s aggressive efforts to reduce costs. Accordingly, the commenters’ objections are unfounded.

The commenters’ objections are flawed for a second reason. It is simply not the case that price-cap models contain a productivity offset that invariably reduces a firm’s rate authority below CPI going forward. In other words, even in regulatory systems where the price cap is formulated as “CPI–X,” it is not always the case that the X-factor results in a downward adjustment for anticipated productivity gains. That is often how it works, at least with respect to capital-intensive industries with growing revenues or meaningful opportunities for increased efficiency above that of the economy as a whole. However, in industries with declining demand (and declining density due to externally driven network growth) or where the regulated firm’s or industry’s cost structure varies from that of the average firm reflected in the chosen inflation index, the X-factor offset may be positive (that is, “X” may have a negative value, which, through double-negation, would allow above-inflation price increases). And it may itself be offset by allowances for the regulated firm’s specific capital needs and for costs over which the

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160 ANM et al. Comments at 53-54; Netflix Comments at 20-21; ACI Comments at 3.

161 USPS March 20 Comments, app. E at 18 (“The cost adjustment [in the Federal Energy Regulatory Commission’s price cap for oil pipelines] can be positive or negative, depending on the relationship between pipeline costs and the [Producer Price Index for Finished Goods (PPI-FG)]. Initially, the cap was set at PPI-FG−1[%] for the 1995-2000 period. Currently, the index for the 2016-2021 period is PPI-FG+1.23%.” (citation omitted)); id., app. E at 22-23 (discussing how the CPI–X price cap for La Poste has consistently allowed for above-inflation price increases, resulting from how the X-factor formula reflects expected rates of change in consumer inflation, revenue-weighted mail volume, and efficiently-incurred costs); see also id., app. F at 24-27 (further explanation about the French postal price cap); cf. also id., app. F at 35-36 (recounting how a change in governing law regarding the relevant rate-of-return metric led the German postal regulator to revise the price cap from CPI–0.2% to CPI+1.9% per year). Although the above-CPI German price cap is probably only a one-time transitional event, id., app. F at 35 fn.138, it bears noting that the underlying change in governing law was premised on recognition of the differences in cost structure between Deutsche Post and the average German firm, such as Deutsche Post’s relative labor-intensity, its declining economies of density, and the need to support universal postal service. Id., app. F at 35.
regulated firm has no control. The Postal Service is significantly more labor-intensive than the average firm in the economy, and it must contend with declining economies of density, as well as a statutory structure that, as the Commission has recognized, constrains its ability to cut costs. As such, an X-factor of zero, which the current and proposed price-cap systems effectively incorporate, is already an aggressive productivity target.

Finally, ANM et al. are off-base in their suggestion that allowing above-CPI rate increases necessarily leads to productivity declines. Although ANM et al. discuss other foreign posts for a separate point about above-inflation price increases, their claim about a “chilling” “breakdown of . . . cost discipline” as one of “the problems stemming from lax regulation” draws on a single example: Royal Mail. And Royal Mail is a particularly poor example from which to derive any general conclusions about the supposed effect of regulatory mode on operational efficiency.

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163 See ACI Comments at 3; Brennan 2017 Declaration at 6.

164 ANM et al. Comments at 50-52; see also Comments of Alliance of Nonprofit Mailers, Association for Postal Commerce, and MPA—The Association of Magazine Media, PRC Docket No. RM2017-3 (Mar. 20, 2017), at 65-66. ANM et al.’s only other attempt to tie above-inflation price increases to other harms is contradicted by the same source that ANM et al. cite for that point. Compare ANM et al. Comments at 50 (claiming that Australia Post’s “service quality has declined”), with United States Postal Serv. Office of the Inspector Gen., RARC-WP-17-003, Lessons in Price Regulation from International Posts (Feb. 8, 2017) [hereinafter “OIG Foreign Post Report”], at 25 (Figure 3) (showing that Australia Post’s service performance for regulated letters was above-target every year since 2007 and that, after some interim decline, it returned to approximately the peak level in 2016). Incidentally, the same report shows that Royal Mail’s service performance was at or close to target levels since the shift away from a price cap in 2012, but erratic and often significantly below-target during the price-cap era. OIG Foreign Post Report at 42 (Figure 19).
A more extensive reading of the WIK-Consult report that ANM et al. cite shows that Royal Mail has lagged other postal operators – including the Postal Service – for years in operational efficiency, not only after the 2012 change in regulatory model, but for the entire duration of the U.K. postal price cap. Royal Mail did not begin its “breakthrough productivity”-type efficiency program in response to volume declines until 2008.\footnote{WIK-CONSULT, REVIEW OF THE PROJECTED COSTS WITHIN ROYAL MAIL’S BUSINESS PLAN x (2016), https://www.ofcom.org.uk/__data/assets/pdf_file/0019/72145/projected-costs-review.pdf.} Notwithstanding the theoretical efficiency incentives of its price cap, Royal Mail waited to adopt automated delivery-sequence sortation for more than a decade after the Postal Service – then operating under cost-of-service regulation and with rising volumes – led the world in doing so in the mid-1990s.\footnote{Id. at 48. Royal Mail’s late adoption of automated sequencing produces other inefficiencies: for instance, the ratio of carriers’ in-office to street time is approximately twice as high for Royal Mail as for the Postal Service. Id.} And a decade under a price cap did not inspire Royal Mail to adopt two-tier wage schedules, as the Postal Service and other postal operators have: as of 2016, Royal Mail still did not plan on doing so.\footnote{Id. at 70, 76, 100-101, 110.} Not only does Royal Mail’s efficiency lag show that its inefficiencies have nothing to do with the shift in regulatory model, it also highlights, by contrast, how many efficiency improvements the Postal Service has already undertaken and how few opportunities remain. Whatever marginal room for further regulatory incentives might exist in theory, it is outweighed by the risk that an unduly rigid regulatory system would pose to financial stability.

Finally, ANM et al. leave out the most important part of the story. WIK-Consult’s report was not designed to evaluate or compare Royal Mail’s efficiency improvement
before and after regulatory reform. Rather, it was intended to evaluate Royal Mail’s forward-looking efficiency plan, in order to inform U.K. regulator Ofcom’s judgment about whether to continue its existing regulatory approach or adopt a different model (such as reimposing a price cap). In the end, neither WIK-Consult’s criticism that Royal Mail’s plans were “less ambitious than its peers” nor Ofcom’s own findings about Royal Mail’s greater-than-forecasted efficiency potential deterred Ofcom from finding that monitoring of efficiency was adequate to ensure continued progress. After considering arguments that a renewed price cap or explicit efficiency targets were necessary to incentivize efficiency gains, Ofcom rejected those arguments. Specifically, it found that any theoretical benefits would add little to incentives already inherent in a market environment marked by strong volume declines, and such benefits did not outweigh the risks to financial stability that more stringent regulation would bring in a time of market decline. The Commission should follow Ofcom’s reasoned example.

D. The Postal Service’s Proposed Adjustment Mechanism for Economies of Density Is More Comprehensive than the Public Representative’s Proposal

If the Commission retains a price cap in the new system, that price cap must correct the root cause of the current system’s shortcomings: Congress’s failure to account for demand declines that would sap the Postal Service’s ability to cover (growing) total costs with constant (inflation-adjusted) prices. Declining demand and

\[^{168}\text{id. at viii, xv, 1-7.}\]
\[^{169}\text{id. at xv-xix, 89, 92-93, 99-100, 109-12.}\]
\[^{171}\text{id. at ¶¶ 3.169-.176, .180.}\]
rising network costs are not within the Postal Service’s control, and so it is not just or reasonable to force the Postal Service to bear the combined effect on its average unit cost. A mechanism is needed to “maintain the USPS’s net revenue position when demand falls” (or rises).172

Two proposals for such an adjustment mechanism are before the Commission. First, the Postal Service has proposed a straightforward formula drawn from a 2013 report by the U.S. Postal Service Office of the Inspector General, in conjunction with Christensen Associates.173 That formula adjusts all other forms of rate authority (i.e., CPI-based, banked, supplemental, additional, and underwater-class rate authority) for the effect on the Postal Service’s ability to cover institutional costs from (1) changes in total volume, (2) changes in the mail mix (that is, volume shifts between types of mail with differing levels of revenue and differing levels of contribution to institutional costs), and (3) changes in the size of the delivery network.174 The first two items are combined in a measure of total revenue-weighted volume. (As discussed in section IV.B.4 above, using organization-wide revenue-weighted volume allows the formula to account for changes in the mail mix between the market-dominant and competitive product categories, as well as within the market-dominant category.) A comparison with the other approach will show why this is “[t]he most comprehensive formula” for this purpose.175

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172 Brennan 2017 Declaration at 24. An adjustment mechanism is also needed to track changes in RHB and pension expenses, which, like the Postal Service’s economies of density, are outside of its control. See USPS March 1 Comments at 74-77.


174 USPS March 1 Comments at 71-74.

175 Id. at 71.
The second formula was presented in the March 20, 2017, declaration of Timothy J. Brennan, which the Public Representative sponsored. Like Christensen Associates, Dr. Brennan set out to design a formula that would hold revenue constant for changes in demand. Dr. Brennan’s proposed formula consists of three factors: (1) change in demand; (2) the elasticity of average cost with respect to volume, approximated by the ratio of (a) market-dominant products’ contribution to institutional cost over (b) total market-dominant cost, for which Dr. Brennan (without explanation) uses market-dominant revenue as a proxy; and (3) an adjustment for the price elasticity of demand, so that the factor can yield the intended amount of revenue notwithstanding its effect on volume.\footnote{Brennan 2017 Declaration at 14-24.} While Dr. Brennan’s formula would be better than no adjustment at all,\footnote{See USPS March 1 Comments at 74 fn.184.} each factor poses distinct conceptual problems.

With respect to the first factor, Dr. Brennan originally proposed that change in demand be limited to changes outside the Postal Service’s control, and that the factor be adjusted for demand response to changes in service quality.\footnote{Brennan 2017 Declaration at 14, 21.} In the same declaration, however, Dr. Brennan illustrated the formula using the overall change in volume, without attempting to make such adjustments.\footnote{Id. at 19.} In his supplemental declaration, Dr. Brennan confirms that the (unadjusted) overall change in volume is the appropriate measure, due to the Commission’s determination in Order No. 4258 that service quality can be monitored through regulatory means outside of the price cap and,
perhaps, due to the lack of any established method to account for theoretical changes in so-called quality-adjusted or hedonic price.\textsuperscript{180} Moreover, as the tortuous history of the exigent case shows, any effort to make annual price adjustments contingent on the cause of volume changes will almost certainly invite complex litigation over econometric analyses and disputes over the standard of causation and burden of proof.\textsuperscript{181} The best approach, on this particular point, is to use the overall change in volume, consistent with Christensen Associates’ recommendation and Dr. Brennan’s examples.

As for the second factor – elasticity of average cost – it should be noted that the term is something of a misnomer. The ratio that Dr. Brennan employs does not actually relate to average cost; rather, it compares contribution to revenue.\textsuperscript{182} Although Dr. Brennan does not expressly explain the substitution, it appears to rest on certain assumptions, such as that contribution equals fixed cost (or institutional cost, as a close


\textsuperscript{181} See, e.g., Order No. 1926, Dissenting Opinion of Vice Chairman Robert Taub, at 1-4 (recounting the history of the Commission’s shifting standards for attributing causation for volume losses, and the impact of that history on the Postal Service’s ability to recover the contribution lost as a result of those volume losses). The Public Representative is too glib in his assumption that the exigent case, which concerned much-disputed distinctions among exogenous sources of volume change and left a substantial amount of volume losses unattributed (and therefore unrecovered by the Postal Service), resulted in a conclusive “decomposition methodology” that can be applied without further ado. \textit{See} Comments of the Public Representative, PRC Docket No. RM2017-3 (Mar. 21, 2017), at 53-54.

\textsuperscript{182} It would be problematic if the formula were to use the ratio of market-dominant contribution to market-dominant products’ share of total costs. While, by definition, there is no economically sound way to attribute institutional costs, objective 9 requires the Commission to determine the appropriate amount for which market-dominant products are to be responsible. Market-dominant products’ share of total costs could hypothetically be computed (or imputed) on the basis of their attributable costs and total institutional costs net of competitive products’ contribution (either actual contribution or the appropriate share). Formulated thus, any increase in competitive-product contribution (or appropriate share) would decrease the denominator of the ratio, thereby increasing the ratio’s value and, with it, the size of the market-dominant price adjustment. Contrary to the expectation of maintaining constant coverage of institutional costs, a rise in competitive product contribution would paradoxically result in an increase, not a decrease, to a Brennan-formula-based market-dominant price adjustment.
analogue). Such assumptions do not necessarily hold in the real world, however: a major problem that the Commission is attempting to solve is the fact that the Postal Service is not in a breakeven condition, and market-dominant product contribution (combined with competitive product contribution) is significantly lower than institutional cost. If the ratio were to take the form of a static number derived from the non-compensatory going-in cost-coverage ratio, then the formula would merely maintain contribution at the original, insufficient level. To have its intended effect in the context of a phased true-up, the formula would have to be dynamic, with the ratio being recomputed every year, at least until market-dominant rates have reached the intended breakeven point and made up for their below-breakeven status in the early years of the phase-in.184

The contribution-to-revenue ratio has a more fundamental conceptual shortcoming. By using single-year values in the ratio and applying them to the year-over-year change in (unweighted) volume, the ratio does not compensate for the effect of year-over-year mail-mix changes on rates’ ability to cover institutional costs. If anything, the formula could reflect such changes in a perverse way. By including contribution in the numerator of the ratio, the ratio and, with it, the formula’s overall price

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183 Brennan 2017 Declaration at 16. Indeed, the earlier analysis by Dr. Brennan and Michael Crew, from which Dr. Brennan’s cap adjustment proposal was derived, started with a breakeven condition in which fixed (institutional) costs were assumed to be constant. See generally Timothy J. Brennan & Michael A. Crew, Price Cap Regulation and Declining Demand, in The Future of the Postal Sector in a Digital World 1 (Timothy J. Brennan & Michael A. Crew eds., 2016). At breakeven, total revenue will necessarily equal total cost.

184 The same point applies to Dr. Brennan’s revised proposal of class-level adjustment factors. Brennan 2018 Declaration at 7-9. If each class’s ratio were set at a static level as of the going-in point, then those contribution rates are what the formula would maintain throughout the period, regardless of whether the inter-class relationships in contribution levels are appropriate. Id. at 10. A dynamic ratio (that is, one that is revised each year) would pick up the impact of price changes aimed at rebalancing contribution levels across classes.
adjustment shrinks as revenue shifts from higher- to lower-contribution products.185 This would amplify, not compensate for, the effect of demand shifts on rates’ coverage of average costs. The Christensen formula would avoid this problem by accounting for the mail mix in the revenue-weighted volume term and by using the ratio of institutional cost to total cost, not a contribution ratio, to adjust for the effect on institutional cost coverage.186

Then there is the formula’s product scope. In his original declaration, Dr. Brennan illustrated the cap authority provided by his formula using the ratio of total market-dominant contribution and revenue. Although he framed the formula in terms of “declining demand for market-dominant services,” he actually used organization-wide volume change in his illustration.187 Dr. Brennan later illustrated a more internally consistent application of his formula at the market-dominant class level.188 Leaving aside the inconsistencies between and within the versions of Dr. Brennan’s proposal,

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185 This observation applies only with respect to changes in mail mix within the ratio’s scope, not across categories. If the ratio applies at the market-dominant-wide level, then it will pick up shifts in contribution among market-dominant products and classes, but not between the market-dominant and competitive categories. Similarly, if the ratio applies at the market-dominant class level, then it will pick up shifts in contribution within each class, but not between classes.

186 As an additional, minor technical issue, Dr. Brennan states that the conceptually appropriate measure would be a price-to-marginal-cost markup ratio, for which the ratio of contribution over attributable (incremental) cost to revenue is a proxy. Brennan 2018 Declaration at 6-7. Dr. Brennan does not explain why he does not use volume-variable costs (VVC), which are equivalent to the product of marginal costs and volumes. VVC are clearly reported in the Postal Service’s annual Cost and Revenue Analysis reports. If the Commission were to adopt Dr. Brennan’s cap adjustment notwithstanding the more significant conceptual problems outlined here, it should use \(\frac{\text{Revenue} - VVC}{\text{Revenue}}\) in place of the contribution-to-revenue ratio.

187 Dr. Brennan used 27 percent as the value for this factor, which represents the change in total mail volume, not just market-dominant mail volume, between FY2006 and FY2015. Brennan 2017 Declaration at 19 (referencing Laying Out the Reality of the United States Postal Service: Hearing Before the Senate Comm. on Homeland Security & Govtl. Affairs, 114th Cong. at 114 (Jan. 21, 2016) (written testimony of Lori Rectanus, Director, Physical Infrastructure Issues, Government Accountability Office). But see id. at 10 (“This Declaration, however, is focusing on a fourth issue: declining demand for market dominant services.” (emphasis in original)).

188 Brennan 2018 Declaration at 7-9.
the use of a market-dominant-specific volume factor may be less desirable, as it would fail to reflect the potentially offsetting effects of competitive volume trends. The use of an organization-wide volume factor would capture those effects, and in doing so it would reduce the additional cap authority for market-dominant products to the extent competitive volumes continue to grow. As noted earlier, however, the organization-level volume would need to be weighted by revenue to capture the true effect of the shifting mail mix on institutional cost contribution.

All of these issues can be addressed by measuring the change in revenue-weighted volume (not the count of mailpieces) at the organization-wide level (not just the market-dominant basket or the market-dominant class level) and weighting it by the annual ratio of institutional cost to total cost (not contribution to revenue, and not a static ratio as of the going-in point). In other words, the Brennan formula, properly reformed, is identical to the volume-related portion of the Christensen formula. The remaining difference between Dr. Brennan’s adjustment, applied at the organization-wide level, and the Christensen adjustment is a factor that Brennan overlooks: growth in delivery points, which drives growth in network-related costs and, like demand shifts, is beyond the Postal Service’s control. Since it was derived from a framework in which institutional costs are considered fixed rather than growing with the Postal Service’s network, Dr. Brennan’s formula contains no term to capture such exogenous growth in institutional costs. Hence, while a refined version of the Brennan formula could appropriately adjust for the specific impact of demand declines, the Christensen formula already does a more comprehensive job of ensuring that the intended value of rate authority is maintained amid changes in overall economies of density.
E. The Commission Should Not Decide What to Do in Year 6 at This Time

Several commenters contend that, under the “phasing-in” approach to supplemental rate authority proposed in Order No. 4258, the rate level at the beginning of the next regulatory period – that is, from the sixth year onward – may begin recovering more revenue than is needed to achieve financial stability.\(^\text{189}\) This concern will not arise as a practical matter under the Commission’s current proposal and, even if it appears that rates must be adjusted at the beginning of the next regulatory period, the time to address that concern is then and not now.

This issue stems from the Commission’s decision that rates must be reset to allow recovery of an additional $2.7 billion per year (on average) over the next five years.\(^\text{190}\) Specifically, the commenters’ objections arise from the Commission’s proposal to allow the Postal Service to recover that amount through rate increases phased in over a five-year period (such that the Postal Service would recover less than $2.7 billion annually in the earlier years and, in theory, more than $2.7 billion annually in the later years) rather than through a one-time rate increase (which, again in theory, would allow the Postal Service to recover the same amount of supplemental revenue during each year of the period).\(^\text{191}\) The chosen phase-in approach results in rates that are higher at the end of the five-year period (but lower at the beginning) than they would have been under the “one-time rate increase” approach. Because rates in the sixth

\(^\text{189}\) See NPPC et al. Comments at 59-62; Netflix Comments at 12-19.

\(^\text{190}\) As explained at length in the Postal Service’s March 1 comments, and as reiterated in Section IV.A above, $2.7 billion is far below the amount needed for a reasonable rate reset. But the commenters’ argument concerns the implementation schedule, and not the amount of the rate authority.

\(^\text{191}\) “In theory” is used here advisedly, because the Commission’s analysis assumes that mail volume will be flat during this entire five-year period, an assumption that the Commission otherwise recognizes is almost certainly incorrect. Order No. 4258 at 42-43.
year are higher than they would have been, the theory goes, the rates could potentially be excessive.

While the commenters’ objection arises entirely because the Commission chose the phase-in approach rather than the one-time approach, the commenters do not suggest that the Commission adopt the one-time approach instead, even though taking that step would wholly solve the theoretical “problem.” Instead, the commenters propose either to convert the supplemental rate authority to a reversible surcharge in the later years,192 or to have it phase in over a longer time period.193 These “solutions” will only exacerbate the fundamental flaw in the Commission’s proposal: that it does not give the Postal Service a meaningful opportunity to achieve medium-term financial stability, and thus cannot accomplish the proposal’s own articulated goal.

In any event, this is not a problem in need of a solution. While it is true that Commission’s chosen approach would permit rate levels in Year 6 to be higher than they would be if the rate authority were redistributed in a one-time increase (and if the Postal Service chose to exercise that authority), it does not follow that rates are likely to be excessive at the end of the regulatory period under the Commission’s proposal. As discussed in the Postal Service’s March 1 comments, the Commission’s proposal does not come close to giving the Postal Service a meaningful opportunity to cover its net losses over the next five years, and so there is no practical danger of “over-recovery” in Year 6. If anything, the rates will merely under-recover to a lesser degree than they otherwise would. So, whatever merit there is in the theoretical principle that mailers

192 Netflix Comments at 18.
193 NPPC et al. Comments at 62.
should not be forced into “paying extra after a financial problem has been remedied,” or that the Postal Service not be allowed to “substantially over-recover” through supplemental rate authority, there is virtually no danger that the Commission’s proposal will produce such a result.

Over-recovery in Year 6 is unlikely even if the Commission adopts the Postal Service’s proposal of a more reasonable rate-resetting baseline and adjustments for some of the exogenous factors that would otherwise erode the intended value of the supplemental rate authority. In the event that the prospect of over-recovery in Year 6 does arise in the real world, however, the time to revisit any possible excessiveness in rates (and to make any corresponding adjustments) is at the end of the regulatory period, and not the beginning. The end of the period will coincide with the Commission’s next planned Section 3622(d)(3) review, which will include, among other things, whether rates are excessive (objective 8). The Commission certainly should not curtail the Postal Service’s available pricing authority now based on theoretical concerns that will arise, if at all, more than five years from now.

V. ADDITIONAL, ABOVE-BREAK-EVEN RATE AUTHORITY IS NECESSARY FOR MEANINGFUL FINANCIAL STABILITY

A. The Postal Service’s Levels of Liquidity Are Not Adequate

While the supplemental authority seeks to address the coverage of the Postal Service’s total costs, the financial-stability objective also requires the Postal Service’s pricing authority be “adequate” to enable it to achieve positive net income and, consequently, to build and maintain adequate liquidity levels. In a nod to the

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194 Netflix Comments at 19.
195 NPPC et al. Comments at 62.
Commission’s “harmonious cycle” concept and to similar mechanisms in other regulatory contexts, the Postal Service’s March 1 comments used the term “capital funding mechanism” as shorthand to indicate that the additional rate authority need not and should not be conditional. As the Postal Service noted in its initial comments, the current system forces the Postal Service to make capital spending decisions in an environment in which it is amassing net losses and has exhausted its borrowing authority and has only a limited amount of financial reserves to account for contingencies.\(^\text{196}\) Indeed, because of the financial instability caused by the current system, the Postal Service was forced to curtail capital spending for a period of time. While the Postal Service has chosen to increase capital spending since that time (by prioritizing such spending over other statutory obligations), the only way to truly assure the Postal Service’s continued ability to make needed capital investments as circumstances change is by providing the Postal Service with sufficient authority to achieve financial stability. The Postal Service therefore proposed to make this authority unconditional.

To be clear, however, ensuring a continued ability to fund capital investments is not the only reason for generating liquidity. Just as significantly, liquidity from positive net income is needed to raise the Postal Service’s cushion against market fluctuations and other contingencies, as its current cushion remains far below what is “adequate . . . to maintain financial stability” from a comparative standpoint.\(^\text{197}\) Order No. 4258

\(^\text{196}\) USPS March 20 Comments at 82.

\(^\text{197}\) See USPS March 1 Comments at 16-18 (discussing USPS March 20 Comments, app. B at 18, 44-46); \textit{id.} at 80.
specifically contemplates that revenues generated by the additional rate authority can be used to pay down debt in addition to funding capital investments. As noted above, under the current system the Postal Service is unable to make capital spending decisions without sacrificing these other necessary goals. As ANM et al. point out, there are a number of uses to which additional liquidity can be put, and it is emphatically the responsibility of the Postal Service’s Board of Governors, not the Commission, to determine the appropriate use of liquidity. Thus, a more appropriate term might be “liquidity-generating mechanism.”

As far as the use of liquidity for capital spending is concerned, it may be technically correct that FY2006 capital spending levels were included in the rate base approved in Docket No. R2006-1, but that fact is irrelevant. In actuality, those rates

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198 Order No. 4258 at 48, 54; see also Brennan 2017 Declaration at 9 (“USPS by statute has exhausted its borrowing authority and is unable to borrow more, even from otherwise willing lenders. This raises the possibility that USPS cannot borrow money today to invest in equipment or reorganizations that might save it much more money in the future. Consequently, even if USPS is inclined to minimize costs, the borrowing constraint may prevent it from doing so over time[.]”). In the long run, surplus revenue could also be used to pay down the Postal Service’s accumulated net deficit and restore equity, which is weighed down by past-due but as-yet-uncalled debt to the U.S. Treasury. Until that is done, the Postal Service does not technically have “retained earnings.”

199 39 U.S.C. § 205(a) (“The Board shall direct and control the expenditures . . . of the Postal Service[,]”); ANM et al. Comments at 43-44. As another potential use of liquidity, ANM et al. offer the possibility of compensation incentives for increased efficiency. Id. at 43 (citing Declaration of John Kwoka, PRC Docket No. RM2017-3 (Mar. 20, 2017), at 14). This example shows that additional capital can be used to start a “harmonious cycle” wherein efficiency improvement and retained earnings flow from investment in human capital, rather than in capital assets.

200 ANM et al. Comments at 44 fn.20. ANM et al. gain nothing by pointing out that “[t]he Postal Service managed to make capital investments in efficiency and cost reduction during 1971-2007, when the breakeven requirement of the Postal Reorganization Act forbade the Postal Service from retaining earnings as a matter of law.” Id. at 44. Of course the Postal Service “managed” to do so: that same breakeven requirement effectively guaranteed that capital investments would be funded from year to year (or rate case to rate case) as operating expenses to be recovered in rates. That is not the case under a price cap. Even if the price cap were reset to the recent historical net loss, that would cover only the actual capital spending level in the relevant year or years; it would not allow for growth in capital spending needs, nor (barring an adjustment mechanism) would it continue to fund the same level of capital spending as volume declines erode the rate base.
did not provide enough cash to fund capital investments deemed necessary at the time, after all other current liabilities had been satisfied.\textsuperscript{201} After funding its escrow requirements in FY2006, the Postal Service had to borrow $2.1 billion “to fund capital investments and provide operating cash for future operations.”\textsuperscript{202} At present, the Postal Service’s borrowing authority is exhausted, and so additional liquidity is necessary to provide the Postal Service with the sort of budgetary flexibility that it had in the past. To guard against future erosion in the value of the liquidity-generating mechanism, the rate authority should be adjusted to provide constant value in the face of future volume declines.\textsuperscript{203}

ANM \textit{et al.} are conspicuously light on specifics in attempting to link pre-PAEA ratemaking to a “tendency to encourage overinvestment.”\textsuperscript{204} That argument rests purely on abstract conjecture, unencumbered by any real-world examples of imprudent or wasteful pre-PAEA spending. ANM’s sponsorship of this argument is ironic, considering that, in the later days of the cost-of-service era, its chief complaint was that the Postal Service was not investing \textbf{enough} in new flats processing equipment.\textsuperscript{205} When

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\item \textsuperscript{201} United States Postal Serv., 2007 Annual Report at 29 ("As was the case in 2007, for 2008 we do not expect cash flow from operations to supply adequate cash to fund our capital investments and P.L.109-435 payment requirements.").
\item \textsuperscript{202} \textit{See, e.g.}, United States Postal Serv., 2006 Annual Report at 34.
\item \textsuperscript{203} That forward-looking adjustment should be performed by the adjustment mechanism for economies of density that the Postal Service has proposed, which should be applied to all forms of rate authority, not just supplemental rate authority. USPS March 1 Comments at 71-74.
\item \textsuperscript{204} ANM \textit{et al.} Comments at 46-47.
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confronted with similarly generic complaints to ANM et al.’s about the need for rate discipline to trim spending levels, the former Commission rejected them each time, noting in one case that the Commission “presumes good faith on the part of the Postal Service in preparing [its] forecasts of dramatic spending increases.” ANM et al. do not point to any established examples of pre-PAEA overinvestment, because they do not exist. In any event, the Commission and other authorities agree that, at present, the Postal Service needs to increase its capital spending in order to reduce risks to the future provision of universal service.

Finally, it is simply incorrect, as a matter of accounting principle, to claim that depreciation expense incorporates future capital investment needs into the net loss,

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207 E.g., Postal Regulatory Comm’n, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2016 (Mar. 31, 2017) [hereinafter “FY2016 Financial Analysis”], at 28 (“In order for the Postal Service to be competitive in today’s growing e-commerce market, it will have to increase its capital expenditures.”); Reforming the Postal Service: Finding a Viable Solution: Hearing Before the House Comm. on Oversight & Gov’t Reform, 114th Cong. at 1-2 (May 11, 2016) (remarks by Committee Chairman Jason Chaffetz) (“Further, the Postal Service lacks the funds it needs for critical infrastructure investments. . . . But if you are going to purchase new delivery vehicles and prepare for the next decade or two, you are going to need some money, and it is something that the Postal Service does not have.”); id. at 24 (oral statement of Commission Chairman Robert G. Taub) (“Low liquidity levels in recent years have impeded the Postal Service’s ability to make capital investments in infrastructure.”); id. at 32 (written statement of Commission Chairman Taub) (“These low liquidity levels in recent years have impeded the Postal Service’s ability to make capital investments in infrastructure and hindered the growth and productivity enhancements in key assets required for primary postal operations.”); Gov’t Accountability Office, GAO-11-386, United States Postal Service: Strategy Needed to Address Aging Delivery Fleet (May 2011), at 40-41.
thereby averting the need for additional rate authority.\textsuperscript{208} Depreciation expense represents the amortized purchase price of past investments; it contains no information about the purchase price of new capital stock in the current or future market.\textsuperscript{209} Many of the assets that the Postal Service would seek to replace are fully depreciated; hence, they are no longer reflected in depreciation expense at all.\textsuperscript{210} The Postal Service cannot simply shrink its scale of operations and, accordingly, its capital stock (that is, forgo replacing depreciated assets) to match declining output, as a private business might; the fixed nature of the universal service obligation and the constant growth of the delivery network require the maintenance of a certain level of network infrastructure. The replacement of fully depreciated assets is, of course, a key financial-stability problem that the additional rate authority is intended to solve.\textsuperscript{211}

\textsuperscript{208} ANM \textit{et al.} Comments at 43.

\textsuperscript{209} See Jason Mumm, “What It Means to ‘Fund Depreciation” (MWH Global Jan. 6, 2015), \url{http://tiny.cc/Mumm-depreciation} (“Fatal flaw number three: Depreciation is based on historical cost, not present or future values. . . . Depreciation was never meant to be a proxy for the cost of future replacement of capital assets.”); John F. Coffey, \textit{The Capex Adjustment}, \textit{The Value Examiner} (Nov./Dec. 2009), at 12-13, \url{available at http://www.coffeypc.com/images/Capex_Article.pdf} (concluding that an estimation of future capital needs should adjust depreciation on the basis of “the business plan, depreciation policy, nature of the industry, and impact of technology,” as well as “the impact of growth and inflation”); Letter from Warren Buffett, Chairman of the Board of Directors, Berkshire Hathaway Inc., to Shareholders (Feb. 27, 1987), app., \url{available at http://www.berkshirehathaway.com/letters/1986.html} (“Most managers probably will acknowledge that they need to spend something more than [depreciation] on their businesses over the longer term just to hold their ground in terms of both unit volume and competitive position. . . . The oil industry has in recent years provided a conspicuous example of this phenomenon. Had most major oil companies spent only [depreciation] each year, they would have guaranteed their shrinkage in real terms.”).

\textsuperscript{210} See Mumm, “What It Means to ‘Fund Depreciation” (“Fatal flaw number one: A portion of the utility’s assets are already fully depreciated and, therefore, have no related depreciation expense anymore. Meanwhile, these assets are still in service and will need to be replaced at some cost. Collecting zero depreciation expense will obviously fail to address those future costs.”); Coffey, \textit{The Capex Adjustment} at 11 (“Circumstances that may require adjustment [to current depreciation when estimating future capital needs] include[ whether o]bsolete and/or nonoperating assets have been depreciated.”).

\textsuperscript{211} FY2016 Financial Analysis at 3, 23-24, 81.
The Postal Service’s comments here, like its March 1 comments, have emphasized capital spending, in recognition of the importance of that issue. As noted above, however, the need for additional rate authority goes beyond capital spending. That need can be most clearly understood if the additional rate authority is framed not in terms of long-term financial stability and positive net income, but rather in terms of rebuilding adequate levels of liquidity that can be applied to multiple short-, medium-, and long-term needs. Those needs include not only capital spending, but also debt service, a financial cushion to reduce the risk that a financial shortfall would pose to the provision of universal service, and, eventually, the paying down of the cumulative deficit in order to achieve retained earnings.

B. A Surcharge Model for Additional Rate Authority Would Not Be Designed to Achieve Objective 5

Some commenters object to the notion that the additional rate authority should cause a permanent increase in the rate base, proposing instead a series of one-time surcharges. As a matter of principle, however, the baseline expectation is that the Postal Service needs an additional 1 percentage point of rate authority in order for the new system to achieve objective 5. Thus, the Commission’s proposal would not result in a permanent increase caused by the Postal Service qualifying for conditional rate authority in a given year, so much as a permanent decrease in the objective-5-compliant level of rate authority in each year when the Postal Service fails to qualify.

212 As noted in footnotes 65 and 198 above, “retained earnings” is a misnomer, as it is used in Order No. 4258’s discussion of performance-based rate authority.

213 ACMA/PSA Comments at 21; DMA Comments at 4-5; Netflix Comments at 23-24.

214 Seen from this perspective, the baseline expectation would be that the price cap provides CPI-based rate authority, supplemental rate authority, and an additional 0.25 percentage point every year. That cap would then be “decrease[d] . . . if service levels slip,” presumably out of a “concern[ ] that the regulated
The new system must be “designed to” provide “adequate revenues, including retained earnings, to maintain financial stability.” In light of that statutory mandate, it is hard to justify withholding the very rate authority that the Commission has identified as necessary to replenishing capital assets, restoring borrowing authority, and achieving other indicia of financial stability.

As a practical matter as well, the commenters’ alternative – a series of one-time surcharges that are rolled back each year – would fall woefully short of fulfilling the financial-stability needs that the Commission has identified. Table 1 below illustrates the gross disparity. Assume that the Postal Service receives the additional 1 percentage point of rate authority every year and that revenue-weighted volume is held constant, as in Order No. 4258.215 In that highly idealized case, it would take seven years under the Commission’s proposal to generate enough incremental revenue ($15.8 billion) to restore the Postal Service’s borrowing authority.216 This is because the additional rate authority enters the rate base from which the following year’s CPI+2% increase would be calculated, and from which that year’s additional rate authority would

firm will reduce service levels as a means of making a profit when placed under the constraint of a price cap.” Netflix Comments at 23-24. The same point applies to the proposed TFP-based rate authority: the Commission’s proposal would set a baseline expectation of 0.75 percentage points in annual rate authority, disqualification for which would “penalize the Service if it were to fail to meet the threshold.” NPPC et al. Comments at 69.

215 The Postal Service’s proposed adjustment mechanism for economies of density would effectively normalize for changes in revenue-weighted volume, albeit on a lag. Barring such an adjustment mechanism, however, volume and mail-mix shifts will almost certainly reduce the yield of any rate authority, meaning that it will take significantly longer to achieve the results illustrated here. See Order No. 4258 at 42-43.

216 In Order No. 4258, the Commission projected that it would take nine years to replace the $7.8 billion decrease in net capital assets that occurred in the PAEA era” and “to also pay off the $15 billion in borrowing authority the Postal Service exhausted during the PAEA.” Order No. 4258 at 54. For the sake of a clearer contrast with the proposed surcharge model, the illustration here focuses solely on the amount needed to restore borrowing authority, without factoring in the replacement of capital assets as a separate item.
be calculated. By contrast, the surcharge model would bar revenues generated by the additional rate authority from growing the rate base. The result would be less than a quarter of the PRC model’s incremental revenue yield (i.e., revenue above CPI+2%) at the seven-year mark ($3.8 billion). And the surcharge model would take more than three times as long (23 years) to restore the Postal Service’s borrowing authority, without even accounting for the impact of volume declines on the additional rate authority’s yield.²¹⁷

Table 1: Comparison of surcharge model and PRC model for additional rate authority (in $ millions)²¹⁸

<table>
<thead>
<tr>
<th></th>
<th>Year 0</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Year 3</th>
<th>Year 4</th>
<th>Year 5</th>
<th>Year 6</th>
<th>Year 7</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Surcharge model</strong></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate base with supp. rate auth. (Y1-Y5)</td>
<td>$47,761</td>
<td>$49,695</td>
<td>$51,708</td>
<td>$53,802</td>
<td>$55,981</td>
<td>$58,248</td>
<td>$59,442</td>
<td>$60,661</td>
<td>$389,538</td>
</tr>
<tr>
<td>+1% yield</td>
<td>--</td>
<td>$478</td>
<td>$497</td>
<td>$517</td>
<td>$538</td>
<td>$560</td>
<td>$582</td>
<td>$594</td>
<td>$3,766</td>
</tr>
<tr>
<td>Total</td>
<td>$47,761</td>
<td>$50,173</td>
<td>$52,205</td>
<td>$54,319</td>
<td>$56,519</td>
<td>$58,808</td>
<td>$60,025</td>
<td>$61,255</td>
<td>$393,305</td>
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<tr>
<td><strong>PRC model</strong></td>
<td></td>
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<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rate base with supp. rate auth. (Y1-Y5)</td>
<td>$47,761</td>
<td>$49,695</td>
<td>$51,708</td>
<td>$53,802</td>
<td>$55,981</td>
<td>$58,248</td>
<td>$59,442</td>
<td>$60,661</td>
<td>$389,538</td>
</tr>
<tr>
<td>Rate base with supp. rate authority + 1%</td>
<td>$47,761</td>
<td>$50,173</td>
<td>$52,707</td>
<td>$55,368</td>
<td>$58,164</td>
<td>$61,102</td>
<td>$69,965</td>
<td>$64,886</td>
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<tr>
<td>+1% yield</td>
<td>--</td>
<td>$478</td>
<td>$999</td>
<td>$1,566</td>
<td>$2,183</td>
<td>$2,853</td>
<td>$3,523</td>
<td>$4,225</td>
<td>$15,827</td>
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<tr>
<td>Difference from surcharge model</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$12,060</td>
</tr>
</tbody>
</table>

Objective 5 requires the new system to be “designed to” provide “adequate revenues, including retained earnings, to maintain financial stability.” As demonstrated here, it cannot reasonably be maintained that the surcharge model would fulfill that objective.


²¹⁸ For the derivation of Table 1, see Microsoft Excel file “USPS.RM17-3.Rep.Com.Workpapers.xlsx” (filed with these comments), tab “Table 1”.

C. Additional Rate Authority Should Not Be Conditioned on Litigation of the Postal Service’s Spending Plans

The Commission’s discussion of the importance of additional rate authority to ensure capital spending is not a basis to condition the rate authority on a prudence review of the Postal Service’s specific investment plans, as APWU and ANM et al. propose.\textsuperscript{219} As the Postal Service explained in its March 1 comments, that proposal would imbue the new system with the regulatory burden, inflexibility, and uncertainty of cost-of-service ratemaking litigation.\textsuperscript{220}

It is hard to understand APWU’s rationale for a cost tracker in light of the statutory objectives. Under APWU’s proposal, the amount of annual rate authority would not be known until after the Postal Service files its request with an annual spending plan, and after that plan has been litigated before the Commission. That process would not be “objective” or “keep[ ] the rate-setting process streamlined and efficient,” particularly in comparison with the Commission’s proposal to base eligibility for additional rate authority on total factor productivity (TFP) data known months in advance of any price adjustment notice.\textsuperscript{221} Of course, the Commission’s proposal to rely on TFP data has its own problems, as identified in the Postal Service’s March 1 comments.\textsuperscript{222} The best solution to those problems – and the best way to meet APWU’s goals of objectivity and procedural efficiency – is to make the additional rate authority

\footnotesize
\textsuperscript{219} APWU Comments at 19-20; ANM et al. Comments at 45-46.
\textsuperscript{220} USPS March 1 Comments at 92.
\textsuperscript{221} See APWU Comments at 20.
\textsuperscript{222} See USPS March 1 Comments at 86-89, 95-112; see also ACMA/PSA Comments at 22-23; APWU Comments at 15-17; Netflix Comments at 22-23.
unconditional until the next Section 3622(d)(3) review or, at a minimum, for the first year or two, until a more methodologically sound TFP-based mechanism can take effect.223

D. If Additional Rate Authority Is Based on TFP, Lengthening the Period of the Benchmarking Exercise Would Not Solve Its Problems

Some commenters claim that, if the Commission retains its benchmarking approach to TFP-based rate authority, the proposed five-year period is too short. Specifically, one of the Public Representative’s declarants suggested that TFP “growth should be measured during a longer period, such as 7-8 years,” because of the likelihood “that any investments for technological improvements would result in a lower 5-year-average TFP growth than it could be without these investments.”224 ACMA and PSA similarly “suggest that five years for an average may be way too short to be meaningful,” although they then appear to claim that an eight-year period “would set up a long-term dynamic that has little relation to operating efficiency and the price cap.”225

These suggestions may make sense in the general context of reviewing and analyzing TFP growth. But as applied in the Commission’s proposed rolling-average-versus-static-average benchmarking approach to determine rate authority, they would only exacerbate, not solve, the inherent fundamental problem with that exercise. As explained in the Postal Service’s March 1 comments, the overlap between benchmark and measured periods essentially turns the first several years of the Commission’s proposed approach into a comparison between two sets of accumulating averages.226

223 See USPS March 1 Comments at 89-95, 112-30.
225 ACMA/PSA Comments at 23.
226 USPS March 1 Comments at 102-108, 115-16.
[T]he problem is that those accumulating averages are compared not against the putative five-year-average benchmark, but against an arbitrary series of corresponding accumulating averages starting with the early part of the benchmark period, when TFP growth rates were highest. The historical standard to which early new-system years’ performance would be held does not reflect any meaningful expectations about the new period, and it sets too high a bar to achievement of the additional rate authority that is supposed to start the “harmonious cycle.”

Extending the length of the periods would not solve that fundamental methodological problem.

If the proposal is to extend both the benchmark period and the measured period to, say, eight years, then all that would do would be to place the TFP-based rate authority further out of reach, because the benchmark would include more years of the post-Great-Recession TFP surge. If FY2009-FY2016 were used as the benchmark period, the benchmark TFP growth rate would be 0.678 percent; if FY2010-FY2017 were used, the benchmark rate would be 0.725 percent. In the FY2009-FY2016 benchmark scenario, reported FY2017 TFP growth (-0.627 percent) would qualify the Postal Service for additional rate authority in the first year, because it is higher than the FY2010 TFP growth rate (-1.001 percent). In FY2018, however, the Postal Service would need to raise TFP growth to 1.668 percent – almost four times the PAEA-era average growth rate (0.428 percent) – in order for the FY2017-FY2018 average to equal

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227 USPS March 1 Comments at 116.

228 For the derivation of figures in this paragraph, see Microsoft Excel file “USPS.RM17-3.Rep.Com.Workpapers.xlsx” (filed with these comments), tab “TFP 8-year benchmarks”, cells B21, C10, D11, F12, I11, & J12. As explained in the Postal Service’s March 1 comments, three-decimal-place precision is unwarranted in determining eligibility for TFP-based rate authority. USPS March 1 Comments at 96-97. As in those comments, such figures are used here for illustrative purposes only. See id. at 106 fn.256. In this case, both benchmark alternatives happen to round to the same single-decimal-place figure (0.7 percent). Single-decimal-place rounding, which the Commission should adopt in any TFP-based benchmarking exercise, would not materially alleviate the challenge to attaining the TFP-growth thresholds enumerated in this paragraph.
that of FY2009 (-1.001 percent) and FY2010 (2.042 percent). A FY2010-FY2017 benchmark period would be even worse: FY2018 TFP growth would need to equal the FY2010 rate of 2.042 percent. The challenge would remain in FY2019 and the following years, since the years of the post-Great-Recession surge would arbitrarily be used as a benchmark, without any consideration of whether such high TFP growth rates are rational to expect in the coming years, given current operating conditions.

If the recommendation is to keep the benchmark set at the FY2012-FY2016 average but use a seven- or eight-year average for the measured period, then this would not solve the problem, either. The eight-year average TFP growth in FY2010-FY2017 (0.725 percent) would qualify the Postal Service for additional rate authority in the first year, since it exceeds the FY2012-FY2016 average (0.614 percent). But a seven-year average of FY2011-FY2017 (0.536 percent) would not. Beyond FY2017, the early, high-TFP-growth years would roll out of the measured period, and not even PAEA-era-average annual TFP growth levels (0.428 percent) would allow the rolling average to ever meet the benchmark. Beyond the fact that the TFP-based rate authority would remain largely unachievable and therefore out of step with regulatory practice, the logic of comparing a seven- or eight-year measured period against a 5-year benchmark is unclear.

The problems with the proposed TFP-based rate authority run far deeper than the length of the period. Ultimately, the best solution is to eliminate the TFP condition altogether and provide additional rate authority unconditionally, as a means toward

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229 See USPS March 1 Comments at 22-25, 99.
230 See id. at 99 fn.245 (citing scholarly sources for the need to set performance targets at an achievable level).
more adequate levels of financial stability (including liquidity) and investment in operational efficiency improvement. If the Commission intends to keep a TFP condition, then the benchmarking approach requires a host of more fundamental repairs than what the commenters have proposed.

E. The Plain Language of Objective 3 Demands a Focus on Service Standards, Rather Than Performance

As noted above, the additional rate authority should be made unconditional, in the interest of raising the Postal Service’s liquidity toward adequate levels. Any attempt to remove a portion of that rate authority on the basis of Postal Service decisions about service standards risks interfering with the complex exercise of policy judgment that Congress expressly delegated to the Postal Service, not the Commission, as objective 3 acknowledges. And the Commission has not established that the current system’s design failed to enable service standards to be maintained at a “high quality” level. Penalizing the Postal Service for any “downward” change in service standards does not

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231 See USPS March 1 Comments at 112-30. It should also be noted that UPS’s claim that developing separate TFP measures for market-dominant and competitive products would be a “simple matter” is incorrect. See UPS Comments at 5-8. Setting aside the technical complexities of using CRA cost component definitions to split TFP resource usage, TFP is fundamentally an enterprise-wide productivity measure that includes institutional costs in its measure of resource usage, and organization-wide delivery network growth in addition to mail and service volumes in its measure of postal output. As the Commission is well aware, there is no causal basis for allocating institutional costs between market-dominant and competitive products. See Order No. 4402 at 81-82. The need to conduct economically arbitrary allocations of institutional costs and network-related output would make the resulting disaggregated productivity measures unreliable. As an additional practical matter, no such breakout of historical TFP data is available for use in determining a reasonably achievable benchmark or other aspects of a performance incentive mechanism.

232 39 U.S.C. § 3691(a)-(c); see id. § 3622(b)(3).

233 USPS March 1 Comments at 27-32; see also ANM et al. Comments at 7, 82-83 (“Without [a cost-benefit analysis], there is no basis for finding that current service standards or actual service performance levels are too low. . . . The Commission does not appear to have asked whether the American people, as mailers, consumers and taxpayers, are in fact willing to pay enough for the faster and more consistent service to cover its cost.”).
begin to answer the question of whether the changed service standards would be of "high quality," as objective 3 requires, or how the unchanged service standards relate to the needs of the mailing public and other considerations of 39 U.S.C. § 3691, which are also incorporated into objective 3. The service-standards-based rate authority proposed in Order No. 4258 lacks a clear justification.

That said, if the Commission remains determined to condition additional rate authority on service standards, the need for caution requires a minimalistic approach to setting the amount of any conditional rate authority.234 As Netflix points out,

Changes in standards, based on costs, needs, and changed circumstances, should be an ordinary part of operating a postal system. There may be, for example, a consensus that a reduction in one or more elements of the standard, (e.g., relaxing two-day service to an area with inadequate transportation) is preferable to an increase in rates. But the Postal Service might be reluctant to change the service standard if it results in loss of cap authority. Or the Postal Service might consider increasing some service standards and reducing others in a class. This would destroy eligibility for the award since apparently all aspects of standards for a class must be maintained at the same levels. The service mechanism would then be giving the wrong incentives to the Postal Service and hindering meritorious changes.235

The setting of a price tag on "changes that could increase [the Postal Service’s] overall effectiveness . . . should not be thought of as good. . . . [M]ailers[ ] . . . want an effective Postal Service; a constraint on changing standards, even reducing them, could impede that."236 Given these concerns, the Commission should decline calls to condition a

234 USPS March 1 Comments at 130.
235 Netflix Comments at 24.
236 ACMA/PSA Comments at 20.
more substantial amount of rate authority on maintaining (potentially inefficient or otherwise undesirable) service standards.\textsuperscript{237}  

A number of parties propose that additional rate authority be based on service performance, rather than service standards.\textsuperscript{238} But the experience of other postal regulators disfavors tying rate authority to service performance. “The U.K. experience clearly shows that even a one-percent service performance factor has little real incentive effect, amid other elements of a price cap, and serves only to add complication.”\textsuperscript{239} The French postal regulator declined to follow through on its erstwhile proposal of a service performance factor, and such factors are not present in Australian, Canadian, or German postal regulation.\textsuperscript{240} The variability of service performance, for

\begin{itemize}
  \item \textsuperscript{237} See NALC Comments at 5, 27-28; NPMHU Comments at 6; Public Representative Comments at 36-37.
  \item \textsuperscript{238} ANM \textit{et al.} Comments at 8, 83-84; Netflix Comments at 23; NPPC \textit{et al.} Comments at 7, 77-79; UPS Comments at 9-10.
  \item \textsuperscript{239} USPS March 1 Comments at 131 (citing USPS March 20 Comments, app. F at 6-7, 9 fn.30).
  \item \textsuperscript{240} See USPS March 20 Comments at 173 & app. F at 25, 33, 36 fn.142. ANM \textit{et al.}’s professed lack of awareness of “any regulatory system” that allows the regulated firm to increase prices while “holding its service constant without reducing its costs,” ANM \textit{et al.} Comments at 84, proves nothing but ANM \textit{et al.}’s inattention to regulatory practices. As to “reducing [of] costs,” the whole point of a cost-of-service regulatory system is to allow price increases as a result of cost increases. Even incentive-regulation systems may be set up to enable profits if costs rise less than a benchmark inflation rate, but that is not the same as requiring the firm to “reduc[e] its costs” in absolute terms. And many incentive-regulation systems accommodate above-inflation price increases as a result of rising firm- or industry-specific cost trends. See USPS March 20 Comments, app. E at 15-26. As to “holding . . . service constant,” most regulatory systems regulate service quality through monitoring and enforcement mechanisms, rather than tying it to pricing. Where regulators have established service-quality-based performance incentive mechanisms (PIMs), those mechanisms do not necessarily take the form of penalties, and even a penalty under such a mechanism can still result in an overall price increase. Mark Newton Lowry & Tim Woolf, Performance-Based Regulation in a High Distributed Energy Resources Future, Lawrence Berkeley National Laboratory, Report No. 3 (2016), at 42, \url{http://tiny.cc/Newton-Lowry-Woolf-paper}; Melissa Whited \textit{et al.}, Utility Performance Incentive Mechanisms: A Handbook for Regulators, Western Interstate Energy Board (2015), at 23, \url{http://tiny.cc/Whited-et-al-Paper}. And PIMs typically allow neither penalties nor rewards around the performance target, which is “usually” set according to “[t]he historic performance of the subject utility.” William P. Zarakas \& Philip Q Hanser, Targeted Performance Incentives: Recommendations to the Hawaiian Electric Companies (2014), at iv, vi-vii, 15, 26-27, \url{http://tiny.cc/Zarakas-Hanser-paper}. Thus, even in a regulatory system with a PIM, it is entirely possible to increase prices while “holding . . . service constant.”
\end{itemize}
reasons beyond the Postal Service’s control, and the risk of measurement error would make it practically impossible to control for such factors and isolate the incentive effect of a price cap factor. The Commission would do well to follow the example of other postal regulators and continue to regulate service performance through other regulatory means.

VI. THE COMMISSION SHOULD TAKE A BALANCED APPROACH TO UNDERWATER CLASSES AND PRODUCTS

The subject of underwater products and classes has historically riven the mailing community. Mailers of such products point the finger at cost measurement and protest that any greater price increase will harm their industries, while other mailers protest having to subsidize underwater products. The initial comments in response to Order No. 4258 continue that long-running strife. Without addressing the merits of these positions, the Postal Service provides the following considerations as the Commission evaluates the inter-product equities.

A. The Commission’s Longstanding Conclusion That Underwater Flats Products Require a Rate Remedy Has Not Been Credibly Rebutted

With respect to underwater classes, the problem cannot solely be laid at the feet of cost control or cost measurement. As the Postal Service explained in its March 20, 2017, comments,

[t]he Periodicals class entered the PAEA underwater. Indeed, it increasingly failed to cover its costs for the entire decade leading up to the PAEA. The cost-coverage problem has persisted despite the fact that Periodicals’ unit attributable costs have risen more slowly than those of other flats products, and have actually sunk in inflation-adjusted terms since 2004. The cost-coverage problem is the result of a complex of factors, such as the fact that Periodicals entered the price cap underwater, declining volumes and density, and changes in mailer behavior that have lowered unit revenue (e.g., reducing the weight and advertising content of
Inasmuch as the Postal Service has tried to constrain Periodicals costs below the rate of CPI growth, unit revenue has continued to fall even faster; CPI-based price increases cannot keep pace. As a result of all of these factors, cost coverage has generally eroded since the PAEA.\textsuperscript{242}

In short, after such a long period in which the CPI-only price cap took rate remedies off the table, no cost-based remedy has been found, and the gap has only grown. At this point, the only other place to turn is rates. The Commission joined the Postal Service in recognizing this six years ago:

Regardless of approach [to estimating potential cost savings], there will still be a cost coverage gap; without price changes or legislative changes, Periodicals will not be able to cover its costs. . . . Cost savings opportunities exist, but are not likely to be sufficient to bring Periodicals to breakeven. . . . Given the remaining financial gap, even after potential cost savings from operational efficiency improvements are realized, the focus must shift to how the revenue side of the cost coverage equation can be improved. . . . [A relaxation of] strict inflation-based price caps by class [that] allows for flexible pricing reflecting market dynamics might enable the Postal Service to further remedy the Periodicals cost coverage issue.\textsuperscript{243}

\textsuperscript{241} [Footnote 253 in original (citation and cross-reference omitted);] Since the Periodicals Mail Study, unit revenue has grown somewhat as a result of the exigent surcharge and changes in the price structure, but not enough to close the historical gap with unit cost. [T]o the extent that Periodicals mail is workshared, adoption of a full ECP approach to worksharing would only make matters worse, as 100 percent of worksharing-based cost reductions would translate into diminished unit revenue.

\textsuperscript{242} USPS March 20 Comments at 132 (footnotes omitted, except as noted).

\textsuperscript{243} Postal Regulatory Comm’n & U.S. Postal Serv., Periodicals Mail Study (2011), at 91-92. Although the Periodicals Mail Study refers to relaxation of the CPI-only cap as a matter for legislative change, that simply reflects the reality at the time, more than five years before Section 3622(d)(3) had any bearing. Cf. Order No. 4258 at 18 (discounting past Commission pronouncements about the primacy of the current system’s price cap as “merely serv[ing] to acknowledge the bounds of Commission authority during the first 10 years of the PAEA”). Moreover, to the extent that the Periodicals Mail Study discussed the possibility of remedial action through an Annual Compliance Determination, id. at 92, the implication is that the Commission could allow above-CPI increases for an underwater class, as it proposes to do here, regardless of whether Section 3622(d)(1) controls as a general matter. Thus, even if other commenters were correct that Section 3622(d)(3) constrains the Commission’s authority to the confines of a supposedly permanent CPI-only price cap, contra section II supra, the Commission would have the remedial power to fix underwater classes’ cost coverage notwithstanding the CPI-only price cap in any event.
The Commission’s proposal in Order No. 4258 of additional rate authority to raise underwater classes’ contribution levels therefore has deep roots in Commission practice.

ANM et al. attempt to paint a contrary picture, but produce only a distorted one. They conduct a complicated analysis of flats costs, focusing on Outside County Periodicals (and, to a lesser extent, Marketing Mail Flats), in an attempt to demonstrate that lack of cost containment on the Postal Service’s part is primarily responsible for the underwater products problem.\(^{244}\) The ANM et al. analysis fails on several fronts.

1. **Unit transportation and carrier costs**

ANM et al. purport to show that unit transportation and carrier costs for Periodicals have increased faster than CPI.\(^ {245}\) In this regard, ANM et al. miss the mark on two main points. First, ANM et al.’s cost trends for Outside County Periodicals include data points from FY2008 and FY2009, which were the core years of the Great Recession.\(^ {246}\) As the Commission and other interested parties are well aware, the Great Recession provided extraordinary financial challenges to numerous organizations and businesses, including the Postal Service. Consequently, the inclusion by ANM et al. of the outlier data points for those years within the cost curves presented greatly distorts the response of the Postal Service in the post-recession era. As shown in ANM et al.’s Figures 11 and 12, the steep unforeseen volume declines during those core years of the Great Recession resulted in dramatic unit cost increases. When ANM et al.

\(^{244}\) ANM et al. Comments at 86-101.

\(^{245}\) Id. at 89-91.

\(^{246}\) Id. at 89, 91 (Figures 11 and 12).
subsequently suggest downward transportation and delivery cost adjustments, those adjustments largely reflect the effects of the Great Recession, as well as incomplete adjustment of measured costs for methodology changes. Second, ANM et al. ignore the cost elasticities associated with transportation and city delivery costs. Cost elasticities for city carriers and transportation that are less than unity logically yield increases in unit costs during periods of declining volume.

Taken together, these flaws result in improper and inaccurate conclusions about transportation and delivery costs that should be rejected by the Commission. Indeed, the data that ANM et al. provide show that the unit cost increases, relative to CPI, are largely a byproduct of the Great Recession years, when volume declines were especially severe. In the post-recession period, both carrier and transportation unit costs for Periodicals have largely tracked inflation.

a. Including Great-Recession-era data produces misleading cost curves

The transportation and carrier cost curves presented in ANM et al.’s Figures 11 and 12 include data points from the Great Recession (FY2008 and FY2009), which are outliers. Including these points distorts the cost curve because the sharp volume declines in FY2008 and FY2009 resulted in 17 percent and 26 percent increases in transportation costs (cost per pound) and carrier costs (cost per piece), respectively. Avoiding these distortions and using a more appropriate effective starting point of

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247 Id. at 104.
FY2010 for both graphs illustrates a much more modestly increasing cost curve between FY2010 and FY2016/FY2017.\textsuperscript{248}

Beginning with transportation costs, the revised cost curve rebased in FY2010 illustrates the cumulative increase in transportation cost per pound to be 25 percent, as compared to 13 percent and 10 percent for general trucking freight and CPI-U, respectively. Removing the recession years greatly reduces the disparity suggested by ANM’s Figure 11 (in which the transportation increase of 71 percent was well over four times larger than the 2007-2016 inflation rate of 16 percent).

**Figure 1: Transportation costs per pound for Outside County Periodicals (rebased to FY2010)**\textsuperscript{249}

\textsuperscript{248} Apparently because of a method change approved by the Commission that materially changed the purchased surface transportation variabilities, ANM et al. did not include FY2017 in their transportation cost curve. For consistency, that approach is also being used in the adjusted version of Figure 11 presented here.

\textsuperscript{249} For the derivation of Figure 1, see Microsoft Excel file “USPS.RM17-3.Rep.Com.Workpapers.xlsx” (filed with these comments), tab “Figure 1”. Figures 1 and 2 use the cost data provided by ANM et al., and differ only in that they rebase the cumulative growth rate series to zero in FY2010. In accord with the ANM et al. methodology, the transportation cost data points include piggybacked vehicle service driver costs (Cost Segment 08) and purchased transportation costs (Cost Segment 14).
Moreover, while the above figure does show an 11-percent increase in unit cost per pound between FY2014 and FY2015, a material portion of that increase was due to the update of the cost-to-capacity variabilities that year in Docket No. RM2014-6. ANM et al. fail to acknowledge this method change in their comments.

An even more dramatic shift occurs in the unit cost curve for carriers when the effective starting point is FY2010, which excludes data points from the core years of the Great Recession. As Figure 2 below illustrates, rebasing to FY2010 shows that unit delivery costs for Outside Country Periodicals actually increased at a slower rate than CPI. In fact, Outside County Periodicals’ unit carrier costs increased by 6 percent, half the rate of increase in CPI (12 percent).

**Figure 2: Carrier costs per piece for Outside County Periodicals (rebased to FY 2010)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Carrier Cost per Piece</th>
<th>CPI-U</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2008</td>
<td></td>
<td></td>
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<tr>
<td>2009</td>
<td></td>
<td></td>
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<tr>
<td>2010</td>
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<td></td>
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<tr>
<td>2011</td>
<td></td>
<td></td>
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<tr>
<td>2012</td>
<td></td>
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<td>2013</td>
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<td>2014</td>
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<td>2015</td>
<td></td>
<td></td>
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<tr>
<td>2016</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2017</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In its own versions of the above figures, ANM et al. erroneously deduct 1.4 and 2.1 cents from transportation and delivery costs, respectively. The rebased cost data

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250 For the derivation of Figure 2, see Microsoft Excel file “USPS.RM17-3.Rep.Com.Workpapers.xlsx” (filed with these comments), tab “Figure 2”. In accord with the ANM et al. methodology, the carrier cost data points include piggybacked costs for city carriers (Cost Segments 06 and 07) and rural carriers (Cost Segment 10).

251 See ANM et al. Comments at 104 (Table 5 at 104).
clearly show that ANM et al.’s proposed adjustments to these components do not reflect inefficiencies under Postal Service control. Rather, ANM et al.’s proposed adjustments amount to little more than an attempt to turn back the clock on the Great Recession. The proffered adjustments do not provide a credible basis for reevaluating the cost coverages of underwater flats products.

b. ANM et al. fail to account for the fact that unit costs rise as volume declines when the cost elasticity is less than unity

ANM et al. also fail to address the algebraic implications that occur in segments with cost elasticities less than one in a declining-volume environment. Volume for Outside County Periodicals has declined 23 percent since FY2010. Surface costs encompass over 90 percent of transportation costs associated with Outside County Periodicals. The weighted variability for those surface costs is approximately 77 percent. The 23-percent volume decline, coupled with the 77-percent variability, would be expected to result in a roughly 7-percent unit cost increase, holding all other factors constant.\textsuperscript{252} Moreover, this impact on unit transportation costs is necessarily understated. In FY2016, almost half of the transportation costs for Outside County Periodicals were from short-haul trips (intra-SCF and vehicle service drivers) that were largely service-related and that consequently had a lower variability of approximately 66 percent. ANM et al.’s failure to acknowledge the less-than-unity volume variability

\textsuperscript{252} Unit cost is the ratio of total cost to total volume. To simplify, if volume declines 23 percent in a component with a variability of 77 percent, total costs would be expected to decline approximately 17.7 percent (= 23 percent × 77 percent), resulting in total costs approximately 82.3 percent (= 100 – 17.7) of the original value. After a decline of 23 percent, total volume would be 77 percent of the original volume. The new unit costs would thus be expected to be higher than the original unit costs by the ratio of 82.3 to 77, or roughly 7 percent higher.
impact on unit costs results in misleading conclusions and deserves further scrutiny from the Commission.

ANM et al.’s carrier-cost analysis similarly fails to account for the variability of roughly 50 percent. Applying the same algebraic approach used above for transportation costs, a 23-percent volume decline would suggest an expected 15-percent increase in unit costs. However, city carrier costs for Outside County Periodicals have increased by only 6 percent since FY2010.

In sum, a comprehensive investigation of transportation and carrier cost trends cannot be done without acknowledging the network or “fixity” aspects of these segments. The foundation of the costing system used by the Postal Service for more than 40 years is marginal costs, which are largely dependent on cost elasticities. Thus, any analysis done without consideration of cost elasticities greatly misses the mark and lacks credibility.

2. Mail processing costs

Declining volumes similarly create challenges for mail processing costs. The Postal Service’s obligation to serve every address in the United States six days a week requires it to conduct certain activities, such as setting up and conducting final sweeps of mail processing equipment, regardless of the amount of volume available to be processed. Spreading such costs over declining volumes puts downward pressure on productivities and (all other things being equal) upward pressure on mail processing unit

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253 Because rural carriers are generally compensated by the piece, the volume variability for volume-related activities is 100 percent. This means that unit costs are not impacted by volume changes, all other things being held constant.
costs. Curiously, given the presentation of Figure 11 regarding transportation costs and Figure 12 regarding carrier costs, ANM et al. do not show a corresponding figure for mail processing costs. The figure below cures that omission. This figure shows that Periodicals mail processing unit costs (labor and piggybacked costs) increased by less than inflation over the entire FY2007-FY2017 period, despite the effects of the Great Recession.

**Figure 3: Mail processing costs per piece for Outside County Periodicals**

![Graph showing cumulative increase in mail processing cost per piece and CPI-U from 2007 to 2017.]

Instead of consistently relying on such a graph to derive its adjustment (as it did for transportation and delivery costs), ANM et al. instead misuse partial productivity data for selected mail processing operations to imply that mail processing costs should be much lower than they currently are for Periodicals and Marketing Mail Flats. ANM et al. observe that measured labor productivities for AFSM 100, SPBS/APBS, and APPS

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254 ANM et al. correctly observe that if mail processing costs were determined to be less than 100 percent volume-variable, at least in operations used more intensively by flat-shape mail, the cost coverage issues for Periodicals and Marketing Mail Flats would be mitigated, though not necessarily eliminated. ANM et al. Comments at 100.

255 For the derivation of Figure 3, see Microsoft Excel file “USPS.RM17-3.Rep.Com.Workpapers.xlsx” (filed with these comments), tab “Figure 3”. The mail processing cost data points include piggybacked costs, consistent with Figures 1 and 2.

256 ANM et al. Comments at 87-88, 99.
operations, as reported by the Postal Service, have declined (in an hours-weighted average) by 29 percent from FY2007 to FY2017. ANM et al. then extrapolate the productivity decline for the selected operations to the entirety of mail processing costs. This leads them to discount total mail processing costs for Outside County Periodicals and Flats by 29 percent, purportedly reflecting lost efficiencies. ANM et al. provide no quantitative evidence to support the extrapolation, citing only a qualitative passage from the FY2015 ACD about allied labor productivities to imply that the extrapolation may be conservative.

ANM et al. overstate the implications of the automation productivity declines for overall Postal Service efficiency. As noted above, some of the decline may be associated with the dramatically reduced scale of flats operations. Additionally, declines in operation-level productivity do not necessarily imply an overall efficiency loss, to the extent they partly represent shifts away from less efficient operations. To the extent that mail migrating from manual operations to automated operations would be more difficult to automate, the shift could reduce measured productivity in the automated operations, while nevertheless increasing overall efficiency net of the shift.

For example, the Postal Service has dramatically reduced non-platform manual allied labor costs over the FY2007-FY2017 period, and it has substantially eliminated

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257 Id. at 87-88. AFSM 100, SPBS/APBS, and APPS cost pools account for approximately 24 percent of piggybacked mail processing costs for Periodicals, and 29 percent of costs for Marketing Mail Flats.

258 Id. at 88.

259 Id. at 88 (citing Postal Regulatory Comm’n, Annual Compliance Determination Report, Fiscal Year 2015, PRC Docket No. ACR2015 (Mar. 28, 2016), at 173).
operations for the FSM 1000. Total labor costs for LDC 17 opening, pouching, and manual sack sorting cost pools have declined by $612 million (72 percent) in nominal terms, or 76 percent in CPI-adjusted 2007 dollars. Costs for the corresponding LDC 13 automated and mechanized operations have declined 12 percent, not adjusted for inflation. Correspondingly, manual Function 1 allied labor unit costs at plants and NDCs have decreased markedly for Outside County Periodicals from FY2007 to FY2017, such that the combined cost for mechanized bundle, tray, and sack operations, plus manual allied labor, has fallen by 17 percent in nominal terms, or 29 percent in 2007 dollars.261 Notwithstanding the widely recognized challenges in reducing flats costs, it is not possible to draw broader cost and efficiency conclusions from partial productivity measures such as the operation-specific measures ANM cites.

3. Outside County Carrier Route Periodicals

Finally, ANM et al. incorrectly claim that Outside County Carrier Route Periodicals have an “unadjusted” cost coverage exceeding 100 percent.262 In ANM et al.’s Table 6,263 the reported cost per piece in ANM et al.’s cost coverage calculation includes only modeled mail processing costs, including a proportional control factor that adjusts modeled costs to the CRA costs for the associated mail processing cost pools. However, ANM et al. improperly omit the non-modeled mail processing cost of 2.321


261 It is coincidental that the inflation-adjusted cost decline matches the weighted average productivity decline reported by ANM et al.

262 ANM et al. Comments at 107-108.

263 Id. at 108.
cents per piece for Outside County Periodicals, representing costs for mail processing
cost pools not covered by the Periodicals model or the CRA control factor applied to the
modeled costs.\textsuperscript{264} The total cost for a workshared rate category is the sum of the
modeled cost and the non-modeled (fixed) cost. Contrary to ANM \textit{et al.}’s claim,
correcting this omission demonstrates that Outside County Carrier Route Periodicals is
underwater, with a cost coverage of 94.4 percent.

\textbf{Table 2: Corrected cost coverage calculation for Outside County Carrier Route
Periodicals}\textsuperscript{265}

<table>
<thead>
<tr>
<th>Row</th>
<th>Item</th>
<th>Data</th>
<th>Source</th>
</tr>
</thead>
<tbody>
<tr>
<td>[1]</td>
<td>Revenue per piece</td>
<td>$0.230</td>
<td>ANM \textit{et al.} Comments at 108 (Table 6)</td>
</tr>
<tr>
<td>[2]</td>
<td>Modeled cost per piece</td>
<td>$0.221</td>
<td>ANM \textit{et al.} Comments at 108 (Table 6)</td>
</tr>
<tr>
<td>[4]</td>
<td>Total cost per piece</td>
<td>$0.244</td>
<td>[2] + [3]</td>
</tr>
</tbody>
</table>

In sum, ANM \textit{et al.} go awry in their effort to develop cost “adjustments” that might
bolster their attempt to blame flat-shaped products’ underwater status on Postal Service
cost management. Actual volume declines, particularly those associated with the Great
Recession, cannot be assumed away, and they have had major consequences for unit
transportation and delivery costs. ANM \textit{et al.}’s proposed adjustment for mail processing
costs, on the other hand, is developed by cherry-picking certain favorable data and
ignoring unfavorable data, and consequently flies in the face of the actual overall trend.

\textsuperscript{264} Not modeled costs include operations such as bulk acceptance (LDC 79), P.O Box distribution,
Computer Forwarding System (LDC 49), and miscellaneous other operations whose costs are not
affected by the degree of worksharing.

\textsuperscript{265} For the derivation of Table 2, see Microsoft Excel file “USPS.RM17-3.Rep.Com.Workpapers.xlsx” (filed
with these comments), tab “Table 2”.

Meanwhile, contrary to what ANM et al. assert, unadjusted costs for even the subset of Outside County Carrier Route Periodicals are indeed below water. The analyses upon which these parties would have the Commission rely do not withstand critical scrutiny. They provide no credible basis to refute the Commission’s sound conclusion that addressing the vexing problem of underwater products and classes requires alterations in the current price cap regime.

B. With More Rigorous Explanation, the Proposed 2 Percentage Points of Additional Authority for Underwater Classes Might Be Appropriate for a Trial Period

While a rate remedy is clearly needed, the Public Representative is right to point out that Order No. 4258 fails to explain why the Commission proposes 2 percentage points of additional rate authority, as opposed to some other number. The Commission’s discussion of various options focuses entirely on Marketing Mail Flats; it offers no comparable quantitative justification for the choice of proposed additional rate authority for Periodicals, which has lower cost coverage and a smaller unit revenue base (meaning that an equivalent price increase will yield less additional unit revenue) than Marketing Mail Flats. If a quantitative analysis shows that 2 percentage points of additional rate authority would do little to close Periodicals’ cost-coverage gap, as the Public Representative believes, and that it might do even less than for Marketing Mail Flats, then the Commission should at least provide a robust qualitative explanation of why, in its judgment, the relatively moderate pace of “narrow[ing of] the coverage gap

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266 Public Representative Comments at 28-30.
267 See Order No. 4258 at 77-80.
268 Public Representative Comments at 29.
and mov[ement] toward full cost coverage over time” is nonetheless consistent with the objectives and factors.\textsuperscript{269}

It may well be that, upon fuller examination, 2 percentage points is the right amount. While a more aggressive rate of potential price increases might close the cost-coverage gap faster, it might also have unexpected effects on volume and revenue from Periodicals, as well as from other products mailed by the Periodicals industry.\textsuperscript{270} In light of these uncertainties, the Commission might be able to offer a reasoned explanation for providing an additional 2 percentage points of rate authority to address Periodicals’ cost-coverage problem, as opposed to some higher amount, for at least the period until the next Section 3622(d)(3) review is complete. (As noted in section II.C above, the amount of maximum rate authority that the Commission provides in accordance with the objectives and factors is a different matter from whether the Postal Service might choose to use that rate authority, or how it might allocate it, in response to market dynamics.) All parties would have a chance to observe the effects over that trial period, and the Commission could then revisit whether a more or less aggressive amount of rate authority would be appropriate thereafter. Of course, if the Commission has reason for concern sooner – in terms of the pace or direction of cost-coverage change, or spillover effects on other products – Section 3622(d)(3) allows it to conduct a review at any “appropriate” time.

\textsuperscript{269} See Order No. 4258 at 85.

\textsuperscript{270} See NMA Comments at 7-9; see also ANM et al. Comments at 81, 98, 108 (discussing multiplier effects of Periodicals).
C. The Commission Should Not Infringe on the Postal Service’s Pricing Flexibility with Respect to Individual Underwater Products

The situation of individual underwater products within an above-water class is somewhat different. The proposal for underwater classes would provide the Postal Service with additional rate authority, and the Postal Service would retain substantial flexibility to allocate that rate authority among products and price categories within a given class. For individual underwater products within an above-water class, however, Order No. 4258 would make unprecedented inroads into the Postal Service’s discretion over how to allocate cap space among products. This rule would rigidly prioritize allocative efficiency (objective 1 and factor 2) above all else, including pricing flexibility (objective 4 and factor 7) and such countervailing factors as that type of mail’s relative value, the public impact of such price increases, and the consequences for electronic substitution (factors 1, 3, 4, and 8).

To borrow the Public Representative’s understatement, “[t]his is a departure from the usual practice of allowing the Postal Service to decide how to price its products.”

The Commission’s longstanding practice has been to take a more holistic, thoughtful approach to underwater products, looking to rate remedies only as a last resort, and then only to a moderate degree that recognizes and reflects the array of policy and business considerations at play. That practice has continued after Order No. 4258, including in the Annual Compliance Determination report that the Commission issued.

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271 Public Representative Comments at 58.
272 See USPS March 1 Comments at 143-45.
only yesterday.\textsuperscript{273} While Order No. 4258 contains some discussion of why 2 percentage points might produce different effects on a unit basis (under idealized conditions) than 1 or 3 percentage points,\textsuperscript{274} it does not provide a reasoned explanation for jettisoning the Commission’s longstanding holistic approach in favor of a rate-rebalancing mandate far in excess of any of the above-class-average price increases for underwater products that the Commission has praised in the past, including during the pendency of this proceeding.\textsuperscript{275} Nor does the Commission so much as acknowledge, let alone respond to, the Postal Service’s explanation of why “a far more radical allocation of limited pricing authority[, which] would be necessary to achieve full [unit] cost coverage,” would be counterproductive on an overall contribution basis, so long as a class-level price cap remains.\textsuperscript{276}

To the extent that the Commission retains a class-level price cap, the approach that best balances the relevant objectives and factors is that proposed by the Public Representative. The Commission should discard the forcible-rate-rebalancing rule and give the Postal Service a chance to apply its pricing flexibility and business judgment to the additional rate authority (including adjustments for volume declines) provided in the\textsuperscript{276}

\textsuperscript{273} FY2017 ACD at 2, 51-76 & app. B at 1-3 (adopting various responses to ten underwater market-dominant products, none of which include directing the Postal Service dedicate a specific quantum of class-based cap space to any such product).

\textsuperscript{274} Order No. 4258 at 78-80.

\textsuperscript{275} See USPS March 1 Comments at 144-45 & fn.312-313.

\textsuperscript{276} USPS March 20 Comments at 134-35. While the Public Representative at least acknowledges the Postal Service’s point, he is mistaken to regard Order No. 4258 as “seek[ing] to avoid the problem identified by the Postal Service.” Public Representative Comments at 59. With its class-based price cap, the proposal in Order No. 4258 would perpetuate the current system’s problem: raising unit cost coverage for the underwater product will require a sacrifice of unit revenue from other products within the class that have more stable volumes, with the overall result of reducing the amount of class-level contribution that the Postal Service otherwise might have been able to garner.
The Commission can review the efficacy of this approach in the next Section 3622(d)(3) review. If specific concerns arise before then, it will continue to possess the same remedial powers that it has today through the annual compliance review and complaint processes.

D. The Commission Should Also Preserve the Postal Service’s Pricing Flexibility as to Above-Water Products Within an Underwater Class

As discussed in section VI.A.3 above, ANM et al.’s contention that Outside County Carrier Route Periodicals are above water is factually wrong. Even if it were true, however, it would raise the question of how the proposed underwater-class rules ought to apply to above-water products (or, in the case of Outside County Carrier Route Periodicals, sub-product-level rate categories) within such a class. ANM et al. argue that the underwater-class rate authority ought not to be applied to an individual above-water product or rate-category.

In the body of Order No. 4258, the Commission purports to propose a rule along the lines of ANM et al.’s argument (albeit at the product level, not the rate-category level). But no principle mandating a particular allocation of rate authority within an

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277 Public Representative Comments at 59. While the Public Representative clearly agrees with his expert declarants’ goal of raising underwater-product rates to compensatory levels “as soon as possible,” the Public Representative’s ultimate recommendation makes clear that this does not necessarily imply a need to mandate a specific allocation of rate authority. Id.

278 If the Commission nonetheless believes it essential to provide some restriction on the Postal Service’s pricing flexibility for individual underwater products, it could provide that those products’ rates (on average) cannot increase by less than the class average. This would guard against any perception of allowing the Postal Service to relax its efforts to improve such products’ cost coverage, while preserving the Postal Service’s flexibility to decide the appropriate size of price increases above the class average.

279 ANM et al. Comments at 9.

280 Order No. 4258 at 85 (“If there are any products within a non-compensatory class for which product-level revenue exceeds the product-level attributable cost, then prices for such products may only be increased up to the amount of the class average.”).
underwater class is to be found among proposed Rules 3010.200-202, and such a principle cannot be inferred from the rules regarding individual underwater products. Although the text of proposed Rules 3010.200 and .201 does not expressly limit their scope to products in above-water classes, the body of Order No. 4258 clarifies those rules’ scope in precisely those terms. Even if that were not the case, basic logic holds that the rate-rebalancing rule for underwater products cannot simply apply as a matter of course to underwater classes: the only current underwater class is composed entirely of underwater products, and it is mathematically impossible to give both of them above-class-average price increases. Thus, if the Commission intends to address the theoretical special case where an above-water product might someday exist within an underwater class, it should do more to explain that intent.

If the Commission follows through with a rule to cap price increases for above-water products within an underwater class at the amount of available rate authority other than underwater-class rate authority, then that rule should apply collectively to the group of above-water products within the underwater class, rather than to each above-water product individually. Collective application would ensure that the class’s cap space would be concentrated on the underwater products within the class, as intended, while preserving the Postal Service’s general pricing flexibility to determine the appropriate distribution of other cap space across above-water products. By contrast, application of the principle to each individual above-water product would gratuitously constrain the Postal Service’s discretion to distribute even class-average or below-

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281 Id. at 80 (“Proposed § 3010.201 sets forth the rate setting criteria for non-compensatory products in classes for which overall class revenue exceeds overall class attributable cost.”).
class-average cap space among multiple above-water products. There would be no benefit in terms of the class-level cap’s concentration on underwater products; they would already be receiving a collective above-average increase. Such an approach would commit an even greater infringement on objective 4 than the proposed rate-rebalancing rule, which is agnostic as to how the Postal Service distributes cap space among above-water products within the class. If the Commission finds it necessary to craft any rule at this time to cover above-water products within an underwater class, it should take care to preserve the Postal Service’s pricing flexibility across products and price categories and, at a minimum, impede that flexibility no more than for above-water products in other classes with underwater products.

VII. INCREASING THE RIGIDITY OF WORKSHARE DISCOUNT RULES IS NOT A WORKABLE SOLUTION

In contrast to the competing views regarding underwater products, the mailing industry is practically unanimous in its support for a floor on workshare-discount passthroughs, with some commenters going so far as to urge the Commission to ratchet its proposed compliance bands more tightly around 100 percent or to demand immediate compliance.282 It bears noting, however, that these comments appear to be coming from bigger mailers who participate highly in worksharing. Most mailers who are not participating in worksharing appear not to recognize the price increases they might face if workshare mailers get lower prices because of the passthrough floor.283


283 But see GCA Comments at 24-27 (supporting decreasing the lower bound).
While those proposals for tighter compliance bands may aim for productive-efficiency perfection, they do not reflect the practical reality of implementation. At such a granular level, even a small change in unit cost can have a significant percentage effect. Yet many workshare pricing structures also use whole-ounce weight intervals and $0.001 price increments, making it difficult to attune pricing precisely to a small numerical, but significant percentage, change in cost avoidance. In light of these challenges, it can take time to shift a discount into a target range. Narrowing the proposed compliance bands beneath +/-15 percent or truncating the proposed three-year grace period would be difficult to administer. It could also force sub-optimal pricing decisions if the Postal Service were forced to decrease workshare customers’ discounts significantly in order to get them closer to 100 percent cost avoidance, and it could harm other mailers if a requirement of deeper workshare discounts impelled the Postal Service to raise revenue from other mailers instead.284 Either consequence would violate the spirit, if not the letter, of the limitations in 39 U.S.C. § 3622(e)(3).285 And as the Postal Service has previously explained, narrow compliance bands can severely constrain its pricing flexibility (objective 4), and even abolish it altogether if the ends of the band converge on a single price point.286

284 See USPS March 20 Comments at 233.
285 The Postal Service maintains that these limitations continue to bind the Commission’s discretion, and that the language, structure, and objectives of Section 3622 indicate Congress’s intent that the Commission should not be authorized to create a floor as well as a ceiling, let alone abolish the exceptions and limitations that Congress deemed necessary. See USPS March 20 Comments at 28-32, 229-31. The Postal Service’s March 20 comments also pointed out why economic literature supports ECP only in highly restrictive conditions; in practice, substantial leeway must be afforded to account for potentially countervailing efficiency concerns. Id. at 231-34. At any rate, the Commission claims that its proposed rules incorporate at least certain statutory exceptions and limitations as a matter of policy. Order No. 4258 at 93, 95 (accounting for Periodicals’ educational, cultural, scientific, and informational value and for the avoidance of rate shock).
286 USPS March 1 Comments at 147.
Another variable is exogenous volume declines. As volume declines, economies of scale and density are lost, and average unit costs rise. As average unit cost increases, so too does the avoided cost of a workshared activity, meaning that the Postal Service would have to increase the size of the discount in order to maintain the same passthrough rate. A passthrough target, even one expressed as a +/- 15- or 25-percent range, would thus force the Postal Service to perpetually chase the volume trend. The narrower the band, the more difficult and high-maintenance this task becomes, particularly in light of the challenges discussed in the previous paragraph. This volume-trend effect is also a reason not to overlay additional restrictions within the compliance bands or grace periods, such as by prohibiting the movement of a passthrough farther away from the target range.287

As noted in section III.D above, “fixing” workshare discounts is not an excuse to defer other needed repairs to the rate-regulation system. The effect of deeper workshare discounts on institutional-cost contribution is ambiguous. For mailers already willing to perform the work at a lower passthrough rate, deepening discounts may do nothing more than confer rents upon those mailers at the expense either of the Postal Service (thereby working against objectives 5 and 8) or of other mailers whose rates will be increased in the interest of revenue-neutrality (potentially working against objective 8 and the allocative-efficiency component of objective 1). In practice, the reduction in the Postal Service’s unit revenue is immediate. Yet the costs of operating a widely distributed universal service network cannot be eliminated immediately as workload

287 Pitney Bowes Comments at 13-14.
shifts to mailers.\textsuperscript{288} Even if, overall, some margin of net contribution increase were somehow to occur, it would not be sufficient to close the financial gap that comprises the current system’s violation of objectives 5 and 8.

Moreover, to the extent that a lower bound is established, the Postal Service agrees with GCA that the bands should allow more leeway to below-100-percent (low) passthroughs than to above-100-percent (high) passthroughs.\textsuperscript{289} Moving low passthroughs closer to 100 percent might have little impact on the mailer’s (or mail service provider’s) decision to workshare. Instead, the main effect might be to reduce the revenue collected from that mailer (or mail service provider), which under a price cap could lower Postal Service revenue, or shift the revenue burden to other rate categories. The social welfare implications of such a shift are unclear, especially considering the windfall that the mailer (or mail service provider) would enjoy.

GCA’s example of widely different costs to barcode mail between the mailer and the Postal Service can be extended to presorting. If mailing lists are presorted prior to the creation of the mail pieces, then the cost of presorting is significantly lower for such a mailer compared to the physical sorting performed by the Postal Service. Setting the discount equal to the Postal Service’s cost savings therefore would lower Postal Service prices, and revenue, much more than is needed for the most efficient mail preparation. Forcing the Postal Service to increase low passthroughs therefore contradicts the interests of efficiency (objective 1) and financial stability (objective 5).

\textsuperscript{288} ANM \textit{et al.} Comments at 8 (acknowledging “the failure to scale down Postal Service operations and costs in tandem with the decline in its volume and workload in recent years”).

\textsuperscript{289} GCA Comments at 24-27.
In addition, over the last ten years, the Commission’s rules have required the Postal Service to bring high passthroughs down to 100 percent, or else to justify how exceptions excuse compliance. On the other hand, the Postal Service has been required only to “identify and explain” low passthroughs. Because a passthrough floor would be a new requirement, more leeway is warranted than for high passthroughs, which are already prohibited by Section 3622(e) unless justified by exception. Thus, if a passthrough floor is to be imposed, the Commission should set it at greater variance from 100 percent than the ceiling. For instance, the floor could be set at 65 percent for Periodicals and 75 percent for all other classes of mail. This approach would be justified legally, and it would make both economic and practical sense.

As stated in its initial comments, the Postal Service does not support establishing a passthrough floor. To the three specific changes that the Postal Service proposed in its initial comments, however, the Postal Service would add two additional recommendations. First, compliance in any annual compliance review should be evaluated against the most recent cost avoidance estimates available at the time of the most recent price adjustment filing, not in relation to any subsequent cost avoidance estimates that might be available at the time of the annual compliance review. In other words, a workshare estimate would be deemed to be in compliance for any given fiscal

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290 39 C.F.R. § 3010.12(b)(6).

291 The result of the statutory asymmetry in requirements is that, using current prices and FY2017 cost avoidances, 45 passthroughs are below 85 percent (or 75 percent for Periodicals) and 35 passthroughs are below 75 percent (or 65 percent for Periodicals), but only 21 passthroughs are above 115 percent (or 125 percent for Periodicals).

292 USPS March 1 Comments at 146-47.
year if it would have been in compliance at the time of the most recent price adjustment filing. Sampling variability from cost systems and operational and technological changes can materially affect the validity of an ACD directive by the time of a price-adjustment notice, thereby interfering with mailers’ ability to maintain stable expectations as to the magnitude of price changes (objective 2).\textsuperscript{293} While the annual compliance review can still be used to gain insights into the trajectory of workshare-discount compliance, it is simply too cumbersome and capricious to have multiple points in a yearly cycle where workshare discounts are measured and changes may be ordered, particularly if the final rule adds new restrictions beyond those in the current system.

Second, whether or not the Commission adopts Pitney Bowes’s proposal to deny a grace period to an existing workshare discount that later falls out of compliance,\textsuperscript{294} the Postal Service should be allowed to make a case for restarting a grace period if a passthrough rate strays beyond where the Postal Service can reasonably move it back into compliance in a single price increase. Such a case-specific showing would allow for a measure of deference to the Postal Service’s pricing flexibility, the challenges of maintaining workshare-discount compliance amid pricing-structural and exogenous constraints, and the Postal Service’s business judgment about customers’ needs.

\textbf{VIII. CONCLUSION}

In Section 3622(d)(3), Congress charged the Commission with evaluating whether the PAEA’s initial price-cap system still lives up to Congress’s expectations, as

\textsuperscript{293} USPS March 20 Comments at 233-34.

\textsuperscript{294} Pitney Bowes Comments at 13.
embodied in the objectives and factors. The Commission has already established that the current system has not done so. Foreseeing this eventuality, Congress further charged the Commission with modifying or replacing the system "as necessary to achieve the objectives." Because the chief failures concern the current CPI-only price cap’s inability to maintain the Postal Service’s financial stability in the face of volume declines, the Commission is statutorily required to reform the ratemaking system in a way that is reasonably expected to cure the problem going forward.

It is clear that the system lacks the necessary flexibility to account for market realities. The most effective way to provide that flexibility, at this time, would be to recognize the primary role of market pressures, rather than regulatory safeguards, in achieving the statutory objectives, and to use regulatory monitoring and the prospect of re-intervention as an additional check. If the Commission is determined to continue price-cap regulation for the near term, then solving the current system’s problems begins with an initial resetting of rates to compensatory levels, consistent with best regulatory practice. It does not end there, however: additional mechanisms must provide a meaningful opportunity to attain income for financial needs above the breakeven point and must insulate the new rate base from the same exogenous forces that caused the current system to fail. This is what the statutory parameters require at this time, in terms of the ratemaking system’s outer bounds. The Commission’s role is limited to the setting of those outer bounds; Congress reserved to the Postal Service’s Governors the exclusive business judgment to determine what actual price increases would appropriately balance market realities and other relevant considerations.
Doing nothing is not a valid exercise of the Commission’s statutory duty. Unrebutted record evidence shows that there are simply not enough meaningful cost-cutting opportunities to fill the current financial gap (or the one that the proposals in Order No. 4258 would leave), let alone to compensate for the growth in that gap under a continued CPI-only price cap. No other commenter has identified a significant or reliable gap-filler that might avert the need for rate-regulation reform. In particular, while the postal community, including the Postal Service, stands united in its desire for legislative reform, speculation about such reform is not a legally supportable basis for the Commission to avoid its responsibilities under Section 3622(d)(3). Nor is it factually supportable, as reform legislation along the lines of current bills would not obviate the need for regulatory reform anyway.

Fears of a “death spiral” are likewise no basis to stint on regulatory reform. Apart from their lack of substantiation, such hypotheses only bear out the Postal Service’s point that demand pressures have eclipsed the need for a regulatory check on the Postal Service’s pricing behavior. As the actor closest to the market, the Postal Service is in the best position to assess and balance market risks and customers’ short- and long-term needs, and it has every incentive to price in a manner that preserves mail volume and to maximize cost-reduction opportunities instead of relying on price increases. No price cap is needed.

To the extent that the Commission follows through on a price cap along the lines of Order No. 4258, its proposal of supplemental rate authority is based on a firm regulatory premise: resetting rates to total costs going into a new price cap. Among the parties that recognize this purpose, there is consensus that the baseline used to
compute the supplemental rate authority must be revised to better reflect recent and expected net losses, the various calculations of which all range between $5 billion and $6 billion. Moreover, because financial stability and compensatory rates inhere a level of income above the breakeven point, additional rate authority is necessary to provide additional liquidity: either an unconditional 1 percentage point of authority beyond the supplemental authority or, less optimally, rate authority that is realistically achievable. To avoid repeating the central cause of the current system’s failings, the intended value of those new forms of rate authority must be preserved through mechanisms to adjust for exogenous factors, such as changes in economies of density and RHB and pension expenses. The alternative approaches recommended by other commenters do not constitute improvements to the Commission’s proposal.

Finally, while there is some basis for caution regarding underwater classes, the Commission’s proposal of an additional 2 percentage points of rate authority may strike the right balance until the situation can be re-evaluated in the next Section 3622(d)(3) review. The new system should also maintain the Postal Service’s pricing flexibility with respect to individual products, consistent with longstanding Commission practice, and with respect to the realities of workshare discount pricing.

Where the current system should have provided the Postal Service with the resilience to recover from severe market shifts, the system instead proved rigid and resistant. That is why it failed. The Commission is now statutorily bound to apply the lessons learned from that failure and to design an improved system. The typical conditions that motivate a price cap – market power that allows the regulated firm to charge unreasonably high prices to captive customers while allowing costs to run
rampant – are simply not present in the current postal market. Hence, the most logical improvement would be to recognize that there is no need for a price cap at all. Failing that, the price cap must at least be reformed in a manner compatible with best practices and reflective of current market realities. No matter the approach taken by the Commission, the Postal Service’s discretion within the regulatory bounds will necessarily be constrained by market conditions, business realities, and the need to sustain a viable, universal postal service.