

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Statutory Review of the System)
for Regulating Rates and Classes) Docket No. RM2017-3
for Market Dominant Products)

**COMMENTS OF THE ALLIANCE OF NONPROFIT MAILERS,
THE ASSOCIATION FOR POSTAL COMMERCE,
MPA - THE ASSOCIATION OF MAGAZINE MEDIA
THE AMERICAN CATALOG MAILERS ASSOCIATION,
THE DIRECT MARKETING ASSOCIATION OF WASHINGTON,
THE NONPROFIT ALLIANCE,
THE ENVELOPE MANUFACTURERS ASSOCIATION,
THE SATURATION MAILERS COALITION,
AND THE CONTINUITY SHIPPERS ASSOCIATION**

February 3, 2020

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February 3, 2020

I. INTRODUCTION AND SUMMARY OF COMMENTS

We (collectively, “Joint Commenters”) represent some of the Postal Service’s largest, longest-tenured, and most loyal customers. We and our customers, subscribers, members, and donors are large-volume mailers of magazines, newspapers, catalogs, charity fundraising appeals, fulfillment pieces, newsletters, letters, financial statements, utility bills, and many other pieces of mail classed as market-dominant. We *want* the Postal Service to remain a viable medium for our communications. That is why we were active participants during Phase I (in response to Order No. 3673) and Phase II (in response to Order Nos. 4257 and 4258) of this docket. And that is why, in these comments, we explain that the Commission’s revised proposals in Order No. 5337 should not be pursued. Our comments are supported by the expert declarations of Robert D. Willig, PhD.; Kevin Neels, PhD., and Nicholas Powers, PhD.; and Robert Fisher, and by the declarations of the

following nonprofit organizations: Consumer Reports, Inc.; American Lung Association; Southern Poverty Law Center; National Wildlife Federation; Guideposts Foundation, Inc.; and Disabled American Veterans.

The Commission's proposals in Order No. 5337 are illegal: the Commission cannot enact them because the Postal Accountability and Enhancement Act (PAEA) does not permit it to grant above-inflation rate authority to the Postal Service. Congress baked a Consumer Price Index-Urban Consumers (CPI) cap into the statute to protect mailers and the American public and to incent the Postal Service to make wise, business-like operating decisions. Thus, PAEA identifies the CPI cap as a "requirement" of whatever market-dominant ratemaking system the Commission designs. Section 3622(d)(3), which obliges this docket, says nothing to the contrary. In fact, it does not refer to the CPI cap at all. The statute's plain language makes clear that the CPI cap is a Congressionally-mandated component of the system, and whatever modified version of the system might emerge from this review must keep it.

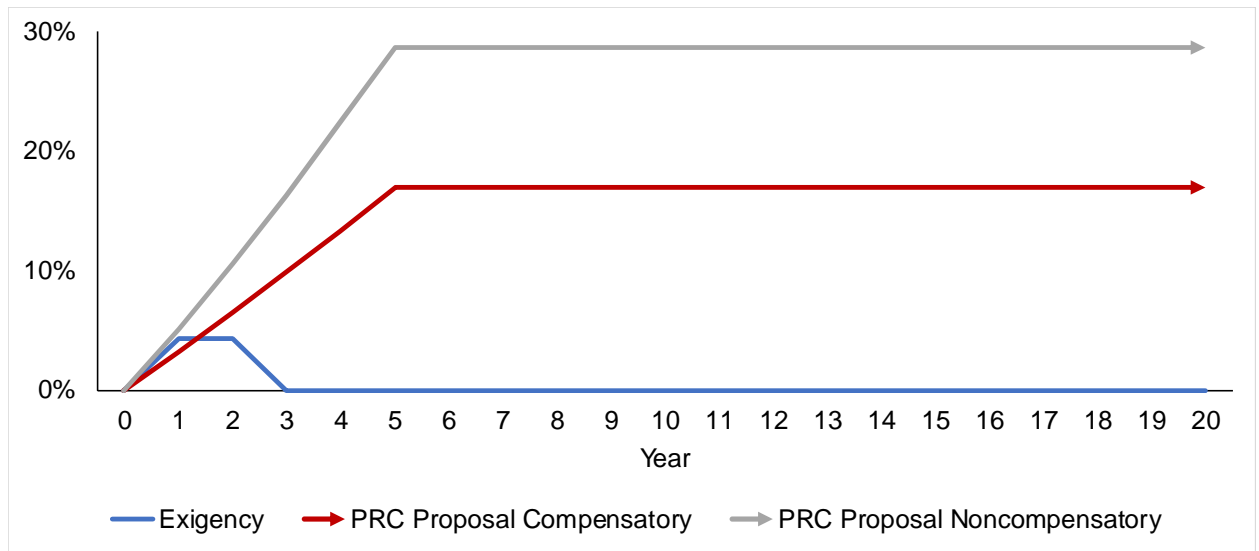
Even if the Commission *could* legally authorize the massive above-inflation price increases contemplated here, it should not *want* to. The proposals will not work. They will not strengthen the Postal Service's financial condition. They will not incentivize the Postal Service to behave more efficiently or become more productive. They will move the "system" farther away from achieving several important statutory objectives, such as maximizing incentives to reduce Postal Service costs (Objective 1), creating predictable and stable rates (Objective 2), and maintaining just and

reasonable rates (Objective 8). What’s more, the proposals will so badly exacerbate market-dominant volume losses that they will eventually deprive the Postal Service of the very revenue that the Commission hopes to provide (Objective 5). The Commission may hand-wave this prediction, but it does so at its peril: although the Commission has performed *no* analysis of the projected volume and revenue impact of its proposals (as reasoned decision-making requires), our comments are supported by both expert and mailer declarations written by people who have.

Order No. 5337 may have some superficial appeal over its predecessor. Whereas the Commission in Order No. 4258 proposed fixed above-CPI rate increases, it now proposes formula-based modifications that at least appear to be tethered to the Postal Service’s underlying problems. Upon scrutiny, however, the revised proposals are revealed for what they are: attempts to “true-up” the prices market-dominant mailers have paid to the Postal Service since PAEA was enacted. Such retroactive ratemaking is unlawful and problematic. It is a thinly-veiled attempt to skirt the CPI cap *ex post facto*. It robs mailers of any predictability inherent in their purchasing decisions. It harms other members of the mail ecosystem—from the beneficiaries of charitable programs funded by mail, to rural Americans who rely on mail delivery, and even (ironically, given their support for above-inflation price authority) postal employees who may lose their jobs when customers flee. And it disrupts the regulatory bargain struck by PAEA, signaling that the Postal Service will be bailed out of perceived financial challenges without having to tighten its proverbial belt, relieving the operator of any motivation to control costs.

The Commission’s plan, when viewed in its historical context, is startling. The last time that the Commission authorized above-CPI rate increases for market-dominant products occurred during the exigency rate case. See Order No. 2623 in Docket No. R2013-11R (July 29, 2015). The exigency increase was a *temporary* 4.3 percent rate increase that cost mailers less than \$5 billion. The revised proposal, on the other hand, would authorize a *permanent* 17 percent phased-in above-inflation rate increase (or 29 percent for noncompensatory products) that will cost mailers about \$8 billion *per year*. The present value of the pricing authority that the Commission is now proposing will cost mailers approximately *\$220 billion*—almost *fifty times* more than the impact of exigency. The two are not remotely comparable, and the exigency’s impact on mail volume is not a predictor of what will happen if the Commission’s current proposals come to pass. Figure A depicts this discrepancy:

Figure A – Comparison of Rate Increases Under Exigency and Order No. 5337 Proposals



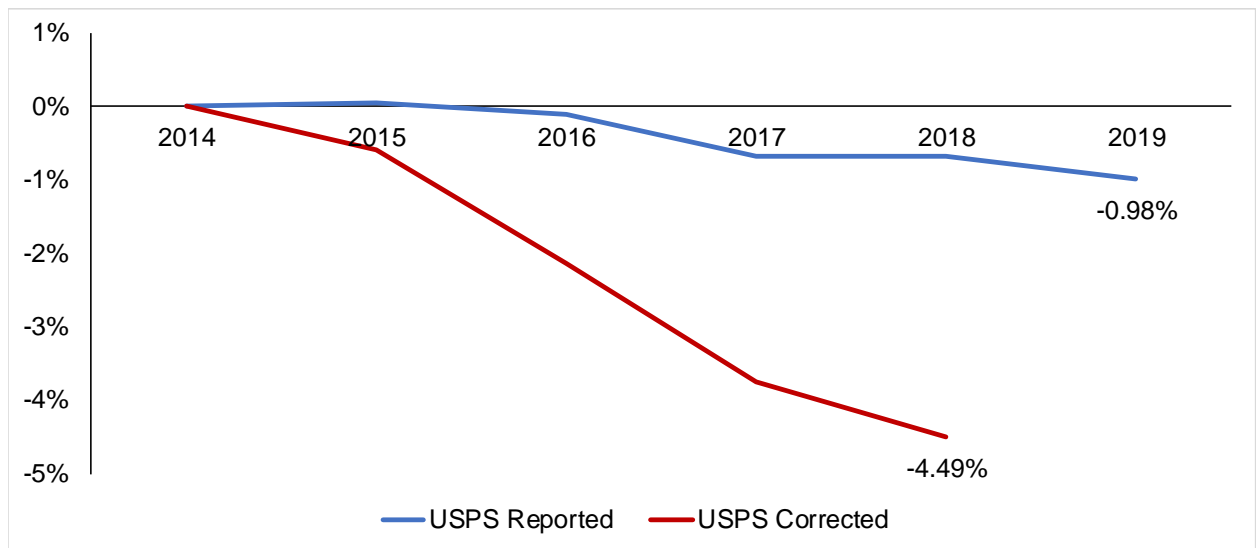
Source: ANMetalRM2017-3 Comment Wkpapers.xlsx, “Price Increase Comparison”

The density-based supplemental authority will invert the Postal Service's incentives to operate efficiently, rewarding the Service with higher prices for previous volume declines that the operator should be working to stem. Moreover, the proposal will dramatically over-compensate the Postal Service for reductions in volume and increases in the number of delivery points: in other words, it is not rationally related to the problem it is trying to fix. The retirement-based supplemental authority is another unlawful and unwise attempt to circumvent the CPI cap after-the-fact. It will hurt mailers, and it will not materially benefit the Postal Service or its retiring workforce, for whom more than \$300 billion has already been put aside for retirement benefits. Congress clearly intended for the Postal Service's retirement prefunding obligation to exist in conjunction with the CPI cap—indeed, both measures were written into the same law—and thus any characterization of the retirement funding obligation causing the Postal Service unanticipated difficulties rings hollow. Both the density and retirement-based proposals are examples of retroactive ratemaking that will grant the Postal Service more pricing authority as volumes decline, triggering a death spiral of the Commission's doing.

The performance-based proposal turns incentive ratemaking on its ear. It is unjustified, backward-looking, and would reward the Postal Service with an additional one percent of pricing authority for achieving productivity levels *below* historical benchmarks. Perversely, mailers would be better off if the Postal Service's productivity *declined* (relieving mailers from having to face an additional one percent price hike) rather than increased. Even worse, the Postal Service's measure of

productivity—total factor productivity (“TFP”)—is inaccurate and overstates productivity growth by about one percent per year from FY2015 to FY2018, on average. Once corrected, Postal Service productivity has not just stagnated in recent years (which is problematic in its own right) but fallen dramatically. Thus, the Postal Service could capture this extra pricing authority *even if its actual productivity fell*.

Figure B – Cumulative Change in Postal Service Productivity



Source: ANMetalRM2017-3 Comment Wkpapers.xlsx, “Productivity”

All told, the Commission is proposing extraordinary changes to a rate system that both it and Congress have recognized was designed to shield market-dominant mailers and incentivize the Postal Service to cut costs. Now, the Commission has seemingly thrown up its hands—it has given up on holding the Postal Service’s feet to the fire and has proposed modifications to the system that will harm mailers and give the Postal Service a free pass. This short-term “free pass” comes with a long-

term price tag: eventually, without a sustainable customer base, the Postal Service will suffer from the Commission's proposals as well.

The proposed modifications are illegal. They constitute bad policy. And they represent a striking abandonment of the Commission's duty to engage in reasoned decision-making. For the reasons below and in our supporting declarations, the proposals must be rejected.

II. THE COMMISSION'S PROPOSED REGULATORY CHANGES VIOLATE PAEA

If implemented, the Commission's revised proposals would be counterproductive, inimical to sound economic theory, injurious to the Postal Service's customers (and, consequently, to the Postal Service's financial health), and an abandonment of the Commission's duty to engage in reasoned decisionmaking. Our comments are predominantly focused on these flaws. *See* §§ III-IV, *infra*.

We also note, though, that the Commission's Order No. 5337 proposals violate 39 U.S.C. § 3622 itself. The Commission seeks to grant the Postal Service pricing authority over market-dominant products equal to:

- Changes to the Consumer Price Index; ***plus***
- Additional rate authority tied to decreases in mail density; ***plus***
- Yet more rate authority to compensate the Postal Service for its retirement benefit payment obligations; ***plus***
- Another one percentage point of authority for each mail class for "meeting or exceeding" modest growth and service standard measures.

See Order No. 5337, Attachment A at 14-38 (published at 84 Fed. Reg. 67685 (Dec. 11, 2019)). Postal products that do not cover their attributable costs, like Marketing

Mail Flats, would be subject to a mandatory annual additional price hike of at least two percentage points above the class-wide percentage increase. Noncompensatory classes, *i.e.*, Periodicals, may be subject to an additional two percentage points of pricing authority also. *Id.*, Attachment A at 38-39 (proposed 39 C.F.R. § 3010.221 and 3010.222). Thus, the Postal Service could be granted annual new rate authority of up to five percent (for compensatory products) or seven percent (for noncompensatory products) above inflation, as depicted here:

		Average	Maximum
Density Rate Authority	[1]	1.23%	2.69%
Retirement Rate Authority	[2]	0.94%	1.11%
Performance-Based Rate Authority	[3]	1.00%	1.00%
Additional Rate Authority for Non-Compensatory Classes	[4]	2.00%	2.00%
Total Hypothetical Rate Authority (Compensatory Classes)	[5]	3.17%	4.80%
Total Hypothetical Rate Authority (Non-Compensatory Classes)	[6]	5.17%	6.80%

See Brattle Decl. at ¶ 35, Table 1. Over five years, compensatory classes could see cumulative average rate increases of roughly 17 percent in real terms and 29 percent in nominal terms, with maximum real and nominal increases of 26 percent and 39 percent, respectively. For noncompensatory classes, the cumulative average rate increases could be even more drastic: 29 percent in real terms and 41 percent in nominal terms. Those cumulative increases over noncompensatory classes could reach as high as 39 percent (real) and 53 percent (nominal):

Authority	Compensatory		Noncompensatory	
	Average	Maximum	Average	Maximum
Density	1.2%	2.7%	1.2%	2.7%
Amortization	0.9%	1.1%	0.9%	1.1%
Performance-Based	1.0%		1.0%	
Noncompensatory	N/A		2.0%	
Total Annual Increase (Above Inflation)	3.2%	4.8%	5.2%	6.8%
Total 5-Year Increase (Above Inflation)	16.9%	26.4%	28.7%	39.0%
Total 5-Year Increase – Nominal	28.7%	39.0%	41.4%	52.5%

Our previous comments submitted in this docket and in a 2014 white paper that we and other parties presented to the Commission both explain why the Commission may not do this: (1) the plain language of 39 U.S.C. § 3622 obligates the Commission to maintain the price cap, which Congress clearly identified as a mandatory “requirement” of the system for regulating market-dominant rates; (2) Congress structured the statutory scheme so that the Commission was instructed to review, and modify if necessary, the “system” that the Commission created via regulation—*not* the statutory provisions that Congress made superior to the system itself; (3) the Commission itself previously, and repeatedly, held that the CPI cap holds a central and primary place atop Congress’ statutory scheme; and (4) Commission efforts to abrogate the price cap will effectively re-write the statute, raising constitutional concerns under the Presentment Clause and non-delegation doctrine. *See generally* ANM *et al.* Comments (Mar. 1, 2018) at 9-29 (“Phase II Comments”); ANM *et al.* Comments (Mar. 20, 2017) at 9-10, n.2 (“Phase I Comments”); ANM *et al.* White Paper (Oct. 28, 2014) (attached as Appendix A to Phase II Comments). Other commenters have raised similar arguments during this proceeding. *See, e.g.*, Docket No. RM2017-3, National Postal Policy Council, *et al.*

Comments (Mar. 1, 2018) at 19-41; Docket No. RM2017-3, Greeting Card Association Comments (Mar. 20, 2017) at 29-34.

Our previous submissions arguing that the Commission lacks the authority to breach the CPI-cap are extensive; we incorporate them by reference into these comments and will not repeat them wholesale. Although the Commission has not persuasively rebutted our earlier-presented legal arguments, we will later respond specifically to the principal contentions advanced by the Commission in Order No. 5337 as to why it still believes PAEA allows it to grant above-CPI pricing authority to the Postal Service. *See* Section V, *infra*.

The Commission also violates PAEA by ignoring Congress’ mandate—in section 3622(d)(3)—that any modified or alternative system for regulating market-dominant rates must be designed “as necessary to achieve the objectives.” Quite the opposite, the Commission’s revised proposals move the ratemaking system farther away from several statutory objectives. Thus, the Commission’s proposals would be held unlawful were they to be incorporated into a final rule and challenged in court. *See* 5 U.S.C. § 706(2)(C) (reviewing court shall “hold unlawful and set aside agency action, findings, and conclusions found to be . . . in excess of statutory jurisdiction, authority, or limitations, or short of statutory right.”).

A. The Commission’s Proposed Above-Inflation Price Increases Violate Section 3622(d)(3) By Undermining Key Statutory Objectives

The Commission’s authority under this ten-year review proceeding is constrained by 39 U.S.C. § 3622(d)(3), which requires that any modified or alternative market-dominant rate system be designed “as necessary to achieve the objectives.”

For this reason, the Commission’s revised proposals violate the statute. The cumulative impact of the proposed density-based, retirement-based, performance-based, and noncompensatory product-specific supplemental authority—resulting in nominal price increases averaging 30 to 40 percent over five years—completely undermines several statutory objectives that the current CPI cap achieves.

The Commission is now abandoning its previous recognition that the price cap balances the statutory objectives well and advances many of Congress’ goals in promulgating them. In the exigency case, the Commission lauded the CPI-based cap as the “centerpiece” of postal reform that achieves Objectives 1 and 2 because it “ensures rate stability and predictability for the nation’s mail users, and provides incentives for the Postal Service to reduce costs and operate efficiently.” Order No. 547 in Docket No. R2010-4, *Order Denying Request for Exigent Rate Adjustments* (Sept. 30, 2010) at 1. The Commission also noted that the “price cap model simplifies the rate-setting process and provides greater accountability for the Postal Service.” *Id.* at 11. This aligns with Objective 6: reducing the administrative burden and increasing the transparency of the ratemaking process. *See* 39 U.S.C. § 3622(b)(6).

The CPI cap system that Congress created not only achieves objectives designed to protect mailers, but pro-Postal Service objectives as well. Again, the Commission correctly recognized this:

The changes effected by the price cap model benefitted ratepayers and other mail users. However, the Postal Service also gained significant advantages in the form of pricing and management flexibility. Senator Tom Carper, one of the primary sponsors of the PAEA in the Senate, stated that the PAEA “give[s] Postal management the tools and the flexibility needed to run the Postal

Service more like a business at a time when there is fierce competition from . . . electronic ‘communication. . . .’ S. Hrg. 109-198 at 9. The PAEA grants the Postal Service broad latitude to alter rates as long as no market dominant class of mail’s rates increased above CPI.

Order No. 547 at 12. The Commission also understood, as did Congress, that the price cap system was designed to allow the Postal Service to earn adequate revenues, including retained earnings. Quoting from the final House Committee report, the Commission explained that “[b]y maximizing gains and minimizing costs, the Postal Service could generate earnings that would be retained, and which could be distributed as incentives to management as well as to employees through collective bargaining.” *Id.* at 70. The Commission went on: “Because the Postal Service does not have shareholders, all accumulated net income would be retained earnings.” *Id.* Thus, the Commission has conceded that the price cap is designed to achieve Objectives 4 and 5.

The Commission’s revised proposals in Order No. 5337 are not designed “as necessary to achieve the objectives.” To the contrary, they represent a complete abdication of the Commission’s statutory obligation to design a system that achieves the objectives.

B. The New Proposed System Would Be Irreconcilable with Objective No. 1

Objective 1 requires that the system “maximize the incentives to reduce costs and increase efficiency.” 39 U.S.C. § 3622(b)(1). The CPI cap does just this, and the Commission knows it. Again, the Commission’s own words ten years ago—when the Postal Service last sought an influx of revenue in response to declining volume—

reveal that it accepted the CPI cap's indispensable role in achieving Objective 1. "A price cap," wrote the Commission, "provided the Postal Service with the proper incentives to control costs." Order No. 547 at 11. The system of market-dominant rate regulation that Congress enacted "provide[s] clear incentives for postal management and the Postal Service as an institution." *Id.* at 12. Indeed, the PRC Chairman during PAEA's enactment, George Omas, testified that a price cap would "provide . . . meaningful incentives that will encourage the Postal Service to be more economical and more efficient." *Id.* (quoting *Postal Reform: Sustaining the Nine Million Jobs in the \$900 Billion Mailing Industry Before the S. Comm. on Govt. Affairs*, 108th Cong. 53, 57 (S. Hrg. 108-527 at 13)).

In Order No. 5337, the Commission sings an entirely different tune. While it "agrees with the commenters that the Postal Service must work to reduce costs," it also accepts that "the Postal Service's cost reduction efforts have been unsuccessful." Order No. 5337 at 156. During exigency, the Commission described PAEA as giving "Postal management the tools and the flexibility needed to run the Postal Service more like a business." Order No. 547 at 12. Today, the Commission laments that it "has limited tools that would directly affect costs." Order No. 5337 at 156-57. The Commission has not only failed to explain how its new proposals will achieve Objective 1; it appears to have given up hope on achieving that objective at all.

The remainder of the Commission's discussion reveals that its strategy to set the Postal Service straight has not changed from its Order No. 4258 proposals: refuse to hold the Postal Service accountable for its cost control failures, gift the Postal

Service the ability to charge its captive customers prices far in excess of inflation, and hope that the Service will use its newfound authority to operate more efficiently. When discussing its noncompensatory product proposal, the Commission makes this plain: “although the Commission expects the Postal Service to continue to work to reduce costs, the Commission proposes to require the minimum product-level increases to increase revenue.” Order No. 5337 at 157. Although this language appears in the section of Order No. 5337 pertaining to noncompensatory products, it reflects a stance that pervades the Commission’s general approach to fixing the Postal Service’s problems. It has abandoned all pretense that it will require the Postal Service to tighten its belt and has decided to bail the Postal Service out of the operator’s cost control failures by authorizing supplemental pricing authority.

Nowhere is this more apparent than in Marketing Mail Flats, a category that was nearly at breakeven in 2006 and is now at about 65 percent cost coverage. During the past two decades the reported costs of this category of mail have gone up 5.4 percent annually, while Factor Prices have risen 2.2 percent annually and inflation has been about two percent. The Postal Service has invested billions in flats automation, ostensibly to reduce the costs of handling flat mail, and during some of this time the Commission has “rewarded” the Postal Service with additional rate authority. These actions have done nothing but drive volume away while the reported costs for flat-shaped mail continue to rise inordinately. The strategy of above-average price increases to combat above-average cost growth is clearly not a recipe for success.

As has been the history following above-average price increases, it has only forced more mail volume out of the system.

The reasons why this proposed approach violates Objective 1 are obvious. If the Commission allows the Postal Service to simply recover for its cost-control shortfalls through excessive pricing, it will have been as if the statutorily-required price cap were all for naught. As a practical matter, the Commission's proposal resembles a cost of service regime with deferred revenue collection, and the type of retroactive ratemaking that generally proscribes regulators from requiring or authorizing the regulated entity to adjust current rates to make up for past errors in projections. *See Town of Norwood v. FERC*, 53 F.3d 377, 381-383 (D.C. Cir. 1995) (“if the company is not, in fact, collecting deferred costs, but instead attempting to make up for errors in earlier approximations of actual costs, [] it engage[s] in impermissible retroactive ratemaking.”).¹ Moreover, the proposals may result in the Postal Service acquiring pricing authority up to five percent (for compensatory products) or seven percent (for noncompensatory products) above inflation annually. That supplemental authority is so high and detached from the CPI cap that it is “completely adverse to

¹ Indeed, courts have long held such retroactive true-ups illegal under the Interstate Commerce Act and related ratemaking statutes. *See, e.g., Old Dominion Elec. Coop. v. FERC*, 892 F.3d 1223, 1227 (D.C. Cir. 2018) (“the rule against retroactive ratemaking ‘prohibits the Commission from adjusting current rates to make up for a utility's over- or under-collection in prior periods.’”) (quoting *Towns of Concord, Norwood, & Wellesley, Mass. v. FERC*, 955 F.2d 67, 71 n.2 (D.C. Cir. 1992)); *see also Associated Gas Distributors v. FERC*, 898 F.2d 809, 810 (D.C. Cir. 1990) (*per curiam*) (Williams, J., concurring) (“for purposes of this doctrine . . . a court must ask whether the costs are past”); *Consol. Edison Co. of New York, Inc. v. FERC*, 347 F.3d 964, 969 (D.C. Cir. 2003) (quoting *Towns of Concord*, 955 F.2d at 71 n.2).

any system of economically efficient incentive regulation.” *See* Willig Decl. at ¶ 7. Put differently, the Commission’s proposals maintain a cap in name only, certainly not in function.

C. The Commission Again Fails To Explain Its Proposal’s Compliance With Objectives 2 and 8

The Commission’s revised proposals also violate Objectives 2 (predictable and stable rates) and 8 (just and reasonable rates). Taking the latter first: we explained at length in our March 2018 comments that the Commission’s then-proposal would violate section 3622(b)(8)’s requirement that the system “maintain a just and reasonable schedule for rates” as well as 39 U.S.C. § 404(b) (authorizing the Governors to establish “reasonable and equitable rates of postage and fees”). *See* Phase II Comments at 62-71. Our critique of the Order No. 4258 proposal applies with even greater force to the Commission’s new proposal. And, the Commission virtually ignores *any* mention of Objective 8 in Order No. 5337. Indeed, the Commission only mentions Objective 8 in reference to its Order No. 4258 noncompensatory product and class proposals. There is no discussion of why the Commission believes that its current proposals will achieve just and reasonable rates, nor any effort to respond to our prior arguments.

Objective 2 requires the system to have predictability and stability in rates. Just as it acknowledged the price cap’s role in incentivizing efficiency and cost reductions (Objective 1), the Commission has similarly observed that the price cap is the feature of the system that “ensures rate stability and predictability for the nation’s mail users.” Order No. 547 at 1; *see also id.* at 11 (“the price cap model was

intended to promote predictability and stability in setting rates”); 38 (“Section 3622(d)(1) of title 39 provides rate stability and predictability through a cap on annual rate increases for each market dominant mail class at the level of CPI-U.”). Authorizing above-CPI price increases on market-dominant mail classes of the magnitude proposed in Order No. 5337 tramples on this important objective.

The Commission does not explain how its revised proposals will achieve Objective 2, and in fact does not address the issue in any serious detail. When explaining its proposal to grant the Postal Service supplemental retirement-based pricing authority, the Commission states in conclusory fashion that the five-year phase-in period “is designed to create a predictable and stable schedule for rate increases while minimizing the impact on mailers.” Order No. 5337 at 95. But the Commission fails to explain *how* this retirement-based supplemental pricing authority will be predictable and minimize the impact on mailers. In fact, the Commission admits that its retirement-based “proposed formula does not attempt to predict future volume to determine the amount of retirement rate authority available in each year of the phase-in period. Instead, it adjusts annually to changes in both volume and the amount of the amortization payments.” Order No. 5337 at 99.

The Commission’s proposals will harm the Postal Service’s customers—the very mailers Objective 2 was designed to protect. Nonprofit organizations, for example, are often high-volume mailers of marketing mail flats, first-class mail, and periodicals that “rely on stable, foreseeable postal rates in order to plan . . . fundraising operations for the following year.” Clark Decl. (Southern Poverty Law

Center) at ¶ 24. The Commission’s “backward-looking formula-based proposals make it impossible . . . to predict how large each year’s postal price increases will be.” Miao Decl. (National Wildlife Federation) at ¶ 13. This means that, as mailers try to develop their budget for the coming year, they will be “unable to clearly project our postal expenses.” O’Sullivan Decl. (Guideposts) at ¶ 6. This lack of predictability “makes business planning in future years very difficult” and will force mailers to consider leaving the mail and moving “member communications to other mediums where we can better predict and control our spending.” Miao Dec. at ¶ 13; *see also* Clark Decl. at ¶ 24 (proposals “make it impossible for the SPLC to project each year’s postage expenses.”). This, of course, is the antithesis of what Congress intended when it drafted Objective 2, as the Commission well knows. *See* Order No. 547 at 11 (“Predictability and stability, the Committee learned, allows mailers to better plan their mailing and could allow them to increase the amount of business they do with the Postal Service.”).

In addition to violating Objective 2’s predictability requirement, the Commission’s proposals also do not achieve stability in rates. As we explained in our comments in response to Order No. 4258, predictability and stability are *each* requisites to compliance with Objective 2, and the Commission’s proposal in that Order improperly conflated the two. *See* Phase II Comments at 57-62. The Commission does not do any better this time. In Order No. 5337, the Commission again avoids any explanation of how its proposals would lead to stability in rates.

Nor could it: allowing the Postal Service to raise rates multiple times the rate of inflation simply does not create rate stability.

When discussing the proposed CPI-plus two percentage point mandatory rate increase that the Postal Service would have to annually impose on noncompensatory products, the Commission claims that this “represents an appropriate mechanism for improving cost coverage while simultaneously maintaining stability and predictability in rates, as required by Objective 2. Both the Postal Service and the mailing community will have notice, through the Commission’s announcement, of the products that are non-compensatory and thus subject to an additional 2-percentage point rate increase.” Order No. 5337 at 157-58. The Commission pays similar lip service to rate stability when addressing the optional CPI-plus two percentage point authority for noncompensatory classes. *Id.* at 168 (“Both the Postal Service and the mailing community will be informed, through the Commission’s announcement, which classes are non-compensatory and thus may be subject to a 2-percentage point rate increase in class-level rate authority.”).

The Commission’s belief that its proposals satisfy Objective 2 because mailers will have “notice” or be “informed” of the price increases reveals the same error that it committed in Order No. 4258: the Commission again appears to think that stability is achieved merely because rate increases—no matter how large—are announced in advance. This is not so. The Commission itself has recognized numerous times that rate stability is defined by the rate’s *magnitude* and that rates that increase measurably faster than inflation violate the stability objective. *See* Phase II

Comments at 58-62. In the exigency case, for example, the Commission adopted Congress' admonition that it is of "primary importance" for predictability and stability that there be "the establishment of a regulatory system *that will provide for limits on the percentage changes in the Postal Service rates*. This system—frequently referred to as a rate or price cap—shall be designed to limit annual rate changes based on the level of inflation." Order No. 547 at 11 (emphasis added).

III. EVEN IF THE PROPOSALS COMPLIED WITH PAEA, THEY WOULD STILL HAVE DISASTROUS EFFECTS

It is obvious that the Commission's primary concern is that the Postal Service cannot raise sufficient revenue to cover its costs and meet its obligations. While no one wants the Postal Service to run out of money, we have previously explained why the Postal Service's financial situation is not nearly as dire as the Commission believes, and there is no realistic danger that the Postal Service will stop delivering the mail anytime in the foreseeable future. *See* Phase I Comments at 34-37 (explaining that the "Postal Service has sufficient liquidity to continue providing essential postal services for the foreseeable future."). While it may be true that the Postal Service would generally be better off if it were bringing in more revenue, it would also be in a better financial position if it had focused more vigilantly on cost cutting, and volume growth and retention over the past thirteen years.

The proposed changes to the system of ratemaking in Order No. 5337 are clearly intended solely to provide the Postal Service with more revenue. They would allow the Postal Service to raise rates well above inflation, which, if volumes remained stable, would increase postal revenues significantly. Therein, of course,

lies the rub. As the Commission has acknowledged, volumes have been declining for years. And while the Commission's price elasticity estimates are ill-suited to predicting the volume loss that would be associated with price increases of the magnitude Order No. 5337 would allow, the Commission acknowledged in Order No. 4258 that higher prices will cause at least some loss of volume. *See* Order No. 4258 at 42-43. That is the problem: in proposing a radical revision of the ratemaking system, the Commission has offered *no* estimates of either volume declines or potential revenue increases, as reasoned decision-making requires of it.

Joint Commenters address the flaws in the Commission's proposals below. First, we explain how the Commission has failed to adequately consider the effect the cumulative price increases allowed by its proposals will have on volume. We then address each of the forms of supplemental authority in turn, demonstrating how each will fail to achieve its stated purpose while contributing to declines in volume, weakening incentives for cost control and efficiency, and failing to protect mailers from unreasonable price increases.

A. The Cumulative Impacts of the Proposed Supplemental Rate Authority Will Lead to Twin Impacts of Massive Price Hikes and Volume Declines

Joint Commenters disagree with the Commission's conclusion in Order No. 4257 that the current system of ratemaking is responsible for the problems the Postal Service is contending with today. *See, e.g.*, Phase II Comments at 55, n.31; Phase I comments at 47-59 (describing actions the Postal Service could take to improve its finances while complying with a CPI-limited price cap). Joint Commenters also disagree with the Commission about the degree of those problems and whether they

require immediate and radical regulatory solutions or would be better addressed through legislative changes, Postal Service management actions, and moderate changes to the regulatory system that would incent proper management actions while retaining the CPI-based price cap. But Order No. 5337 makes clear that Joint Commenters and the Commission largely agree on the fundamental challenge facing the Postal Service: declining volumes and rising costs.

While the statutory prefunding obligations impose an unnecessary burden on the Postal Service's balance sheet, the Postal Service has suffered no consequences for failing to make these payments. As the Commission understands, these missed prefunding payments account for nearly all of the deficit the Postal Service accumulated during the PAEA era. *See* Order No. 4257 at 171 (“The accumulated deficit of \$59.1 billion includes \$54.8 billion in expenses related to prefunding the RHBF.”) While a deficit of \$4.3 billion accumulated over 10 years is not a cause for celebration, it is a problem different in kind and magnitude than the one the Commission believes it is trying to address.

Even with these obligations, it is easy to imagine how the Postal Service's finances would look if market dominant volume were not declining and the Postal Service was focused on improving the efficiency of its operations. In such a world, the Postal Service's revenues would be increasing every year as a result of CPI-limited price increases being applied to stable or increasing volume. These revenue gains would be enhanced by gains from the growth in competitive products (which, even in the real world, has mostly offset any contribution loss resulting from declining

market-dominant volumes). If the Postal Service would only keep its costs increases in line with inflation, its long-term prospects would be significantly rosier than they are today.²

This simple thought experiment illustrates how the Postal Service's financial difficulties are primarily a result of above-inflation price increases, exacerbated to some degree by declining market dominant mail volumes. Any changes to the system of ratemaking in this docket must recognize that fact. Principally, the Commission must ensure that any changes will not reduce incentives for efficiency or accelerate volume loss and thereby exacerbate the very problems it is trying to solve. Unfortunately, by eviscerating the incentives of the price cap and authorizing rate increases that could in aggregate exceed CPI by well over six percent annually, the Commission's proposed rules will likely have just this effect.

1. The Commission's Proposal Would Authorize Dramatic Cumulative Price Increases

Indeed, the Commission seems not to acknowledge that it is authorizing cumulative annual price increases that could exceed six percent for some products.

The major difference between Order No. 4258 and Order No. 5337 lies in the Commission's abandonment of the additional two percent above CPI authority that Order No. 4258 would have authorized for all products. Perhaps recognizing that this authority was not tied to any specific revenue need of the Postal Service, the

² Such an improvement would be consistent with the roll-forward analysis Joint Commenters presented in their Phase I comments, which showed how the Postal Service could continue annual controllable operating income growth between FY 2015 and FY 2019. See Phase I Comments at 33-34; Library Reference ANM *et al.*-LR-RM2017-3/1, Rollfwd.xlsx.

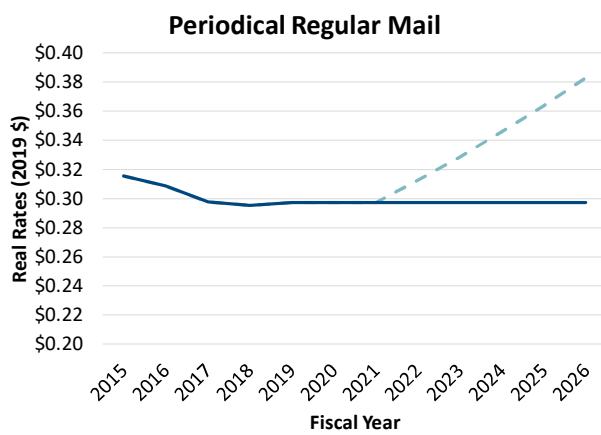
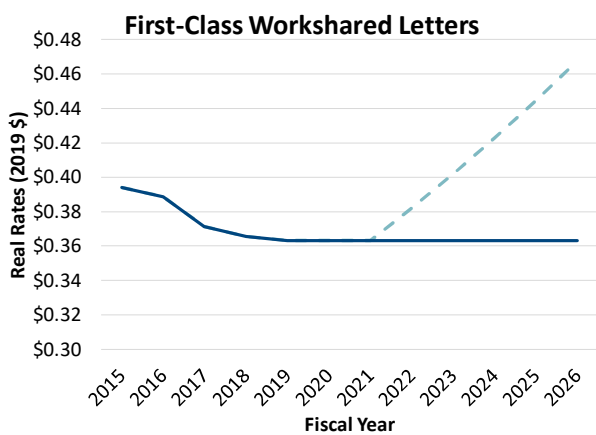
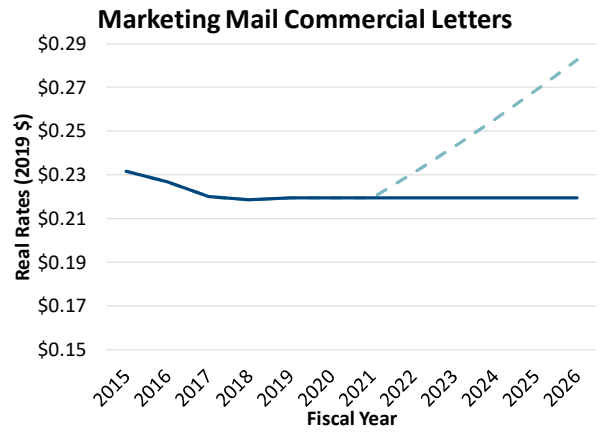
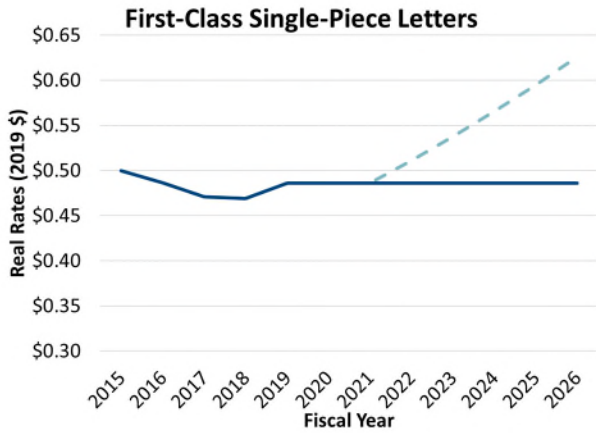
Commission has replaced this authority with supplemental retirement authority and density rate authority. Each of these authorities could exceed one percent above CPI in a given year. Since the Commission has maintained the supplemental rate authority authorized in Order No. 4258 for noncompensatory products and functionally maintained the additional one percent of performance-based rate authority, the total annual rate increases authorized by Order No. 5337 will likely exceed those authorized by Order No. 4258.

As illustrated in the Declaration of Dr. Kevin Neels and Dr. Nicholas Powers (“Brattle Declaration”) as depicted in the tables at pages 7 and 8, *supra*, the cumulative price increases for market-dominant products over the next five years could be massive. Because the available authority for the Postal Service can increase when volume declines, Order No. 5337 will likely authorize price increases even further above CPI. *See* Brattle Decl. at ¶ 46.

The Commission’s attempted justification for each of these supplemental rate authorities—that they allegedly “address[] the underlying causes of the failure to achieve the objectives”—is unpersuasive. *See* Order No. 5337 at 11. As we explain below, these proposals do not “address” the problems the Commission seeks to remedy. And, from a mailer’s perspective, the reasoning behind a price increase is irrelevant. Mailers will pay one postage rate; they will not have the option of choosing between the standard rate, the density rate, and the retirement rate. As Meredith Corporation, the largest magazine publisher in the U.S., states: “The PRC’s method for calculating different types of above-CPI rate authority is not Meredith’s main

concern. Our concern is the total postage price that we will have to pay when all of the PRC's methodologies are implemented." Meredith Corp. Comments (Feb. 3, 2020) at 1; *see also* Brophy Decl. (Consumer Reports) at ¶ 13 ("It does not matter to CR or to our members and donors that the PRC is trying to fix so-called exogenous costs. What we see is that our prices will skyrocket and postal mail volumes will drop."). If the Postal Service exercises all its authority for Marketing Mail Flats and raises prices by more than six percent above CPI each year, mailers of that product will have to decide whether they can obtain a reasonable return on their mailing investment at that cumulative price level.

Make no mistake about it: the cumulative price increases mailers will be evaluating will be significant. The dramatic real price increases the Commission's proposals would authorize are vividly illustrated in the following charts Dr. Neels and Dr. Powers have prepared, which compare the authorized increases to a base case of CPI-U increases through 2026:



Brattle Decl. at ¶ 37, Figure 1. In these charts, the solid line represents the base case in which prices increase at CPI-U, and the dashed line indicates price increases in real terms under the Commission’s proposals in Order No. 5337, relying on the indicative magnitudes of price increases presented by the Commission.

2. These Cumulative Increases Will Significantly Accelerate Market Dominant Volume Decline

Joint Commenters have repeatedly raised the issue of induced volume decline in this docket. See Phase I comments (Cohen Decl. at 5-8; Faust Decl. at ¶ 12); Phase II Comments at 65-70 (discussing how Periodicals and nonprofit mailers will decrease volume in response to price increases). The Commission’s Order No. 4258 wrongly projected revenue impacts of above-CPI rate increases based on the assumption that

volumes would remain steady even though PRC admitted that “recent volume trends and the effects of price elasticity” made that unlikely. Phase II Comments at 80 (quoting Order No. 4258 at 42). Order No. 5337 does not remedy these defects. In fact, it compounds them by authorizing price increases that could exceed even those suggested in Order No. 4258. Despite granting increased pricing authority, the Commission fails to make any projections whatsoever regarding volume impacts of the price increases the order would authorize. Accordingly, the Commission should evaluate the volume impacts of its pricing proposals at a cumulative level, not based on whether the individual supplemental authorities will address a specified problem. The Commission has not done so in Order No. 5337.

Joint Commenters, on the other hand, have commissioned such an analysis. Dr. Neels and Dr. Powers assess the likely impact of price increases of the magnitude the Commission’s proposals would authorize. Brattle Decl. at ¶¶ 34-53. They note that using the Postal Service’s own estimates of price elasticity, rate increases of the magnitude described in the previous section “could increase cumulative volume losses at the class level by an additional 4.7% to 8.5% over the next five years.” Brattle Decl. at ¶ 39.

There are good reasons to believe that this estimate likely understates the volume loss that would occur as a result of the Commission’s proposals. Brattle Decl. at ¶¶ 44, 46. Because the existing Postal Service price elasticity models are based on 16 years of data during a period in which price increases, on average, have simply tracked inflation (*i.e.*, when real costs for mailers have not risen), they were not

developed from observations of how mailers respond to large and sustained above-CPI price increases. *See* Brattle Decl. at ¶ 42.

The Commission may point to the exigency rate case, but that was not remotely comparable to what the Commission is proposing today. The above-CPI rate increases authorized in that docket were different in kind and magnitude from those proposed here, and they were time-limited from the outset and set to expire as soon as the Postal Service recovered its losses. *See* Order No. 3186 in Docket No. R2013-11, *Order On Removal Of The Exigent Surcharge* (Mar. 29, 2016) at 2-3. The approved exigent authority was \$4.634 billion. This exigent increase was not baked into the rate base, meaning that there would be no cumulative rate impact over time.³ It is possible that the annual increases proposed in Order No. 5337 for all products will exceed the 4.3 percent increase authorized in the exigency case, and certain that they will for non-compensatory products.

The long-term rate impact of the Order No. 5337 proposals dwarfs that of the exigency increase. The total five-year increase above inflation is approximately 17 percent. Brattle Decl. at ¶ 36. In sum, the Commission is proposing to award the Postal Service with total supplemental price authority that can increase market-dominant mail and services revenue by \$7.7 billion.⁴ Because there is no expectation

³ The 4.3 percent exigent increase took effect in January 2014 and was rolled back on April 10, 2016.

⁴ Our calculation applies the proposed cumulative increase to the USPS FY2019 Total Market Dominant Mail and Services Revenue. *See* Docket No. ACR2019, Library Reference USPS-FY19-1, Public_FY19CRAReportRev.1.10.2020.xlsx, “Cost2”, cell D33.

of a rollback in these rates, the present value of these increases in perpetuity is a whopping \$220.6 billion—well more than an order of magnitude higher than the value of the exigency-based rate hike. It seems obvious that price increases of such differing magnitude would have disparate impacts on mailer behavior.

In fact, mailers themselves tell us so. According to Consumer Reports, “[i]f the PRC permits the Postal Service to raise prices on market-dominant mail in this way, we estimate needing to cut our acquisition Marketing Mail volume by about 9.5M pieces in the same time period—a cumulative loss of 18.35 percent in our prospecting volume alone, which creates a downstream effect.” Brophy Decl. ¶ 11. The American Lung Association’s board of directors and management would “divert resources away from direct mail,” reducing ALA’s “ability to raise significant funding using the mail to combat lung disease.” Finstad Decl. ¶ 9. The “mere possibility of the proposed postage rate hikes has already had an impact on Guideposts,” and if the Commission’s proposals were actually implemented the organization “would be forced to reduce direct mail volumes.” O’Sullivan Decl. ¶¶ 6-7. The Southern Poverty Law Center “would be forced to reduce the amount of mail for its fundraising appeals, publications, investigative reports, and other important communications.” Clark Decl. ¶ 25. And Disabled American Veterans will be forced “into the untenable position of having to further reduce the volume of mail sent each year.” Burgoon Decl. ¶ 10.

The Postal Service elasticity estimates likely, therefore, understate elasticity under the scenarios the Commission’s proposal would allow. Dr. Neels and Dr.

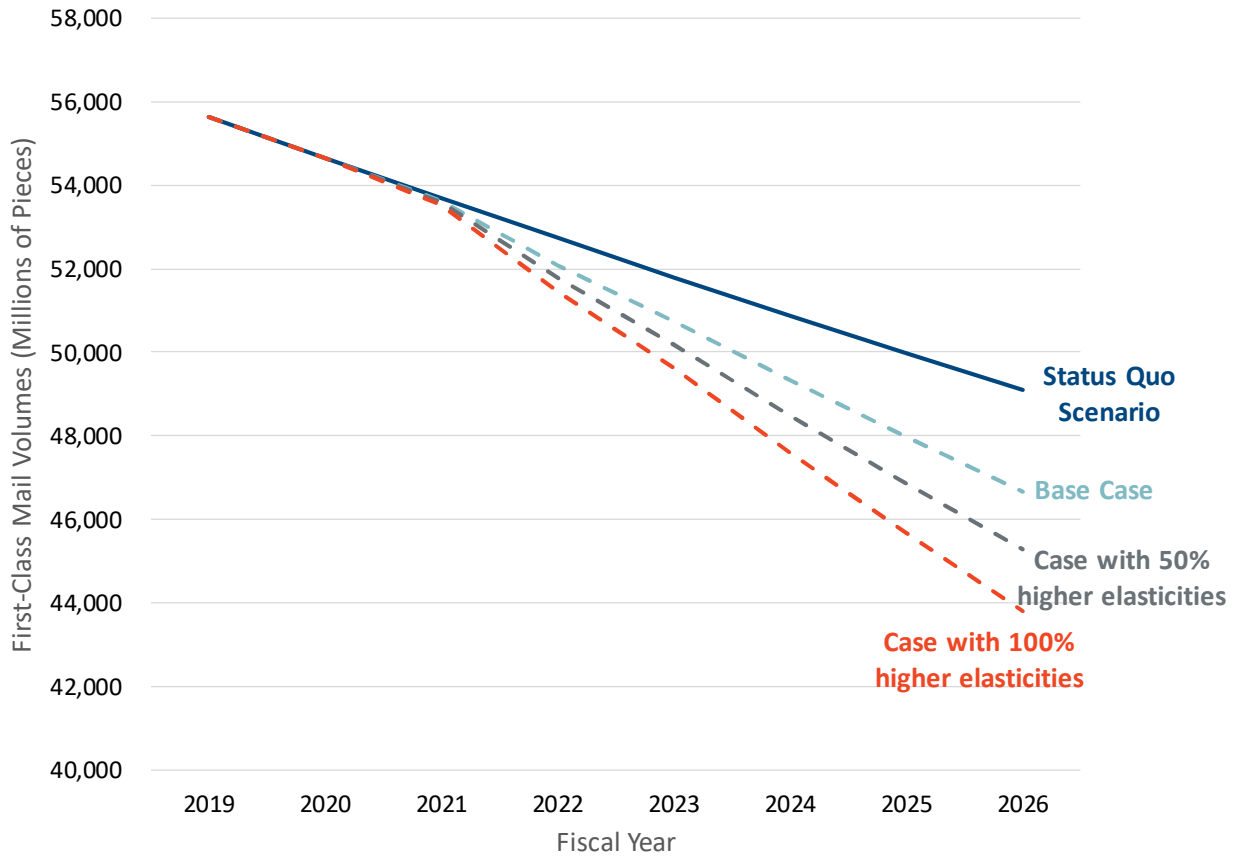
Powers explain that “as prices move outside the range over which the data are calibrated, the estimated elasticity parameters are necessarily less reliable.” Brattle Decl. at ¶ 43. Generally speaking, larger price increases will make demand increasingly price-elastic because “they present erstwhile consumers of the good or service in question with increasingly large incentives to search for and find acceptable substitutes.” *Id.* at ¶ 44. In the postal context, this dynamic means that mailers with the ability to do so may be more likely to leave the mail entirely in favor of digital alternatives. The growth and importance of digital technology itself may also increase the price sensitivity of mailers. Brattle Decl. at ¶ 45. In light of these factors, and when faced with the prospect of rate increases of this size, mailers may not wait to see what the Postal Service does with its increased rate authority (*i.e.*, whether it uses all of its authority in each year). Instead, they may alter their business models to take advantage of other modes of communication and may not return to the Postal Service even if the prospective price increases fail to materialize. Brattle Decl. at ¶ 46; *see also* O’Sullivan Decl. ¶ 6 (“once we make this conversion, we will not be able to return to our previous mail volume levels.”).

Accordingly, Dr. Neels and Dr. Powers caution that “far greater responses to rate increases are very plausible,” and “[t]he mere possibility of sustained and unprecedentedly large rate increases may trigger sudden and potentially significant volume losses.” Brattle Decl. at ¶ 53. Additionally, at some point a “tipping point” could be reached where “a large exodus of mail volume in a given year triggers a large density authority related rate increase in a subsequent year, setting the Postal

Service on a vicious cycle where a dwindling number of mailers pay ever-increasing rates to cover the costs of the increasingly oversized and under-utilized Postal Service network.” *Id.*

Nevertheless, likely effects of the Commission’s proposals on mail volume can be assessed quantitatively. Using data and parameters from the Postal Service’s demand equations, cost and revenue data, Postal Service data on delivery points, and historical data provided to the Commission, Dr. Neels and Dr. Powers quantify the impact of these proposals in a variety of scenarios. Brattle Decl. at ¶ 47 In the “status quo” scenario, they assume the current price cap is maintained and price increases are limited to inflation. Brattle Decl. at ¶ 48. In the “base case” scenario, they assess the effects of the Order No. 5337 proposal using existing Postal Service elasticity estimates. *Id.* In other scenarios, consistent with the preceding discussion, they estimate the volume impacts of the Order No. 5337 proposal if demand turns out to be more elastic than these estimates would suggest. *Id.* Their results, reproduced in the charts below for First-Class Mail and Marketing Mail, illustrate how the Commission’s proposals will accelerate volume decline versus the status quo scenario:

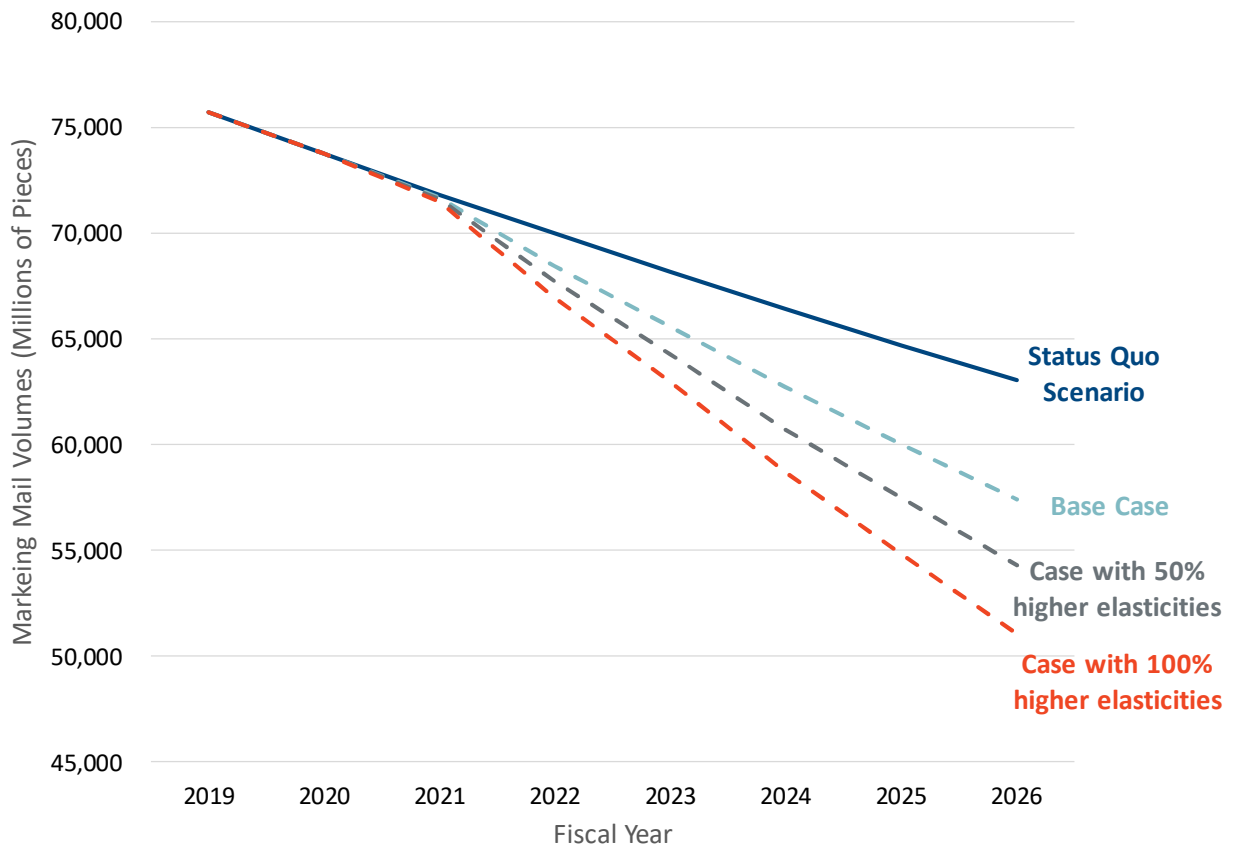
Figure 1: First-Class Volume Under Different Scenarios, FY19-FY26



Notes and Sources:

This chart plots First-Class mail volumes that can be expected to result from the analysis of the various scenarios, as described above.

Figure 2: Marketing Mail Volumes Under Different Scenarios, FY19-FY26



Notes and Sources:

This chart plots Marketing Mail volumes that can be expected to result from the analysis of the various scenarios, as described above.

Brattle Decl. at ¶ 50, Figures 3 and 4. Table 2 of the Brattle Declaration displays these changes numerically, indicating volumes could decline between 51 to 111 percent more for First-Class Mail versus the expectation under the status quo, 62 to 131 percent more Marketing Mail, and 18 to 37 percent more for Periodicals:

		Status Quo	Base Case	50% Higher Elasticities	100% Higher Elasticities
		[A]	[B]	[C]	[D]
First-Class Mail					
Absolute Change (Millions of pieces)	[1]	(4,590.8)	(6,961.0)	(8,303.6)	(9,754.9)
Relative Increase in Volume Loss	[2]		52%	81%	112%
USPS Marketing Mail					
Absolute Change (Millions of pieces)	[3]	(8,807.5)	(14,271.0)	(17,279.7)	(20,461.6)
Relative Increase in Volume Loss	[4]		62%	96%	132%
Periodicals					
Absolute Change (Millions of pieces)	[5]	(954.5)	(1,078.6)	(1,145.7)	(1,216.4)
Relative Increase in Volume Loss	[6]		13%	20%	27%

Brattle Decl. at ¶ 51, Table 2.

As discussed above, the Commission has not publicly estimated the volume impacts of its proposal, much less grappled with the entirely foreseeable outcome that volume will decline faster under its proposals than it would under the CPI-limited price cap. The Commission’s only retort to such arguments seems to be to reiterate that the Postal Service is not obligated to use the full rate authority it has been granted and should exercise its discretion not to increase prices to a level that would cause counterproductive volume losses. *See, e.g.*, Order No. 5337 at 123-24 (explaining that the full amount of performance-based rate authority “is not required to be used or exhausted by the Postal Service” and that “the Postal Service must exercise business judgment to determine the appropriate level of rate increases in light of various considerations, including the effect on mail volumes”).

There are multiple problems with relying on the Postal Service’s “business judgment” to protect mailers (and the Postal Service from itself). First, there is a

well-established record of the Postal Service eventually using virtually all of the rate authority it has been granted. Brattle Decl. at ¶ 40. Second, the Postal Service has publicly advocated for increased rate authority, in this docket and in other settings. *See, e.g.*, Docket No. RM2017-3, Comments of the United States Postal Service (March 20, 2017) at 175-228 (arguing for replacement of the current system with a system that grants the Postal Service to set prices at any level subject only to monitoring by the Commission as to compliance with the objectives).⁵ It is unlikely, after undertaking such efforts, that it would not take advantage of such rate authority. Third, the Commission’s proposals are clearly premised on the Postal Service taking advantage of its full authority. The Postal Service must use its supplemental authorities in the first price change after they become available, or it loses access to that authority in future rate changes.⁶ Further, there would be no point in granting authority tied to the amount of revenue the Commission believes the Postal Service is losing from supposedly exogenous factors if the Commission did not believe the Postal Service would use that authority to cover these obligations.

⁵ *See also* Docket No. RM2017-3, Initial Comments of the United States Postal Service in Response to Order No. 4258 (March 1, 2018) at 40-48; *The Financial Condition of the Postal Service: Hearing before the House Comm. on Oversight and Reform, United States House of Representatives* 116th Cong. 14-15 (Apr. 30, 2019) (Statement of Megan J. Brennan, Postmaster General and Chief Executive Office, United States Postal Service); USPS FY2019 10-K at 42 (“We continue to assert that the price cap should be eliminated, and that the PRC should engage in after-the-fact, light-touch review of the Market-Dominant prices we set to ensure that those prices are just and reasonable.”).

⁶ This feature further undermines the responsibility for managing its customer portfolio that was a central feature of PAEA, granting the Postal Service authority over the prices it charges customers as long as it stayed within the overall inflation capped maximum price.

But perhaps most importantly, the Postal Service will be motivated to use all of this supplemental pricing authority. As Dr. Neels and Dr. Powers explain, “the Postal Service’s estimates of price elasticity, which are generally less than 1 in absolute value, imply that by raising rates, it can increase market dominant contribution and its overall profits. Indeed, it is because of the likelihood that the Postal Service would abuse unlimited freedom to raise rates that PAEA subjected the Postal Service to regulatory oversight by the Commission.” Brattle Decl. at ¶ 40.

Ultimately, not only do the Commission’s proposals do nothing to address the root causes of the Postal Service’s financial problems—volume loss and costs that are rising faster than inflation—but they will have the opposite of their intended effect, driving volume from the mail and creating the risk of a death spiral for the Postal Service. As Joint Commenters explained in their Phase II Comments, the CPI-based price cap requirement of PAEA was motivated by a desire to avoid precisely this outcome. See Phase II Comments at 81-82 (citing Cong. Rec. S11674 (Dec. 8, 2006) (Sen. Collins) (supporting a price cap to avoid “a potential death spiral in which escalating rates lead to lower volume, which in turn leads to even higher rates, which in turn causes the Postal Service to lose more business”); *accord* Cong. Rec. H65613 (July 26, 2005) (Chairman Davis comments on H.R. 22)).

The fact remains that the Postal Service cannot solve its financial problems simply by raising prices, and the Commission cannot guarantee the Postal Service sufficient revenue to cover its obligations. As Joint Commenters explained in their Phase II comments, “[W]hen a regulated industry is in financial trouble . . . there is

nothing a regulator can do to guarantee a ‘fair rate of return.’” Phase II Comments at 80 (quoting WILLIAM J. BAUMOL AND ALAN S. BLINDER, MICROECONOMICS: PRINCIPLES AND POLICY at 442 (7th ed. 1998)). The Postal Service, like any business, is subject to the laws of supply and demand. If it raises its prices, it will depress demand for its services.

As the analysis above shows, the price increases authorized by Order No. 5337 would almost guarantee significant volume loss, thus exacerbating one of the primary problems the redesigned system of ratemaking should be seeking to remedy. They will also allow the Postal Service to increase prices well above inflation, thus eliminating the incentives to reduce costs that are imposed by the current price cap. Finally, as a basic matter, allowing these price increases fails to protect captive mailers from the Postal Service’s monopoly power. While the price increases will accelerate volume declines, mailers will still enter billions of pieces of mail. PAEA requires that the rates for these mailers be just and reasonable, and rate increases averaging 40 percent over five years on products that already cover their attributable costs facially violate that requirement. *See* 39 U.S.C. § 3662(b)(8).

B. The Density Rate Proposal Will Undermine, Not Achieve, the Commission’s Objectives

The Commission’s proposed volume density supplemental authority suffers from several theoretical flaws that will almost certainly result in its failure to improve the financial circumstances of the Postal Service. This supplemental authority subverts the incentives typically provided for in price cap regulation by retroactively compensating the Postal Service for volume loss. Through this

backwards-looking approach, it undermines the regulatory bargain by placing all the risk of volume loss on postal customers. By failing to distinguish between volume loss resulting from exogenous factors such as technological change and that resulting from factors within the Postal Service's control, such as quality of service, it reduces incentives for the Postal Service to maximize efficiency, embark on growth initiatives, and ensure its customers are receiving quality service. The no-strings-attached rate authority provides a perverse incentive, awarding the Postal Service additional rate authority for volume declines it potentially could have prevented.

Additionally, the density authority is not rationally related to the expenses it is intended to recover. The Commission has made no attempt to tie the additional rate authority it would award to the financial impact either a decline in volumes or an increase in delivery points has on the Postal Service.

1. The Proposal is Theoretically Flawed

As Dr. Willig explains in his declaration, declining volumes are a real problem for a regulated entity with high fixed costs, and it is reasonable in certain circumstances for a system of regulation to account for exogenous volume declines. *See Willig Decl. at ¶ 20.* The modifications the Commission has proposed in Order No. 5337, however, are not a reasonable response to the problem of declining volumes. In fact, they violate basic tenets of price cap and industrial organization theory.

As Dr. Willig explains, any adjustment to the price cap to account for declining volume should be prospective, with an element of risk sharing between the Postal Service and its customers. *Willig Decl. at ¶ 20.* By contrast, "adjustments to allowed prices that are based on actual, measured volume loss every year are decidedly

contrary to the fundamental concept of price caps and would confer dysfunctional incentives on the regulated entity.” *Id.* Instead, any adjustment should be “established based on the predicted future decline in mail density.” *Id.* at ¶ 21. If, like the Commission’s proposal, the adjustment represents an attempt to make up for past losses, the adjustment “would thoroughly undermine the efficiency incentives of the price cap mechanism because the regulated firm could look forward to true-up compensation as a replacement for its needed efforts to control cost increases and volume losses.” *Id.*

Not only does a forward-looking approach appropriately share risk of volume declines between mailers and the Postal Service, but it creates “an incentive for the Postal Service to limit density declines to the extent it can because it would directly benefit.” *Id.* at ¶ 24. By contrast, the Commission’s proposal “in effect rewards the Postal Service for density declines by providing additional annual pricing authority retroactively without providing any built-in incentive for the Postal Service to limit density declines (to the extent it can do so, even indirectly).” *Id.*

2. The Postal Service Should Not Be Compensated for Volume Declines Within its Control

Additionally, as Dr. Timothy J. Brennan explained on behalf of the Public Representative in Phase I of this proceeding, any adjustment to the price cap designed to account for declining volumes “should be based on events outside the control of USPS, such as the growth of the Internet and the consequent use of electronic communication instead of USPS services. In particular, if demand falls because USPS reduces the quality of service, it should not be rewarded through

higher rates.”⁷ The Commission appears to recognize this principle in Order No. 5337, stating that it is providing the Postal Service with additional rate authority to compensate it for “increases in per-unit cost that are driven by measured declines in year-over-year density, which are outside of the Postal Service’s control.” Order No. 5337 at 77. But the Commission’s proposal is not consistent with this reasoning.

As Dr. Neels and Dr. Powers explain, the density authority does not differentiate between density declines resulting from exogenous volume decreases (*i.e.*, technology-driven decreases in mail volumes) and those that result from rate increases or other factors within Postal Service control. Brattle Decl. at ¶ 30. This design flaw is exacerbated by the self-reinforcing nature of the density authority, through which mail volume losses that result from sub-optimal marketing efforts (or other controllable factors) will be *rewarded* with additional rate authority in the future. Brattle Decl. at ¶ 33.

This design flaw is further exacerbated by the fact that there are *numerous* factors associated with mail volume declines that are clearly within the Postal Service’s control. These include things like weak marketing efforts and a failure to price services according to mailer demand. Then, there is poor customer service: beyond the Postal Service’s shabby treatment of its mailer base (as reported to Joint Commenters by many of our members), instances like the Postal Service’s surprise publication of proposed changes to Marketing Mail content standards springs to

⁷ Docket No. RM2017-3, Declaration of Timothy J. Brennan for the Public Representative (Mar. 20, 2017) at 14 (“Brennan Declaration”).

mind. *See* USPS Marketing Mail Content Standard, 83 Fed. Reg. 42624 (Aug. 23, 2018). That proposal would have harmed a large number of our members, required us to fight the effort (we won), and failed to inspire any loyalty from market-dominant mailers to the Postal Service. There is also, of course, the Postal Service’s inability to contain cost and expense growth, as well as its failed investment in the Flat Sequencing System (“FSS”). We have addressed this issue *ad nauseum*. *See, e.g.*, Docket No. R2019-1, MPA Comments (Oct. 30, 2018) (reiterating that the Commission should not consider above-CPI price increases for Periodicals until the Postal Service ends the failed FSS experiment). But when the Postal Service’s own Inspector General reports that flats mail processed on the FSS costs three times as much per mail piece as those processed on the AFSM, and that flats volume “will continue to decline as customers move to less expensive ways to achieve their communication goals,” that is something within the Postal Service’s control. *See* USPS OIG Report No. AR-18-008 (July 26, 2018). It is certainly not an exogenous factor for which the Postal Service should be rewarded with extra pricing authority.

3. The Commission Fails to Account for the Large Cumulative Impact of the Proposed Price Increases

The impact of the cumulative price increases described in section III.A. must also be accounted for when assessing the implications of this proposal. Dr. Neels and Dr. Powers explain that these increases “can be expected to accelerate future volume declines,” which, all things being equal, “will accelerate decreases in density.” Brattle Decl. at ¶ 31. They further note that the institutional cost ratio multiplier that partly determines the amount of density authority is likely to increase because attributable

costs can be expected to decrease more quickly than institutional costs. *Id.* For this reason, the full effects of the density adder will exceed the backward-looking estimates provided by the Commission in Table IV-3. *Id.* at ¶ 31.

Dr. Neels and Dr. Powers conclude that “[t]he year-over-year effect of sustained price increases means that the density authority embeds a positive feedback loop in the regulatory structure of the Postal Service. The presence of this feedback loop means that the Commission’s Table IV-3 is not a reliable indicator of the future impact of its proposed density authority.” *Id.* at ¶ 32.

4. The Density Authority Is Not Rationally Related to The Impacts of Declining Density

The Commission’s density authority proposal is arbitrary and capricious because the Commission fails to make any credible effort to quantify the impact of the change in density on postal finances and the size of the adjustment required to offset it. The arbitrariness of the Commission’s implementation can be seen in its dramatic contrast with the estimates that would be produced by applying previously approved and longstanding Commission methods to calculate the financial impact of density reductions.

Established PRC methods for calculating the financial impact of changes in volume and delivery points show that the proposed adjustment factor substantially overstates the negative impact of these factors on postal finances. Specifically, in its Order, the Commission shows (based upon an analysis of changes in density from FY 2011 to FY 2018) that if its proposal had been implemented historically, the Postal Service would have received 8.96 percent density-based rate authority from FY 2013

to FY 2019, translating into approximately \$6.3 billion in FY 2019 in revenue.⁸ This is an order of magnitude above the actual negative impact (about \$600 million) of these factors on postal finances using established methods.

First, using the Commission’s method to quantify the impact of volume changes on postal finances from Docket No. R2013-11⁹—multiplying the per-piece contribution (“profit”) by mail class by the change in volume in the mail class and summing—the impact of mail volume changes on postal finances was minimal. See Figure C.

Figure C – Contribution Loss (FY 2011 – FY 2018)

Mail Class	Volume			Contribution	
	FY 2011	FY 2018	Change	Unit	Change
First-Class Mail	73.1	57.3	(15.8)	\$0.229	(\$3.6)
USPS Marketing Mail	84.7	77.3	(7.4)	\$0.064	(\$0.5)
Periodicals	7.1	5.0	(2.1)	(\$0.123)	\$0.3
Package Services	0.7	0.6	(0.0)	\$0.035	(\$0.0)
Priority Mail Express	0.04	0.03	(0.01)	\$15.474	(\$0.2)
Priority Mail	0.8	1.1	0.3	\$1.973	\$0.6
First-Class Package Service	0.6	1.3	0.6	\$0.924	\$0.6
Ground	0.4	3.1	2.7	\$1.028	\$2.8
Total					(\$0.1)

Source: ANMetalRM2017-3 Comment Wkpapers.xlsx, “Vol-Related Contribution Change”
Note: Volumes and Contribution Changes are in billions

⁸ The \$6.3 billion is calculated by multiplying the 8.96 percent of density-based rate authority against total revenues of \$69.9 billion from Docket No. ACR2019, USPS-FY19-1. This is consistent with the Commission’s concession that the entire burden of density declines should not be borne by market dominant products in its use of both Market Dominant and Total Volume in calculating density authority. Even if the 8.96 percent of density-based rate authority were applied just to Market Dominant revenue, the resulting \$3.9 billion is still multiple times higher than the actual negative impact of these factors.

⁹ See Order No. 1926 in Docket No. R2013-11, *Order Granting Exigent Price Increase* (Dec. 24, 2013) at 106.

The primary reason for this result is that volume gains were concentrated in mail classes (*i.e.*, classes consisting primarily of packages) with high per-piece contribution and the beneficial effect of these volume gains largely offset the negative effect of larger volume declines in mail classes with much lower per-piece contribution.

Second, the established approach for estimating the impact of increasing number of delivery points on Postal Service costs is to increase institutional carrier costs to reflect the higher non-volume workload. This approach was last used in Docket No. R2013-11.¹⁰ Using this approach in FY 2014, the Postal Service last estimated that the annual cost increase due to increased delivery points was about \$76 million¹¹ or about \$530 million over seven years. Furthermore, this estimate is biased upward because it doesn't reflect the fact that new delivery points are generally lower-cost delivery points.¹² Indeed, the Postal Service's move towards cluster boxes neutralizes much of the impact of delivery point growth. Brattle Decl.

¹⁰ See the non-volume workload factors calculated in Docket No. R2013-11, USPS-R2010-4R/8, Input_12.xls, "Non-vol Wkld", cells D42:D46, and the result of the non-volume workload adjustment in FY2014BR.CompSumRpt.BR-Final.xls, "Component Summary", cell G300.

¹¹ See Docket No. R2013-11, USPS-R2010-4R/8, FY2014BR.CompSumRpt.BR-Final.xls, "Component Summary", cell G300.

¹² See UNITED STATES POSTAL SERVICE, POSTAL OPERATIONS MANUAL (POM), https://about.usps.com/postal-bulletin/2018/pb22492/html/updt_002.htm ("[Low-cost] Centralized delivery is the preferred mode of delivery for all new residential and commercial developments. [Higher-cost] Curbside, sidewalk delivery, and door modes are generally not available for new delivery points, with very rare exceptions, as determined by the Postal Service in its sole discretion, on a case-by-case basis."). GAO has found that centralized/cluster box delivery is the lowest cost delivery mode. <https://www.gao.gov/products/GAO-14-444>.

at ¶ 29. In a recent update to its Postal Operations Manual, the Postal Service states that “centralized delivery is the preferred mode for new or extended business or residential delivery points, with very rare exceptions, as determined by the Postal Service in its sole discretion.”¹³ Accordingly, new delivery points will simply be less costly to serve, as dozens or even hundreds of mailboxes can be co-located. Brattle Decl. at ¶ 29.

Additionally, Dr. Neels and Dr. Powers explain that mail density, which the Commission defines as a function of both mail volumes and delivery points (Order No. 5337 at 64), is most relevant to delivery costs. Brattle Decl. at ¶ 27. Delivery points, for example, are not a recognized cost driver of several other large cost segments and components, such as mail processing and transportation. *Id.* The Commission’s proposal does not account for these other cost drivers or quantify the impact of declining density on the Postal Service’s ability to recover these costs. And it does not explain why growth in delivery points should be a prime determinant of the additional authority the proposal would grant when, as shown above, this growth has little impact on the Postal Service’s cost structure.

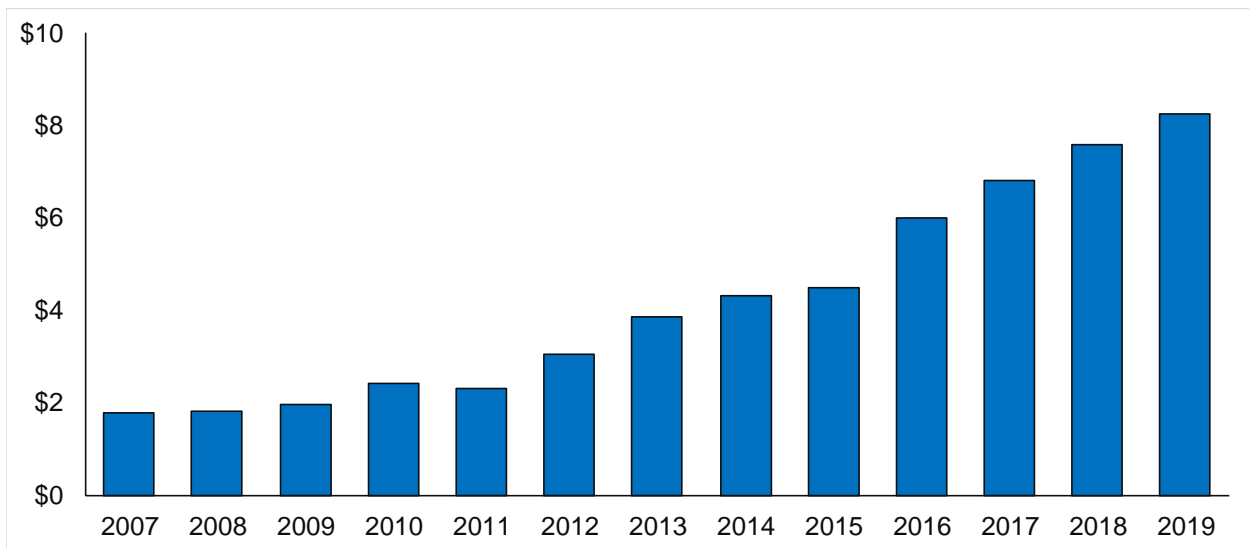
As Dr. Neels and Dr. Powers relate, a simple calculation can be used to demonstrate why the Postal Service’s problems are not driven by growth in delivery points. Brattle Decl. at ¶ 28. Relying on existing Postal Service costing methodology and an average growth of delivery points of 0.9 percent per annum, they estimate

¹³ See, *e.g.*, https://about.usps.com/postal-bulletin/2018/pb22492/html/updt_002.htm and https://about.usps.com/publications/pub265a/pub265a_006.htm.

that “prices would need to increase by 0.23% annually on average in order to offset the increased delivery costs (including affiliated costs).” *Id.* However, under the Commission’s formula, the same increase in delivery points (holding volume constant) would result in additional rate authority of 0.38 percent. *Id.* In other words, the Commission’s proposal would grant the Postal Service 65 percent more rate authority than even the Postal Service’s costing suggests it needs.

Finally, the density adjustment does not recognize the increasing contribution to fixed costs provided by ongoing growth in competitive products. Since FY 2013, the Postal Service has increased competitive product prices by 45.7 percent. These price increases, combined with volume growth, have resulted in the contribution of competitive products increasing from \$3.9 billion in FY 2013 to \$8.2 billion in FY 2019.

Figure D – Competitive Products Contribution (Billions)



Source: ANMetalRM2017-3 Comment Wkpapers.xlsx, “CP Contribution”

No effort was made by the Commission to adjust the price cap for these substantial tailwinds provided by above-inflation competitive product prices increases. While the growth in competitive product volumes have recently moderated, the tailwinds will likely continue (a fact that must not be ignored). In particular, the Postal Service projects (1) competitive product revenue to increase by \$800 million in its recently-filed FY 2020 Performance Plan¹⁴; and (2) forecasts modest long-term growth in competitive product volumes in its FY 2020-2024 Strategic Plan¹⁵. Furthermore, the Commission has found Postal Service package delivery prices have consistently outpaced inflation despite the competitive nature of the package delivery industry.¹⁶

Accordingly, not only is the density adder theoretically flawed, but it is not rationally related to Postal Service cost drivers, does not reflect the actual impact of declining density, and fails to properly recognize the impact of contribution from competitive products. The proposal is arbitrary and capricious and should be withdrawn.

¹⁴ UNITED STATES POSTAL SERVICE, FISCAL YEAR 2019 ANNUAL REPORT TO CONGRESS, at 30.

¹⁵ UNITED STATES POSTAL SERVICE, THE U.S. POSTAL SERVICE FIVE-YEAR STRATEGIC PLAN, FY2020-FY2024, at 17.

¹⁶ Order No. 4963 in Docket No. RM2017-1, *Order Adopting Final Rules Relating To The Institutional Cost Contribution Requirement For Competitive Products* (Jan. 3, 2019), at 10-12, 169-170; *see also* Order No. 5308 in Docket No. CP2020-5, *Order Approving Price Adjustments For Competitive Products* (Nov. 15, 2019) at 3, Table I-1.

C. The Proposed Retirement-Based Authority Is Unnecessary and Misguided

As the Commission found in Order No. 4257, the Postal Service's "accumulated deficit of \$59.1 billion includes \$54.8 billion in expenses related to prefunding the RHBF." Order No. 4257 at 171. In other words, one could argue the prefunding obligations are responsible for nearly all of the paper losses the Postal Service has suffered in the PAEA era. *See* Order No. 5337 at 90 ("Although these congressionally mandated payments are outside of the Postal Service's direct control, they continue to be one of the primary drivers of net loss."). In a change from Order No. 4258, Order No. 5337 attempts to address this expense by tying some of the above-CPI authority provided to the retiree health benefit and other retirement benefit prepayments PAEA imposes on the Postal Service. Rather than provide a blanket two percentage points of above-CPI rate authority, "[t]he Commission proposes to provide additional price cap authority . . . for the statutorily mandated amortization payments for unfunded retirement liabilities, including RHB, FERS, and CSRS, as computed by OPM for each fiscal year." Order No. 5337 at 95. The Postal Service would be required to make partial payments against its outstanding liabilities after the first year of receiving revenues under this provision, and if it fails to make these payments, it will forfeit the balance of additional authority. After a five-year phase-in period, the Postal Service would be required to pay all the revenue collected under this provision toward amortization obligations.

While the Commission may believe this proposal is at least better targeted to the underlying problem it identified than the blanket authority proposed in Order

No. 4258, the Commission still should not pursue it. It is both theoretically deficient and unnecessary. First, it singles out and attempts to true up a single expense that the Postal Service was always intended to recover in its rates, an action that is contrary to incentive ratemaking theory and amounts to impermissible retroactive ratemaking.¹⁷ Second, it attempts to solve a theoretical problem that is nonexistent in practice. Resuming prefunding payments would not place the Postal Service or its retiree programs in meaningfully better financial shape than they are now. Finally, the proposal will contribute to further volume losses, potentially leaving the Postal Service in a worse financial position than it currently faces.

1. The Proposal is a True-Up Designed to Recover Prior-Period Expenses

As Dr. Willig explains, regulatory systems that react to increases in the regulated entity's costs by providing that entity with greater rate authority reduce incentives to operate efficiently and, unlike price caps, do not do a good job of replicating competitive forces that protect customers from excessive pricing. *See* Willig Decl. at ¶¶ 8-11. Incentive regulation, such as the price cap required by PAEA, on the other hand, divorces the price the regulated entity can charge from its costs. *Id.* at ¶ 9 n.4, ¶ 11. Under this type of regulation, the prices the regulated entity can charge “do not rise with increases in the costs incurred by the firm, nor with increases in the firm's capital stock, nor with diminutions in the consumer demand for the

¹⁷ *See, e.g., Old Dominion Elec. Coop. v. FERC*, 892 F.3d 1223, 1227 (D.C. Cir. 2018) (“the rule against retroactive ratemaking ‘prohibits the Commission from adjusting current rates to make up for a utility's over- or under-collection in prior periods.’”) (quoting *Towns of Concord, Norwood, & Wellesley, Mass. v. FERC*, 955 F.2d 67, 71 n.2 (D.C. Cir. 1992)).

firm’s outputs.” *Id.* at ¶ 11. As a result, a price cap system “both protects consumers from excessive pricing where effective competition is absent, while still presenting the firm with strong incentives to behave competitively since it will be rewarded at its bottom line for its productivity, cost control and market appeal.” *Id.*

A key feature of an effective price cap system is that it does not allow “backward looking true-ups.” *Id.* at ¶ 12. Instead, the system “intentionally leaves some risks to each side arising from exogenous cost or demand changes that are lower or higher than was anticipated.” *Id.* In fact, “[i]t is crucial the regulated entity and consumers should *prospectively* share in the risk of cost increases that are higher, ex post, than expected.” *Id.* at ¶ 13 (emphasis added). While the price cap may be reevaluated after a period of time, this evaluation is not designed to true-up for past cost changes—those risks were already shared when the cap was initially established. Instead, the goal is to look at the going-forward value of exogenous anticipated trends in factors “such as improvements in the industry’s technology, or changes in the anticipated rates of inflation in the industry’s input prices and wages, or alterations in the firm’s mandated outputs, or thinning of the volume of demands where there are scale economies.” *Id.*

The Commission’s retirement authority proposal violates all of these tenets of incentive regulation. It is a transparent attempt to retroactively correct the price cap to recover costs that the Postal Service failed to recoup since 2006. Instead of respecting the bargain that Congress, the Commission, and the Postal Service entered through PAEA and its CPI-U price cap, the Commission proposal

retroactively shifts all the risk of underperformance to mailers. As Dr. Willig notes, “if the Postal Service’s retirement benefit funding obligations were built into the level of allowed prices previously, then it would be highly problematic to allow the Postal Service pricing authority that effectively lets the Postal Service collect this cost a second time.” Willig Decl. at ¶ 24, n.16.

There can be no question that Congress and the Commission intended for the Postal Service to recover the costs of its prefunding obligations while remaining within the CPI-U price cap. In the same law in which Congress mandated the use of a CPI-based price cap, it required the Postal Service to make prefunding payments ranging from \$5.4 billion to \$5.8 billion annually to pay down USPS unfunded retirement obligations, followed by these smaller—approximately \$3.2 billion—annual amortization payments.¹⁸ By establishing these prefunding requirements and a price cap, Congress plainly intended the Postal Service and mailers to share the risk that exogenous factors impacting the Postal Service’s revenues (or cost reductions) would impact its ability to recover these costs. Importantly, if Postal Service revenues had increased (or costs decreased sufficiently), the Postal Service would have received the benefit of that bargain in the form of retained earnings, which under this price cap system are not shared with mailers. But now that the

¹⁸ See 39 U.S.C. § 8909a. Additionally, these larger initial payments were largely incorporated into the Postal Service’s rate base in Docket No. R2006-1. The Commission stated therein that enactment of PAEA was “expected to result in both favorable and adverse financial consequences for the Postal Service during the periods under scrutiny. . . . On brief, the Postal Service projects a consequent negative impact on test year income of \$662 million.” Docket No. R2006-1, *Opinion and Recommended Decision* (Apr. 27, 2007) at 19.

opposite result has obtained, forcing mailers to cover these losses would renege on this deal. In a classic sense, this misaligns the risks and rewards. It is certainly doubtful that the Postal Service and Commission would be so eager to true up this account if the Postal Service had in fact achieved retained earnings. In retrospect, it appears the risk of loss was all on the mailers.

**(a) The Commission Cannot Defend its Retroactive
Ratemaking Through Claims of Changed
Circumstances**

Perhaps recognizing that the Postal Service's prefunding expenses are no different than any other expenses the Postal Service was expected to recover in its rates under PAEA, the Commission claims this supplemental authority is appropriate because "the Postal Service's financial situation began to unexpectedly decline in ways not anticipated by the PAEA" after the prefunding obligations were established. Order No. 5337 at 90. But the Commission does not identify what these supposedly unanticipated declines were. The Great Recession was arguably unanticipated, but economic slowdowns are certainly to be expected and the Postal Service recovered all the losses it suffered as a result of that event through the exigent surcharge.¹⁹ Electronic diversion was not unanticipated. The Congressional Record contains multiple references to electronic diversion in debates leading to the passage of PAEA; PAEA was in fact designed to give the Postal Service the tools to combat this diversion by incentivizing more efficient operations and providing more pricing

¹⁹ See Order No. 3186 at 2-3 (approving removal of exigent surcharge from Postal Service rates after explaining that the order approving the surcharge required that it "would be removed once the loss associated with the Great Recession was recovered" (citing Order No. 1926 at 1-3, 193)).

flexibility.²⁰ The degree of growth in e-commerce and the package business may not have been entirely anticipated, but that growth has, substantially benefitted the Postal Service and improved its ability to cover costs.

What may have been unanticipated was the Postal Service's inability to improve its efficiency in response to the incentives provided by the price cap and its inability to limit its cost increases to less than the rate of inflation. Notably, in justifying its proposal, the Commission provides the example of a required payment calculated by OPM of \$3 billion in a year in which the Postal Service's total revenues are \$60 billion. Order No. 5337 at 92. The Commission explains that in this scenario, "revenue would need to increase [by] 5 percent" to meet the payment obligation, which, "[p]hased in over 5 years," means "the annual increase needed would be approximately 1 percent." *Id.* However, the Commission is incorrect that this obligation can only be met by a 5 percent increase in revenue. It could just as easily be met by a 5 percent decrease in cost—1 percent per year—which would have the same impact on the cash available to the Postal Service to make the payment.

PAEA and the CPI-based price cap were designed to force the Postal Service to increase efficiency. In establishing the retirement benefit prefunding requirements, Congress anticipated that the Postal Service would generate the cash necessary to

²⁰ See, e.g., 152 CONG. REC. 23,306 (daily ed. Dec. 8, 2006) (Statement of Rep. Shays on HR6407) ("due to the increasing use of electronic forms of communication, such as e-mail, first-class mail volume is declining."); Order No. 4257 at 12 (quoting Sen. Carper's statement that a price cap "give[s] Postal management the tools and the flexibility needed to run the Postal Service more like a business at a time when there is fierce competition from . . . electronic 'communication . . .') (internal citation omitted).

meet these payments through this type of activity. Certainly, 1 percent per annum reductions in costs were well within the realm of anticipated outcomes of PAEA, yet the Postal Service has not been able to meet even these modest targets. But there is no reason that a renewed commitment to reducing costs (or increasing volumes) could not be just as effective in providing “the Postal Service the ability to begin funding its retirement benefit obligations in the future” as the additional rate authority the Commission has proposed. *Id.* at 103. Such cost reductions would also limit the impact of cumulative price increases on demand.

2. The Proposal Will Contribute to Volume Losses Caused by Cumulative Price Increase Impacts Without Making a Meaningful Difference in The Postal Service’s Ability to Honor Its Obligations to Retirees

As discussed above, the Commission’s proposals must be evaluated not only in terms of their individual reasonableness, but in terms of their cumulative impacts. In the hypothetical example presented by the Commission, the Postal Service would receive between 0.827 percent and 1.111 percent of additional pricing authority from the supplemental retirement provision in the first five years after the proposed rule takes effect. Order No. 5337 at 100, Table IV-6. This example is not a forecast, and the actual authority provided could be higher or lower. In particular, the Commission notes that “[i]f volume declines, the full amortization payment will represent a greater proportion of total revenue, and the proposed formula will provide additional retirement rate authority.” Order No. 5337 at 92.

Moreover, the cumulative supplemental pricing authority will be greater than the sum of its parts. The retirement-based authority (which is potentially self-

compounding) will be combined with the density authority (which is self-compounding), the performance-based authority, and in some cases the noncompensatory products authority to provide additional pricing authority that far exceeds CPI. Price increases of this magnitude will have a detrimental impact on mailers, significantly increasing their postage costs. While the Commission acknowledges these “concerns about the potential financial impact of the supplemental authority on mailers,” its proposal does not meaningfully respond to them. Order No. 5337 at 94.

Rather, the Commission states that “retirement prefunding payments have remained relatively stable and followed a predetermined schedule, and as such, protect Market Dominant mailers by ensuring that rates can be consistently forecast and do not include sudden or extreme fluctuations.” *Id.* (citing Order No. 4257 at 52). This response is a complete non-sequitur. Mailers are concerned about the impact the *absolute value* of the rates will have on their business. The additional retirement rate authority—especially when combined with the additional supplemental rate authorities—will cause rates to rise much faster than inflation. The proposal violates Objective 2, destabilizing rates, and fails to account for Factor 3 by ignoring the effect of the authorized rate increases on business mailers. Whether the prefunding payments are similar each year or not, the Commission’s proposal will increase the rates mailers will pay. The Commission must account for the impact these increases will have on business mailers. It has utterly failed to do so.

The Commission also ignores the impact this proposal is likely to have on mail volume and how that impact could undermine its stated goal in providing the retirement authority. The Commission claims that its “proposed rules provide the Postal Service a method to begin to meet these [retirement] obligations.” Order No. 5337 at 91; *see also id.* at 102-03 (claiming its proposal “is giving the Postal Service the ability to begin funding its retirement benefit obligations in the future”). But the Commission has made no attempt whatsoever to quantify the impact of its proposal. It can only assess whether it will help the Postal Service meet its prefunding requirements if it evaluates the amount of additional revenue the proposal can be expected to raise, taking into account the volume declines that will result from the increases authorized by all of the supplemental authorities. The Commission has not performed this analysis—or at least it has not made it public.²¹ Perhaps this is why the Commission indicates the proposal will only “begin” to help the Postal Service make these payments.

Or, perhaps the Commission recognizes that attempting to provide the Postal Service with sufficient pricing authority in an attempt to cover unnecessary prefunding expenses would be a fool’s errand. Perhaps the Commission implicitly

²¹ See section III.A, *supra*, for Dr. Neels’ and Dr. Powers’ assessment of the potential volume impacts of this cumulative authority. Note that while their analysis of the density authority was updated recursively to account for the effects on volume of above-inflation increases in each year, the same calculation was not performed for the retirement rate authority. Thus, their estimates may understate the volume decline these cumulative rate increases would cause.

recognizes that just because a cost is “uncontrollable”²² or “outside the price cap,” that does not mean it can be recovered by simply adding pricing authority on top of the price cap. While one could ensure recovery of these costs through a government subsidy, *mailers* will only subsidize this cost to the extent postage prices remain at a level that meets their business needs. If the retirement authority, combined with other available authority, causes the price of a mailpiece to rise above this level, mailers will not pay it, and the Postal Service will not receive the revenue it needs to recover this cost. As explained previously, the Postal Service is still subject to the laws of supply and demand, and the Commission cannot guarantee the Postal Service will be able to recover its costs no matter how much pricing authority it grants it.

In light of these practical limitations, the Commission should ask itself what the Postal Service can realistically expect to gain from the supplemental retirement authority. The proposed authority will have little impact on whether the Postal Service will actually be able to make promised payments to its retirees. That is because the Postal Service already has the ability to fund its retirement obligations.

As Joint Commenters explained in their prior comments, even as the Postal Service has stopped prefunding its obligations, its retiree benefit programs remain better funded than the vast majority of public and private sector retirement programs. *See* Phase II Comments at 76 (Figures 8 and 9); *see also* Phase I Comments at 40-44 (demonstrating that the prefunding obligations are no measure of the Postal

²² While the Postal Service excludes amortization payments from “controllable expenses,” it readily admits that this unique presentation is not GAAP-compliant. *See* United States Postal Service, 2019 Report on Form 10-K, at 18.

Service’s actual ability to honor its obligations to retirees). The Commission does not address these arguments in Order No. 5337. It proceeds as if the failure to make these prefunding payments is equivalent to a default on actual payments owed retirees. That is simply not the case—if it were, nearly every private and public enterprise in the United States would be at risk of defaulting on its obligations to retirees. In reality, the Postal Service simply does not need additional funding to meet the obligations it has toward its retirees, whether the prefunding obligations are recorded against its balance sheet or not.

The Commission’s choice, therefore, is not between providing additional rate authority or causing the Postal Service to default on its obligations to its retirees. The Postal Service is in position to meet its retiree obligations without any additional funding. The choice, rather, is between providing additional authority that will do little to improve the Postal Service’s financial position while adding to the cumulative rate increases that would be imposed on mailers, or abandoning the proposal to provide useless rate authority to limit rate increases, protect mailers, and avoid further erosion of volume. If the Commission has any concern for limiting the cumulative impact of rate increases on mailer finances and Postal Service volume, it must abandon the retirement rate authority proposal.

D. The Proposed Performance-Based Authority Is Unsound and Will Not Incent the Postal Service to be More Productive

The Commission has proposed to provide the Postal Service with an additional one percent of pricing authority above CPI if the Postal Service’s TFP “for the measured fiscal year [exceeds TFP for] the previous fiscal year.” Order No. 5337 at

150. To receive this authority, the Postal Service’s service standards, including applicable business rules, must meet or exceed the service standards in place during the prior fiscal year, but the authority does not depend on any service performance metrics. *Id.* While the Commission perfunctorily casts this authority as a means to maximize incentives for the Postal Service to reduce costs and increase efficiency, the true impetus behind this authority is to provide the Postal Service with additional revenue that it can invest in capital improvements to restart the so-called “financial health cycle.” *Id.* at 105-106. Whatever the reasoning behind the proposal, it should be withdrawn. In addition to being theoretically unsound, there are serious technical problems with the proposal as designed that could lead to false positive results and distort incentives to improve productivity.

1. The Commission’s Performance-Based Rate Authority Proposal is Theoretically Unsound

(a) The Proposal Departs From Traditional Price Cap Regulation Without Justification

As Dr. Willig explains, “[i]n standard price cap theory, as in effectively competitive markets, productivity improvements provide their own reward: after a percentage of the incremental revenue is shared with consumers, the remainder falls to the bottom line in the form of higher retained earnings.” Willig Decl. at ¶ 27. This reward alone “provides a strong incentive for the regulated entity to achieve improvements in productivity.” *Id.* As a result, the extra 1 percent of pricing authority the Commission proposes to provide for productivity improvements “is largely redundant and unnecessary.” *Id.*

Additionally, a price cap system should pass a portion of the productivity benefits a regulated firm achieves on to its customers. *See Willig Decl.* at ¶ 14. Under this approach, the price cap will incorporate an “X” factor, where “X is a predetermined percentage reflecting a productivity growth target, which would remain in effect for an extended period of time, such as 4-5 years.” *Id.* Dr. Willig explains the economic logic behind such a mechanism:

When a regulated entity’s productivity growth performance is lower than the productivity target, the entity automatically incurs a penalty similar to what a firm in an unregulated competitive market suffers if its productivity growth is lower than its competitors. And the converse is also true: if the entity’s productivity growth performance is higher than the target, the entity receives a reward akin to the benefits of having higher productivity growth than one’s competitors.

Willig Decl. at ¶ 15. The CPI-based price cap employed in the current system has no such mechanism. As such, it is already more generous to the Postal Service than a typical price cap system. The Commission’s proposal in Order No. 5337 would make postal customers even worse off. As Dr. Willig explains, “[i]f, for example, the Postal Service were to increase productivity by a miniscule amount, like 0.1 percent, consumers would have to pay 1 percent higher prices. Mailers would, paradoxically, be better off if the Postal Service’s productivity *declined* by 0.1 percent.” *Willig Decl.* at ¶ 27.

Dr. Neels and Dr. Powers provide numerical examples to show how far this proposal departs from traditional price cap regulation. *Brattle Decl.* at ¶ 59. They consider the hypothetical case of a product or service produced by a regulated entity at a cost of \$10.00 per unit and sold to consumers at a price of \$11.00, then evaluate

how different productivity gains would be distributed under various price cap systems and the Commission's Order No. 5337 proposal. In sum:

- A private enterprise under price cap regulation with a 1 percent per year productivity adder that reduces cost by 1.5 percent would achieve 15 cents of cost savings. The 1 percent X-factor would force it to reduce its price by 11 cents, leaving it with additional pretax profits of 4 cents per unit (which would be reduced to 2.76 cents per unit after paying a 21 percent corporate tax rate on the profit). However, if this same entity were to reduce its costs by 2.0 percent, it would achieve 20 cents of costs savings but still only have to reduce its rates by 11 cents due to the X-factor. It would net 6.21 cents after taxes. Thus, the incremental rewards for this entity from more aggressive pursuit of productivity gains are substantial.
- A private enterprise under price cap regulation with *no* productivity adder that reduces cost by 1.5 percent would achieve 15 cents of cost savings. With no productivity adder, it would not have to reduce its rates, and that 15 cents of savings would directly translate into 15 cents of pretax profits. Taxes would reduce this profit to 10.35 cents per unit.
- The original PAEA system involves a public entity (the Postal Service) under price cap regulation with no productivity adder. If the Postal Service under this system reduces its cost by 1.5 percent, it will again translate into 15 cents of costs savings and profit, just as in the prior

example. But because it does not pay taxes, the Postal Service will enjoy after-tax profits of 15 cents, not the 10.35 cents a private enterprise would realize.

- Order No. 5337 proposal. If the Postal Service reduces cost by 1.5 percent, this reduction translates again into cost savings of 15 cents per unit. As a reward for achieving this gain, the Postal Service is allowed to increase its price by 1 percent, generating additional pretax profits of 11 cents per unit, leaving it with additional pretax profits of 26 cents per unit. Because it does not pay taxes, it also enjoys additional after tax profits of 26 cents per unit.

These examples make an important point: the existing PAEA system richly rewards the Postal Service for productivity gains. Compared to systems regulating private entities or containing productivity adders, the PAEA system allows the Postal Service to realize greater profits (*i.e.* retained earnings) with less cost reduction effort. As Dr. Neels and Dr. Powers opine, “[t]here is little reason to believe that the existing system is insufficiently generous.” Brattle Decl. at ¶ 60.

The performance-based rate authority is also theoretically flawed because it seeks to correct prior performance failures rather than incentivize future behavior. In essence, it is a backward looking true-up that should be proscribed under a healthy system of incentive ratemaking. Willig Decl. at ¶ 30. The proposed adjustment would give the Postal Service money in part to fund capital investments that were (allegedly) foregone by the Postal Service. *Id.* A more reasonable design would tie

any authority to anticipated future needs. The Commission, however, has declined to even estimate such future needs. *See* Order No. 5337 at 122 (indicating that the 1 percentage point of authority was derived from “the amount of capital spending and the value of assets pre-PAEA compared to post-PAEA and the amount of borrowing authority exhausted during the PAEA era” as well as “its expert judgment”); Phase II Comments at 45-47.

Similarly, the performance-based rate authority is inappropriately provided based solely on the past performance of the Postal Service. Dr. Willig explains that any productivity adjustment to the price cap “should be set at a level based on the Postal Service’s expected ability to improve productivity over the next 4-5 years.” Willig Decl. at ¶ 31. In other words, “[t]he productivity adder should be based on the CPI minus X, where X is a preestablished percentage inclusive of a productivity growth anticipation.” *Id.* Doing so would provide the Postal Service with the “full dollar for dollar impact on its bottom line from diminutions in cost and increases in productivity.” *Id.* As Dr. Willig concludes:

Rather than allowing the Postal Service to charge more for outcomes that already happened, (which would in fact convert the system to cost of service with deferred revenue collection), and contrary to economic efficiency to charge more according to outcomes that resulted in cost savings, setting the regulatory policy up according to the concepts of price caps with pricing authority governed with a “price index minus X” formulation incentivizes the Postal Service to be more productive to an economically efficient degree.

Willig Decl. at ¶ 31.

Dr. Neels and Dr. Powers further emphasize that the generous rewards the proposed system would provide could encourage gaming of the system by providing

the Postal Service with an incentive to manage its productivity improvement efforts over time “to assure its ability to reap the reward in all years.” Brattle Decl. at ¶ 61 (citing Willig Decl. at ¶ 27).

**(b) The Commission’s “Financial Health Cycle”
Justification is Unsupportable**

Notably, the Commission does not justify the proposed performance-based authority exclusively, or even primarily, on the grounds that it will provide the Postal Service with incentives to reduce costs and increase efficiency. Instead, it expressly states that the purpose of the proposed performance-based rate authority is to “promote greater capital investment and allow the Postal Service to reenter the financial health cycle by providing the Postal Service with additional revenue if it achieves the specific operational efficiency and service standard benchmarks.” Order No. 5337 at 105. According to the Commission, “[t]he financial health cycle requires the generation of ‘adequate revenues to ensure net income, which provide retained earnings.’” *Id.* (citing Order No. 4258 at 46). It then clarifies that “the proposed performance-based rate authority serves as an incentive for the Postal Service to gain that additional revenue by first meeting the specific efficiency and service benchmarks.” *Id.* at 117.

Joint Commenters provided extensive critiques of the factual basis for this reasoning in their prior comments. *See* Phase II Comments at 41-48; ANM *et al.* Reply Comments (Mar. 30, 2018) at 39-43 (Phase II Reply Comments). These critiques remain valid: Order No. 5337 does not remedy these defects; the Commission still has not presented evidence indicating the Postal Service’s failure to

restrain cost increases has resulted from an inability to make capital investments. The only foregone investment the Commission has identified is the immediate upgrading of its transportation fleet (Phase II Comments at 45-46, Order No. 4258 at 50 n.69), and the Postal Service is currently proceeding with that upgrade. Order No. 5337 provides no additional information regarding foregone, required, or planned capital improvements or their impacts on volume and efficiency. The Postal Service continued making capital investments throughout the PAEA era, and it anticipates obligating \$6.3 billion in capital investments in FY 2020. *See UNITED STATES POSTAL SERVICE, FISCAL YEAR 2020 BUDGET CONGRESSIONAL SUBMISSION* at II-14, (March 11, 2019) (reporting actual capital investments of \$1.573 billion in FY 2018 and estimated new obligations of \$1.849 billion in FY 2019 and \$6.302 billion in FY 2020).²³ The Commission’s proposal to restart the financial health cycle through the performance-based rate authority lacks a factual basis in the record and therefore remains arbitrary and capricious.

But the “financial health cycle” theory suffers from more than a lack of a factual foundation. It is illogical from the start. As Dr. Willig explains, “[t]here seems to be no reason to conclude that the proposed productivity adder would incentivize the Postal Service to improve productivity as appropriately as the built-in incentives under a ‘price index minus X’ approach.” Willig Decl. at ¶ 30. This is because “[t]he achievement of productivity improvements under a ‘price index minus X’ approach

²³ Available at <https://www.prc.gov/docs/108/108499/USPS%20FY2020%20Congressional%20Submission.pdf>

will itself generate gains in net revenue appropriately scaled to compensate the entity for the needed capital investment.” *Id.* Because the Commission’s proposal does not similarly provide an “economically efficient connection between productivity gains, their financial benefits, and the cost of the investments needed to accomplish them,” there is no reason to believe the Postal Service will respond to the incentives as the Commission hopes. *Id.* The Commission’s proposal does not even require any after-the-fact oversight to determine whether the additional revenue produced is put toward productivity-enhancing capital investments. Dr. Neels and Dr. Powers echo Dr. Willig’s critique, noting that if the Postal Service has failed to respond to the incentives of the existing price cap, through which cost savings fall directly to the Postal Service’s bottom line, it is not clear why the Postal Service needs an additional reward in order to motivate it to reduce costs. Brattle Decl. at ¶ 56. The Postal Service will not be motivated to reduce its costs in the future when the price cap incentives are attenuated and the Commission “rewards” the Postal Service with more money for meager productivity improvements.

Moreover, as Dr. Neels and Dr. Powers explain, the “financial health cycle” posited by the Commission implies that once the Postal Service has retained sufficient earnings to make the needed capital investments, productivity gains will subsequently become easier to finance, and thus to achieve. Brattle Decl. at ¶ 62. The logical conclusion of the Commission’s theory is thus that once it has reentered the financial health cycle, the Postal Service’s ability to generate retained earnings, and thus to make subsequent productivity-enhancing investments, will be

significantly improved. *Id.* This reasoning suggests that any additional rate authority awarded with this objective need only be temporary. *Id.* at ¶ 64. However, rather than grant the increased rate authority temporarily, the Commission has proposed to increase it on annual basis, seemingly in perpetuity. *Id.* at ¶ 65. Further, the explanation offered by the Commission for why costs have not fallen more—namely, that the Postal Service has not been able to generate the needed investment funds—would not be addressed by this proposal. Consistent with the critique provided by Dr. Willig above, extra revenues would be awarded only *after* productivity gains have been achieved. *Id.* at ¶ 66. Rather than allow the Postal Service to reenter the financial health cycle, it “would only reward the Postal Service once it had managed to get there on its own.” *Id.* at ¶ 66.

In light of these critiques, the design of the performance-based rate authority suggests that its real purpose is just to grant additional rate authority. Although nominally a reward for achievements, the threshold is set so low that it is, in effect, simply an authorization to impose additional rate increases. *Id.* The “performance-based” incentive is a misnomer.

2. The Design of the Performance-Based Rate Authority Is Ill-Conceived

Even if there were a theoretical basis for providing the Postal Service with extra pricing authority to encourage productivity gains, one would not design a system with the features the Commission has proposed. The Commission’s proposal could reward the Postal Service for productivity growth far below historic levels. It does not adjust the authority provided to the size of the gains in productivity. And it

relies on a metric designed for a different purpose that can produce false positives when measuring year-over-year changes in productivity. As such, the proposal will violate Objective 1. The Commission should withdraw this proposal and rely on the inherent incentives of a standard price cap to encourage the Postal Service to reduce costs and improve efficiency.

(a) The Proposal Rewards Increases in Productivity Far Below Historical Levels

When viewed in historical perspective, the Commission's proposal provides extra rate authority for significant decreases from historical levels in the Postal Service's rate of productivity growth. The requirement that TFP growth merely be positive allows the Postal Service to receive extra rate authority for changes in TFP that are 0.7 percentage points *below* the long-standing annual average rate of increase. Effectively, the Commission is providing extra rate authority that can be received despite a dramatic and substantial reduction in the rate of growth in TFP. The Commission provides no explanation of its reasoning for doing so, nor could it: this is not the reasoned decisionmaking that the APA requires.

While the proposal provides a retroactive bonus to the Postal Service for increasing productivity by a small amount, it provides no additional incentive for being any more productive than the bare minimum. The Postal Service would receive the same additional rate authority for improving productivity growth substantially (1 percent per year), for maintaining productivity growth at historical levels (0.7

percent per year),²⁴ or for dramatically decreasing productivity growth to a very low level (0.1 percent per year). Far from maximizing the Postal Service's incentive to increase productivity growth above past levels, the proposal does not even provide an incentive to maintain productivity growth at past levels.

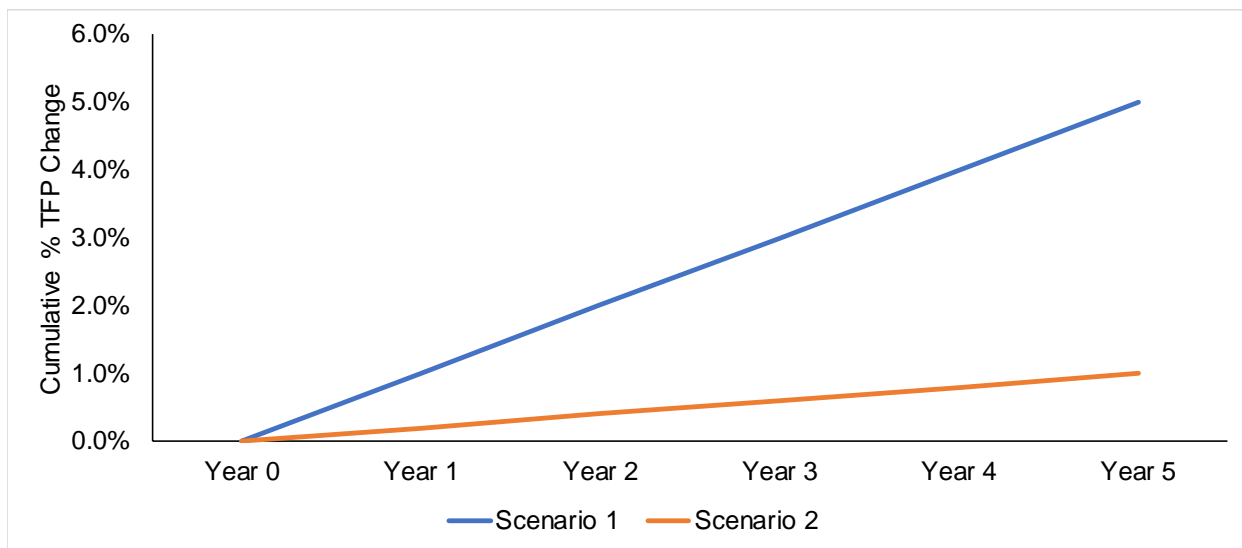
Under this proposal, TFP growth will likely fall to a low positive level. Significant management attention is required to bring about the kinds of organizational change that cause productivity growth. However, without a need to bring about that change, it is likely not to occur. The Commission's performance-based rate authority provides the Postal Service with substantially more money every year (1 percent) for near-zero productivity improvements than have been generated in the past from management efforts to improve productivity (0.7 percent on average). The Commission's proposal therefore invites the Postal Service to work to achieve a minimal level productivity growth each year, but only a minimal level.

As a result of the typical behavioral responses to incentives, the Commission's proposal could give rise to a variety of perverse results that are consistent with achieving minimal productivity growth each year and inconsistent with Objective 1. As Dr. Willig explains, "[i]t is highly dysfunctional and problematic for a regulated entity, or any firm for that matter, to be presented with a disincentive to maximize productivity improvements each year." *See Willig Decl. at ¶ 28.* For example, as Figure E shows, the two scenarios would both result in a cumulative additional

²⁴ Average annual growth in TFP was 0.72% before PAEA (1990-2006) and 0.75% in the initial years after PAEA through 2015.

performance-based rate authority of 5 percentage points after five years despite Scenario 2 having much slower growth in TFP.

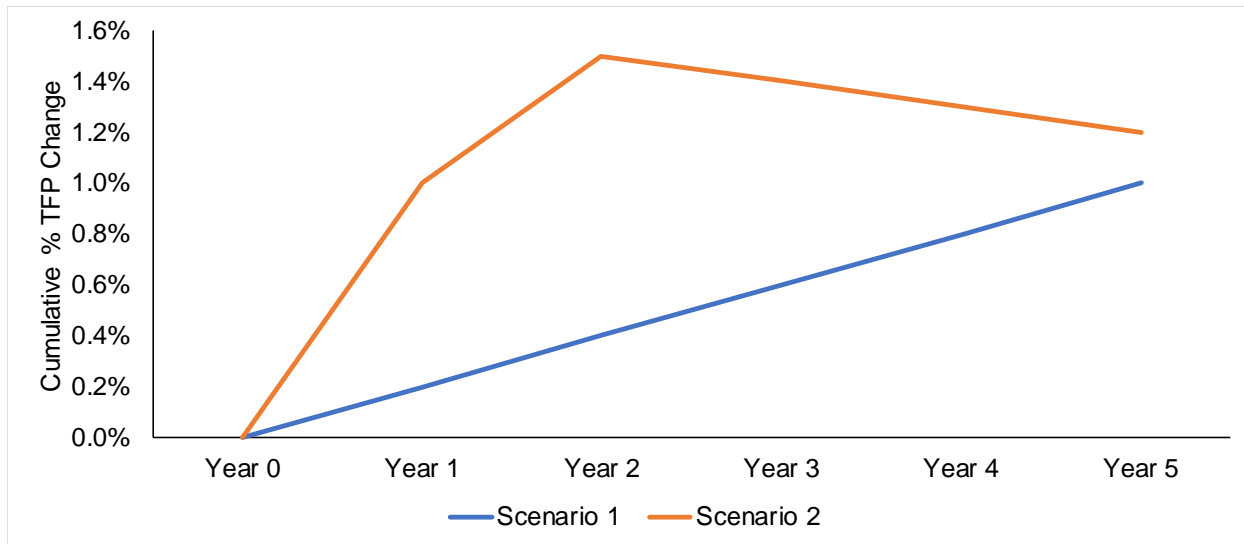
Figure E – Sample TFP Scenarios



Source: ANMetalRM2017-3 Comment Wkpapers.xlsx, “TFP Examples”

Even more problematic, because the prior year’s TFP sets the productivity bar for receiving the performance-based rate authority in the subsequent year, there is a perverse incentive to increase productivity only marginally to ensure the performance-based rate authority is achieved every year. As Figure F shows, Scenario 1 grows at a consistent 0.2 percent per year, resulting in a cumulative additional performance-based rate authority of 5 percent; however, Scenario 2 sees significant growth in the first two years, with small declines in years three through five, resulting in a cumulative additional performance-based rate authority of 2 percent, despite ending Year 5 with a higher overall TFP.

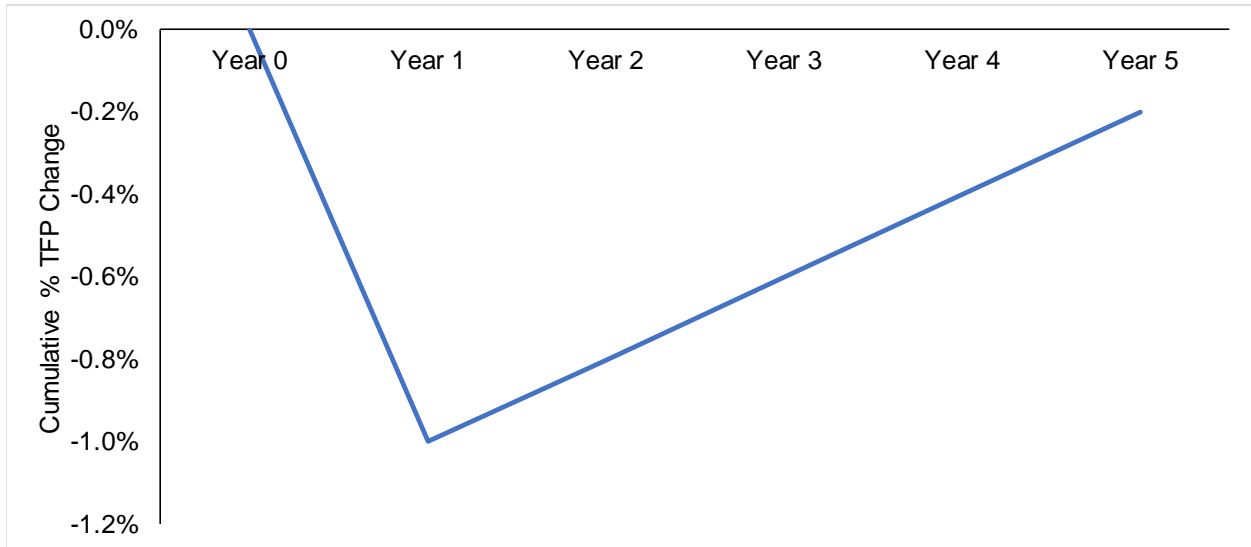
Figure F – Sample TFP Scenarios



Source: ANMetalRM2017-3 Comment Wkpapers.xlsx, “TFP Examples”

As Dr. Willig notes, “the Postal Service could game the system by seeking trivial positive productivity gains (or even negative ones) in Year 1 so that productivity improvements in Year 2 and subsequent years are easier to achieve.” See Willig Decl. ¶ 28. Figure G shows that the Postal Service would receive 4 percentage points of additional performance-based rate authority after five years, despite the overall TFP being lower in Year 5 than in Year 1.

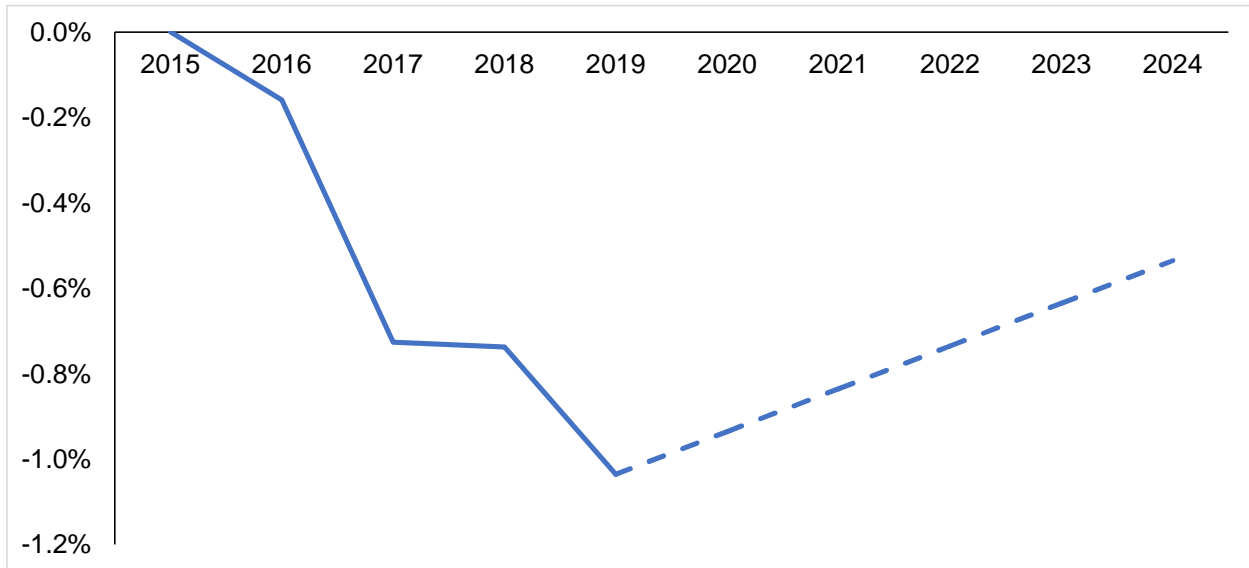
Figure G – Sample TFP Scenario



Source: ANMetalRM2017-3 Comment Wkpapers.xlsx, “TFP Examples”

This last scenario is not far-fetched; in fact it resembles current reality. As discussed above, Postal Service productivity is 0.63 percent below where it was in FY 2013. So, as Figure H below illustrates, the Postal Service could receive the performance-based rate authority every year despite its TFP remaining below where it was in FY 2015. Even if TFP would grow at 0.1 percent per year for five years, productivity would still be below FY 2015 levels at the end of FY 2024. This would clearly be an inappropriate outcome.

Figure H – Cumulative Percent Change in TFP
(Actual FY 2015 – FY 2019, Projected FY 2020 – FY 2024)



Source: ANMetalRM2017-3 Comment Wkpapers.xlsx, “TFP Examples”

In a similar vein, Dr. Neels and Dr. Powers explain that the proposal could provide incentives for the Postal Service to waste funds on uneconomic investments. Brattle Decl. at ¶ 67. Where the Postal Service is at risk of narrowly missing its productivity target—the low bar of any year over year increase in TFP—it could “could fund an investment that made no economic sense on its own, but that nonetheless could provide a small near-term payoff sufficient to push the Postal Service over the necessary threshold.” *Id.* Because it will receive 1 percent of additional authority regardless of the increase in productivity or amount of capital investment, this rate increase could “more than make up for the losses on the otherwise ill-considered investment.” *Id.*

3. Technical and Practical Flaws in the TFP Calculation Create Unacceptable Risks of Awarding Performance-Based Rate Authority without Real Productivity Improvements

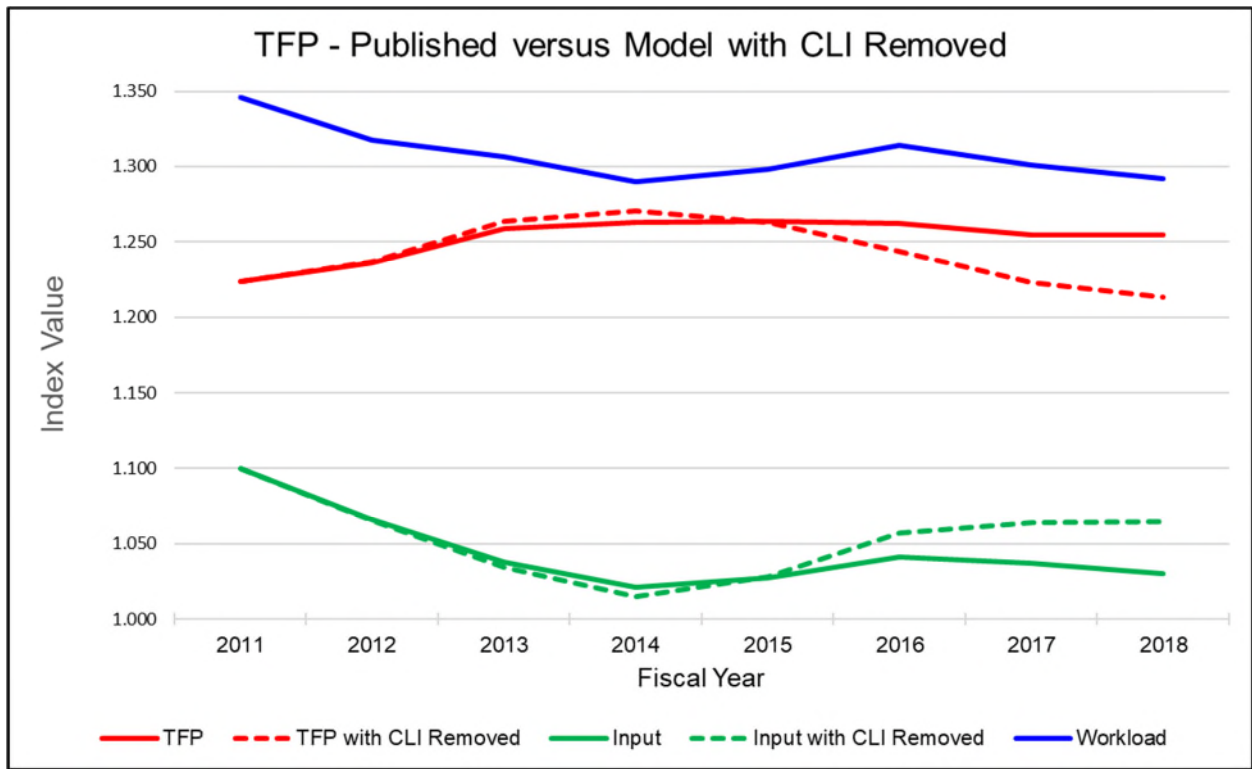
The Commission’s performance-based supplemental authority proposal is also unreasonable because it carries a high risk of rewarding the Postal Service for illusory gains in productivity. The attached Declaration of Robert Fisher (“Fisher Declaration”) details deficiencies in the use of TFP as the basis for performance-based rate authority. Mr. Fisher identifies three summary concerns tying the authority to changes in TFP: First, the inclusion of inappropriate factors and issues with the component values used to calculate TFP can cause “false positive” results in which TFP is shown to increase, but productivity has not. Fisher Decl. at 2. Second, the TFP methodology is not transparent and cannot be independently validated—the Postal Service makes adjustments to the methodology that are not published and can result in values different than those obtained using the published formula. *Id.* Third, TFP includes inputs that are beyond the control of the Postal Service, and therefore measures factors that are not conceptually appropriate as a basis for rewarding productivity gains. *Id.* Mr. Fisher’s report explains each of these deficiencies in detail; we will briefly summarize them and discuss their implications here. His analysis demonstrates that TFP could overstate the Postal Service’s productivity growth by over *one percent* per year. *Id.* at 8, Figure 5; *id.* at 30 (explaining that Figure 5 demonstrates that published TFP results of 1 percent growth could actually reflect negative productivity growth when CLI is removed). Not only does this disparity result in an unacceptable risk of false positive awards of performance-based

authority, but it shows that Postal Service productivity is declining significantly faster than reported.

First, Mr. Fisher identifies several inputs to TFP that are not valid productivity inputs or contain other methodological errors. These inputs can cause false positive results. For example, the Composition of Labor Input (“CLI”) is not a valid productivity input. Fisher Decl. at 4. CLI is a factor applied to workhours to adjust for employee experience level, which TFP assumes to be a key determinant in labor productivity performance. *Id.* But as Mr. Fisher relates, for most Postal Service positions, there is no reason to assume that an employee with one year of experience would be any more or less productive than one with 15 years experience in a non-professional position. *Id.* Similarly, CLI measures the change in number of employees, grouped by five year increments, which relates only to recent employee demographic shifts, not changes in productivity. *Id.* Additionally, non-career employees are not considered in the CLI factors, but when they are moved to career status, their workhours are then indexed as more productive even though there has been no change in the work they actually perform. *Id.*

The inclusion of the CLI factor in TFP significantly distorts the Labor input (which represents 75 percent of total dollar inputs used in TFP, Fisher Decl. at 3) and, as a result, the TFP result. Fisher Decl. at 4. Mr. Fisher details this distortion in Figure 5 of his declaration, in which he compares published TFP values to the TFP values that would obtain if the CLI factor was removed. Fisher Decl. at 8, Fig. 5. As Mr. Fisher shows, the differences in the measure are significant—TFP is overstated

by about one percent per year. Moreover, inclusion of CLI in TFP resulted in a false positive in 2015. That is, the year over year change in the published TFP factor was 0.06 percent from 2014 to 2015, indicating an increase in productivity. Yet when CLI is removed, the same period shows a *decrease* in TFP of 0.59 percent. *Id.* The difference between published TFP and the TFP model with CLI removed is viewable in the difference in the solid and dashed red lines below:



Fisher Decl. at 8, Figure 6. This graph demonstrates that when CLI is removed, productivity is declining at a much faster rate than the Postal Service reports.

Because the Commission’s revised proposal would provide the Postal Service with one percent above CPI rate authority for any year over year increase in TFP, the consequences of false positive results are extremely high. If this proposal had been in place in 2015, the Postal Service would have been awarded additional rate

authority even though its productivity, properly measured, declined. This is a debilitating flaw in the Commission’s proposal. If the Postal Service can be rewarded with rate authority without actually improving productivity, the performance-based rate authority has no rational basis. It certainly will not “maximize” incentives to increase efficiency and reduce costs if the Postal Service can earn the authority without increasing efficiency at all.

Mr. Fisher discusses several other flaws with the TFP inputs that could lead to false positives. For instance, he explains that TFP Labor dollars are overstated by over a billion dollars in 2018. Fisher Decl. at 14. Moreover, actual national labor costs are not measured for change against the previous year in TFP. *Id.* at 19. Due to the methodology and cost weighting used in the TFP formulas, adding labor costs to the calculation counterintuitively results in *higher* TFP productivity— an unreasonable result that could cause the Postal Service to earn performance-based authority in the absence of any productivity increases. *Id.* at 18-19. Additionally, multiple inputs in the Material Price Index cannot be independently validated because they contain differences with published Bureau of Labor Statistics metrics. *Id.* at 21. Again, these flaws could lead to false positive results. *Id.*

As a related matter, it is impossible to independently verify the Postal Service’s TFP calculations. Several inputs rely on non-public data. *See, e.g.,* Fisher Decl. at 26; Brattle Decl. at ¶ 68. The TFP tables supporting the calculation provide values only, not formulas that can be used to replicate results. Fisher Decl. at 28. Perhaps most troubling, adjustments are made to the structure and factors of TFP with no

public input or acknowledgement, and values change in tables form one year to the next with no explanation. *Id.*; *see also* Brattle Decl. at ¶ 70 (citing NORTHWEST POSTAL CONSULTING, ADEQUACY OF THE POSTAL SERVICE’S TFP MODEL at 43 (Mar. 27, 2017)). These characteristics of TFP make it impossible for the public to verify the Postal Service’s TFP results and meaningfully comment on whether they accurately describe changes in productivity. Worse, they create the potential for gaming the performance-based authority through methodological adjustments. It is unreasonable to provide the Postal Service, a public entity, with additional rate authority without giving the public the tools necessary to independently verify that an award of the authority is appropriate. Dr. Neels and Dr. Powers opine that “[t]he fact that an obscure and undocumented technical change of this nature would, under the Commission’s proposal, potentially affect the rates paid by millions of market dominant mailers . . . is a significant problem.” Brattle Decl. at ¶ 70.

Finally, TFP measures some factors that the Postal Service and Commission may consider outside of management control. *See* Fisher Decl. at 13, 31. While there may be debate over which costs should be considered controllable, as a matter of principle, it does not make sense to award performance-based authority for changes in costs that are outside of management control. The purpose of the performance-based authority, however misguided it is, is to incentivize Postal Service management

to take actions to reduce costs and increase efficiency. The reward must, therefore, be tied exclusively to factors within management control.²⁵

Joint Commenters acknowledge the challenge of accurately measuring productivity and recognize that criticisms of the specific inputs to TFP may be viewed as nitpicking.²⁶ Any metric used by the Commission would likely have some data or methodological flaws that one party or another could highlight, though a metric based on the criteria Mr. Fisher describes would at least be transparent, replicable, and focuses on controllable costs. *See* Fisher Decl. at 31. That is not a reason, however, to continue to use TFP as a basis for performance-based rate authority. It is instead an argument for withdrawing the performance-based rate authority proposal altogether. As discussed above, one of the benefits of a price cap system of regulation is that productivity gains automatically accrue to the regulated entity's bottom line. *See* Brattle Decl. at ¶ 71. Under such a system, productivity growth does not need to be measured at all: it will manifest in retained earnings. Rather than attempt to retroactively measure gains in productivity and reward the Postal Service with

²⁵ Providing additional capital to the Postal Service for management to invest in productivity-enhancing projects does not resolve this concern. As Mr. Fisher explains, the TFP Input Index would not be substantively changed if the Capital Index were excluded. Fisher Decl. at 25. TFP is therefore not a good measure of productive capital investment. Furthermore, Mr. Fisher opines that if the Capital Index—one of three main components of TFP—“can be removed with no substantive change to the TFP result, it calls into question the underlying theory of the measurement.” *Id.*

²⁶ Though the Commission should also recognize that the use of TFP as the basis for performance-based authority has been criticized by its own econometrician in this docket. *See* Brattle Decl. at ¶ 68 (citing Docket No. RM2017-3, Declaration of Lyudimila Y. Bzhilyanskaya for the Public Representative (March 20, 2017)).

additional rate authority for such gains, the Commission should rely on the incentives of the price cap and the inherent self-interest of the Postal Service to drive productivity gains. *See id.* (recommending an “X factor” reduction in price increase authority as an alternative to the performance-based authority proposal).

E. The Commission Should Focus on Cost Control, Not on Punishing Noncompensatory Products

Order No. 5337 carries over the Commission’s proposal to impose above-CPI rate increases on products and classes that do not cover their attributable costs. The only difference between the proposals in Order No. 4258 and Order No. 5337 is that the Commission no longer proposes to mandate above-CPI increases for Periodicals. Order No. 5337 at 168. This change, while welcome, does not remedy the primary underlying defect of the Commission’s proposal: by authorizing above-CPI increases on these products, the Commission ignores the fact that the Postal Service’s inefficient management is the root cause of these products’ non-compensatory status. Additionally, the proposal fails to further Objective 1 of the PAEA by reducing incentives for the Postal service to eliminate inefficiencies and reduce the costs of processing and delivering these products; the proposal violates Objective 4 by limiting the Postal Service’s pricing flexibility, hampering its ability to recognize the multiplier effect this type of mail can create; and the proposal ignores Factors 3 (impact of increases on mailers), 8 (value of the different kinds of mail entered into the system), and 11 (the educational, cultural, scientific, and informational value to the recipient of the mail matter). Moreover, mailers cannot rely on the Postal Service’s largesse: they must assume that the Postal Service will use its full pricing

authority when planning campaigns and making strategic decisions about resource allocation. In that context, the ability of the Postal Service to use its full authority is equivalent to a requirement that it do so.

Joint Commenters presented extensive evidence in their Phase II comments regarding the Postal Service's failure to control costs associated with processing Flats and Periodicals Mail. *See* Phase II Comments at 84-107. As Joint Commenters explained, "[t]he failure of Periodicals Mail and Marketing Mail Flats to cover attributable costs is a cost-control problem, not a revenue problem." *Id.* at 85. The Commission has no rejoinder for this argument. It agrees "that the Postal Service must work to reduce costs," but it laments that "the Postal Service's cost reduction efforts have been unsuccessful." Order No. 5337 at 156. The Commission further claims that it lacks the ability to force cost reductions and that its actions "requiring more transparency, requiring additional reporting, and directing the Postal Service to reduce costs, have not eliminated the problem of underwater products." *Id.* at 157.

The Commission's solution to this problem is to simply throw up its arms. Rather than enforce—or even tighten—the price cap to force the Postal Service to reduce its costs going forward, it "proposes to require minimum product-level price increases to increase revenue." *Id.* Doing so undermines any incentives the current system contains for the Postal Service to reduce its costs and essentially ensures that the status quo will remain in effect. Flats and Periodicals costs will continue to rise unabated, and mailers will be forced to subsidize the Postal Service's inefficiency.

This strategy is misguided, and other options exist. In addition to reinforcing its commitment to the price cap, the Commission could tackle inefficient pricing that drives mail to more costly categories. *See* Phase II Comments at 94 (explaining how reductions in passthroughs for Carrier Route Basic Flats caused “inefficient mail preparation by mailers and needlessly high costs for Periodicals Mail”). Such practices have limited the growth of co-mailing, among other ill effects. *See id.* at 95. Statements in the most recent Annual Compliance Report (“ACR”) support the value of adjusting these incentives.

In the Fiscal Year 2019 ACR, the Postal Service attributes increases in per-piece costs for processing Marketing Mail Flats primarily to volume declines in this product category. Docket No. ACR2019, Fiscal Year 2019 ACR, (Dec. 27, 2019), at 18 (FY 2019 ACR). In turn, it attributes volume declines in part to “[c]o-mailing, which shifts pieces towards High Density.” *Id.* The result is that Marketing Mail Flats covered only 67.7 percent of their attributable costs in FY 2019. *Id.* However, the cost-coverage for High Density and Saturation Flats and Parcels was 137.84 percent in Fiscal Year 2019, meaning that this volume moved from a non-compensatory category to a compensatory category. *See id.* at 13 (Table 2). The Postal Service notes that High Density Flats volume increased nearly 10 percent in FY 2019, “following increases of approximately 20 percent in both FY 2017 and FY 2018.” *Id.* at 18. In other words, as co-mailing has increased, Postal Service operations have become more efficient.

The Commission should be focused on designing a system of regulation that encourages this type of activity rather than focusing on squeezing revenue out of the remaining volume in Marketing Mail Flats. No doubt in no small part due to the above-inflation rate increases leveled on it in recent years, Marketing Mail Flats volume has already declined from 10 billion pieces in FY 2008 to 3.8 billion pieces in FY 2019. FY 2019 ACR at 18. Before requiring the Postal Service to raise prices on this remaining volume by over 6 percent more than CPI each year in the future, the Commission must ask itself why it is willing to drive all this mail out of the system, and whether doing so is necessary to ensure the financial health of the Postal Service.

IV. THE POSTAL SERVICE'S MONOPOLY STATUS AND SOUND ECONOMICS REQUIRE THAT THE COMMISSION MAINTAIN A PRICE CAP

Joint Commenters have explained why the Commission's approach to evaluating whether the current system of regulation is achieving the objectives of PAEA was flawed and led to unsupportable conclusions in Order No. 4257. Joint Commenters have explained that the Commission lacks the authority to abrogate the CPI-based price cap PAEA applies to each class of mail. Joint Commenters have further explained why, even if the Commission could allow above-CPI increases in rates, the specific proposals in Order No. 5337 are unlikely to either achieve the objectives of PAEA or solve the specific problems the Commission has targeted these proposals toward.

One point requires further emphasis in light of the Commission's attempts to effectively eliminate the CPI-based price cap and the Postal Service's statements, in this docket and elsewhere, that it should be subject to hardly any restrictions on its

pricing at all.²⁷ That is that the Postal Service remains the monopoly provider of market dominant mail services and must continue to be regulated as such. Because the Postal Service retains both statutory and de facto monopolies over the delivery of printed matter, it does not face sufficient competition in these markets to discipline price increases. While there are of course some limits to how high the Postal Service could raise its prices without losing business in some categories of market dominant mail—indeed, the rate increases authorized by Order No. 5337 would likely exceed those limits—captive mailers still require protection from the exercise of the Postal Service’s market power. *See* Brattle Decl. at ¶ 47 (“Indeed, it is because of the likelihood that the Postal Service would abuse unlimited freedom to raise rates that PAEA subjected the Postal Service to regulatory oversight by the Commission.”).

In other words, even if the Commission is intent on replacing its current system of regulation, the new system must still protect mailers from excessive price increases and ensure just and reasonable rates. It should attempt to replicate the features of a competitive market that restrain price increases and incentivize firms to reduce costs, increase efficiency, and grow their customer base. The system should also minimize administrative costs and account for the information asymmetry that inherently exists between regulator and regulated entity. As Dr. Willig explains in

²⁷ *See* Order No. 4258 at 59 (relating Postal Service claims that it has inherent incentives to pursue cost reductions and efficiency gains and that any efficiency gains it has made were not driven by the price cap); USPS FY2019 10-K at 42 (“We continue to assert that the price cap should be eliminated, and that the PRC should engage in after-the-fact, light-touch review of the Market-Dominant prices we set to ensure that those prices are just and reasonable.”).

the attached declaration, a system of regulation incorporating a strong price cap protected against efforts to retroactively adjust for past changes to costs or volumes is the best approach to achieving these goals.

Dr. Willig succinctly summarizes the virtues of price cap regulation:

The primary virtues of price cap regulation include: a) its direct control of overall prices instead of a related variable such as earnings that does not directly affect consumer welfare, b) the freedom it allows the regulated firm to choose its own relative prices subject to the constraint of the cap, and c) its function as a regulatory mechanism that can be shown analytically to comport with the competitive market model in offering consumers all the price protection that effective competition can provide, while presenting the regulated firm with incentives to operate with static and dynamic efficiency in its costs, price structure, and its choices of the characteristics of its products and services.

Willig Decl. at ¶ 8.²⁸ Price caps are preferred to cost-plus or rate of return regulation, both of which tie prices to the firm's changes in costs. *Id.* at ¶ 9. While "such regulation is motivated by the understandable aspiration to keep prices and the revenues they generate in line with costs, as real effective competition would accomplish . . . cost-plus regulation inadvertently but nonetheless powerfully presents the firm with incentives to allow its costs to rise, because not only will correspondingly permitted increased prices cover the excess costs, but they will provide extra profits from the 'plus.'" *Id.* Additionally, with rate of return regulation, "the firm is motivated to increase its capital base well beyond the level of efficiency

²⁸ *Citing* Baumol, W.J. and R.D. Willig, "Price Caps: A Rational Means to Protect Telecommunications Consumers and Competition," *Review of Business*, Spring 1989 at p. 3.

for product quality and savings of variable costs,” leading to higher prices and inefficient capital expenditures. *Id.*

Perhaps most importantly for the Postal Service, firms under cost-plus or rate of return regulation are not incentivized to grow volume without incurring excessive costs. This is because doing so raises the firm’s profits (rate of return), which can compel the regulator to reduce the price the firm can charge. *Id.* at ¶ 10. Conversely, where declining demand raises average costs due to sale economies, the firm lacks “incentives to avoid diminishing the appeal of its products and services because loss of demand would generate regulatory permission to compensate with higher prices.” *Id.*

A price cap system, by contrast, decouples the regulated price from a firm’s costs, capital stock, and consumer demand. *Id.* at ¶ 11. In doing so, it “both protects consumers from excessive pricing where effective competition is absent, while still presenting the firm with strong incentives to behave competitively since it will be rewarded at its bottom line for its productivity, cost control and market appeal.” *Id.* Thus, where competition cannot be relied on to constrain prices, a price cap system of regulation is preferable to a cost-plus or rate-of-return system.

Dr. Willig identifies key features of an effective price cap system. These include limiting price changes to CPI or some other index measuring economy-wide inflation while accounting for the “anticipated difference between changes in costs in the industry that are exogenous as compared to the CPI.” *Id.* at ¶ 12. When these adjustments are renegotiated, the regulator can take into account “anticipated trends

such as improvements in the industry’s technology, or changes in the anticipated rates of inflation in the industry’s input prices and wages, or alterations in the firm’s mandated outputs, or thinning of the volume of demands where there are scale economies.” *Id.* These adjustments, however, must be *forward-looking*. “[B]ackward looking true-ups are to be strongly discouraged in an optimal system on incentive grounds.” *Id.* Adjustments to the index do not assure recovery of costs or compensate for past forecasting failures; rather, they “intentionally leave[] some risks to each side arising from exogenous cost or demand changes that are lower or higher than was anticipated.” *Id.* Indeed, “[i]t is crucial that the regulated entity and consumers should prospectively share in the risk of cost increases that are higher, ex post, than expected; and conversely, they should also share in possible benefits of cost-reducing and demand increasing static and dynamic efficiencies that are higher than expected.” *Id.* at ¶ 13.

Dr. Willig further explains that “to stimulate productivity growth and innovation, it is vital that the regulated entities are permitted to retain a portion of the benefits resulting from any such improvements that they generate.” *Id.* at ¶ 14. Further, the price cap system should incorporate a productivity growth target through which a portion of the benefits of productivity growth are passed on to consumers. *Id.* Like other features of a well-designed price cap system, the division of productivity gains between the regulated entity and its customers should be established in advance, remain in effect for a defined period, and not be subject to retroactive true-ups or amendments. *Id.*

Dr. Neels and Dr. Powers echo these principles, and further emphasize that holding to the regulatory bargain is especially important in the case of a public entity like the Postal Service. Brattle Decl. at ¶¶ 16-24. Without shareholders, and aware of the prospect that the government may step in to fund operations if its financial situation deteriorates significantly, the Postal Service may need reinforcement of the message that the regulator will not allow it to recoup past losses.

As discussed above, Dr. Willig has concluded that the proposals in Order No. 5337 are at odds with these basic principles of a well-designed system of price cap regulation. Additionally, Dr. Willig notes that “if the value of the cap is set too high, and if competition is not an adequate constraint on price, consumers are likely to be harmed by prices exceeding competitive levels.” *Id.* at ¶ 13, n.7. By tying the Postal Service’s prices to actual costs, extent of capital investment, and declining demand, and doing so through retrospective assessments of those factors, the Commission’s proposals in Order No. 5337 do not implement best practices for regulating a monopoly service provider. Instead, they incorporate features of cost-plus or rate-of-return regulation without providing mailers any assurance that prices will decline if Postal Service costs decline. Furthermore, by allowing price increases that could exceed CPI by over 6 percent annually, the Commission’s nominal price cap would be set at a level far above what would be expected in a competitive market.²⁹

²⁹ Indeed, if one assumes the economy as a whole is generally competitive, CPI-based increases can be assumed to reflect the actions of a competitive market. While the postal industry might experience some variation from that norm, the Commission’s proposals would authorize price increases that triple recently experienced changes in CPI.

If the Commission is intent on changing the current system of regulation, it should redesign the system in line with the principles identified by Dr. Willig. A well-designed price cap system will serve the interests of the Commission, the Postal Service, and the mailing industry, achieve the objectives of PAEA, and provide the Postal Service with the proper incentives and greatest opportunity to align its operations with market realities and achieve financial stability.

V. THE COMMISSION’S REVISED PROPOSAL TO ELIMINATE THE CPI-U PRICE CAP AGAIN VIOLATES SECTION 3622(D)(1)(A)

A. The Commission’s Analysis of PAEA’s Plain Text Is Erroneous

When it enacted PAEA, Congress instructed the Commission, by regulation, to establish “a modern system for regulating rates and classes for market-dominant products.” 39 U.S.C. § 3622(a). This is precisely the same “system” that must be designed to achieve the statutory objectives found in 3622(b), accounting for the factors found in 3622(c). And it is the same “system” that “shall” include a CPI cap on annual market-dominant price changes. Congress identified this CPI cap as a “requirement” of the “system” not once (*see* 39 U.S.C. § 3622(d)(1)(A)), but twice. *Id.* at 3622(d)(1)(D).

On these foundational points, we and the Commission agree. The Commission’s analysis goes awry when it concludes that “the CPI-U price cap is plainly a part of the system that is subject to review under paragraph (d)(3) and, if necessary to achieve the statutory objectives, subject to potential change or replacement.” Order No. 5337 at 36. Nothing in the statute makes such a conclusion reasonable, let alone “plain.” Indeed, Congress’ words necessitate a contrary

conclusion: the “system” that the Commission is reviewing (and may modify if necessary) in this docket is the same “system” that Congress instructed it to establish “by regulation” in 3622(a). Nowhere does the legislature instruct, or even permit, the Commission to modify or abandon any aspect of the “system” that Congress itself mandates. Unless Congress changes the law, the Commission cannot, for example, propose a revised system of ratemaking that eliminates the 3622(b) objectives. Nor could it propose modifications that eliminate the exigency authority provision in 3622(d)(1)(E). Nor may it amend the system to abrogate the CPI cap. That the statutorily-required price cap is not subject to modification or abrogation because it is not part of the system that the Commission created “by regulation” is clear from the language of the statute. *See USPS V. PRC*, 785 F.3d 740, 743 (D.C. Cir. 2015) (“Under the Act, the Commission is charged with ‘regulating rates and classes for market-dominant products,’ . . . *which includes promulgating regulations implementing the inflation-based price cap.*”) (emphasis added). When the language of the statute is clear, as it is here, “that is the end of the matter.” *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984).

In Order No. 5337, the Commission looks to PAEA’s structure, the alleged contextual differences between sections 3622(a) and 3622(d)(3), and the negative implications of words Congress elected *not* to include in the statute to support its belief that the plain text of PAEA permits it to grant the Postal Service above-inflation pricing authority. We address each here.

1. PAEA's "Structure" Does Not Permit the Elimination of the CPI Cap

First, the Commission states that "[t]he structure of subsection (d) of section 3622 confirms the Commission's interpretation." Order No. 5337 at 36. The Commission's analysis is as follows:

Subsection (d), titled "Requirements" is subdivided into three paragraphs: (d)(1) "In General;" (d)(2) "Limitations;" and (d)(3) "Review." Paragraph (d)(2) modifies the preceding text appearing in paragraph (d)(1). This structure reinforces the conclusion that the general provisions of paragraph (d)(1) and the limitations of paragraph (d)(2) are part of the system to be reviewed (and, if necessary to achieve the statutory objectives, changed or replaced) pursuant to paragraph (d)(3).

Id. The Commission reiterates this argument later, claiming that "paragraph (d)(3) structurally follows paragraphs (d)(1) and (d)(2), which strongly suggests that the provisions of paragraphs (d)(1) and (d)(2) are subject to modification by paragraph (d)(3)." *Id.* at 39.

We are unaware of any authority, the Commission cites none, supporting this novel proposition that last-in-sequence sections of a statute swallow up the ones preceding them. That is certainly not how 39 U.S.C. § 3622(d) works. Section 3622(d) contains three distinct paragraphs, and *each* is a requirement of the market-dominant ratemaking system. Paragraph (d)(1) sets forth the general requirements that must be included in the system, including the CPI cap. Paragraph (d)(2) further defines the contours of the system: it states that the (d)(1) price cap applies to mail classes, it permits the Postal Service to round prices upward to the nearest whole number, and it delineates how the Postal Service can utilize unused rate authority. Paragraph (d)(3) instructs the Commission to review the system after ten years; the

same system that includes a CPI cap, applies that cap to mail classes, and subjects rounding and banked rate authority to the cap. Nothing in the law’s structure states that paragraph (d)(3) eliminates the CPI cap from paragraph (d)(1).

One wonders how the statutory structure can “reinforce the conclusion” or “strongly suggest” that paragraph (d)(3) supplants (d)(1)’s price cap when Congress drafted section 3622(d)(3) without any reference to the CPI cap at all. Congress clearly knew how to explicitly refer to the CPI cap when writing this portion of the statute: paragraph (d)(2) does so several times. In contrast, paragraph (d)(3) is *entirely silent* with respect to the (d)(1) price cap. There is simply nothing in (d)(3)’s text indicating that the price cap is subject to whatever “modification” or “alternative system” the Commission creates as part of its ten-year review. If Congress intended to allow the Commission to promulgate regulations abrogating the CPI cap during the ten-year review, it could have instructed the Commission to “review the system for regulating rates and classes for market-dominant products established under this section, *including the annual limitation under paragraph (1).*” As we stated in previous comments during this proceeding, “[t]hese extra words presumably were not omitted just to save on printing costs.” *See* Phase II Comments at 23 n.8. It strains credulity to believe that Congress would allow the Commission to eliminate what the Commission itself has called PAEA’s “centerpiece”—the CPI cap—during this review without once mentioning the cap in paragraph (d)(3) of the statute. *See* Order No. 547 at 1. “Congress . . . 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.” *Whitman v. Am. Trucking Assn’s*, 531 U.S. 457, 468 (2001).

The Commission’s theory that section 3622(d)’s paragraph sequencing “strongly suggests” that paragraph (d)(3) permits it to abolish (d)(1)’s price cap is especially misplaced. When reviewing the plain language of a statute, one does not guess at what statute’s structure “strongly suggests.” The Commission’s assertion about what the law suggests, hints at, or insinuates does not change what Congress actually wrote. “Repeals by implication are very much disfavored.” *Fogg v. Gonzales*, 492 F.3d 447, 453 (D.C. Cir. 2007) (citing *Tenn. Valley Auth. v. Hill*, 437 U.S. 153, 189-189 (1978); *see also id.* (“we cannot infer from the addition of § 2000e–2(m) the implicit repeal of § 2000e–2(a)”); *see also TVA v. Hill*, 437 U.S. at 189 (calling it a “cardinal rule” that “repeals by implication are not favored.”). For all of these reasons, the Commission’s structural argument is unsound and cannot withstand judicial scrutiny.

2. The Commission’s “Differing Context” Argument Is Specious

The Commission asserts that the “differing statutory context under which [it] acts—subsection (a) versus paragraph (d)(3)—determines the extent of the Commission’s rulemaking authority.” Order No. 5337 at 37 (citing Order No. 4258 at 17-18). In our previous comments, we explained why differences in the wording of sections 3622(a) and 3622(d)(3) do not authorize the Commission to disregard the price cap. *See* Phase II Comments at 16-19. The Commission doubles down on this argument in Order No. 5337, however. It refers multiple times to the allegedly

“different purposes” of subsection (a) and paragraph (d)(3), imagines disparate roles for the statutory objectives, and envisions malleable definitions of the word “system” depending on its location within the statute. *See* Order No. 5337 at 37-39. The Commission’s interpretations cannot be squared with the statutory text.

The Commission asserts that PAEA “makes it clear that the statutory objectives and factors play different roles to effectuate the different purposes of subsection (a) and paragraph (d)(3).” *Id.* at 37. Nowhere does PAEA do this. The Commission then goes on to say that “subsections (b) and (c) explain the role of the objectives and factors during the course of any rulemaking undertaken pursuant to subsection (a).” *Id.* This is also not true. Section 3622(b) identifies the objectives that the system must be designed to achieve, and 3622(c) identifies the factors the Commission must take into account when creating or revising the system. Congress did not limit the role of the objectives and factors to 3622(a) rulemakings. It deemed them to be important elements of the “system” in all contexts, including rate reviews. *See Carlson v. PRC*, 938 F.3d 337, 343 (D.C. Cir. 2019) (“Based on the text and structure of the PAEA, we conclude that the PAEA requires consideration of all relevant statutory objectives and factors as part of the regulatory process . . .”). There is simply nothing in the statute that relegates the objectives and factors to a mere “background role” under subsection (a) and promotes them to a “primary role” during the ten-year review required by paragraph (d)(3). Order No. 5337 at 37. The statutory objectives are *always* important: the system—whether originally created pursuant to section 3622(a) or modified under 3622(d)(3)—must *always* be designed

to achieve them. The assignment of relatively different values to the objectives based on “context” is an invention of the Commission’s making that lacks any support in the statute.

More fundamentally, the Commission’s discussion of the objectives and factors’ roles under section 3622 is a red herring. Even if one presumes that Congress gave the objectives a relatively larger importance during the ten-year review proceeding, that *still* does not mean that Congress authorized the Commission to ignore the CPI cap in the event the Commission modifies the system. The Commission creates an artificial binary choice here when it writes that “[t]he purpose of paragraph (d)(3) is to ensure that the objectives appearing in subsection (b)—not the provisions of paragraphs (d)(1) and (d)(2)—are being met.” *Id.* at 40. It is true that Congress authorized the Commission during this proceeding to modify the system “as necessary to achieve the objectives.” 39 U.S.C. § 3622(d)(3). No one suggests otherwise. But the Commission invents a false dilemma by deducing that, if the ten-year review process is designed to achieve the objectives, it necessarily is at odds with the statutory requirements of 3622(d)(1) and (d)(2). This is a logical fallacy. The paragraph (d)(1) CPI cap is a Congressionally-mandated requirement of whatever system is created or modified. That paragraph (d)(3) instructs the Commission to make sure any revised or alternative system achieves the objectives does not alter the price cap’s preeminence in any way.³⁰

³⁰ In our previous comments, we explained that a canon of statutory interpretation holds that the same word or phrase—in this case “system”—is presumed to have a consistent meaning throughout the statutory text. The

3. The Commission's Negative-Implication Argument Is Not Compelling

The Commission also draws on the absence of specific limiting language in section 3622(d)(3) to infer that its ability to modify the system is unbounded. First, it observes that “nothing in paragraph (d)(3) states that the Commission’s review of the system, and the range of action that can be taken in response to that review, is to be limited by the provisions appearing in paragraphs (d)(1) and (d)(2).” Order No. 5337 at 38. Next, the Commission proclaims that “[i]f Congress had intended to restrict the scope of review or action authorized under paragraph (d)(3), it could have done so easily.” *Id.*

The first observation is true, but it proves nothing. Sections 3622(d)(1) and (d)(2) set forth the required parameters of the system. Those parameters do not magically disappear into the ether because Congress decided not to repeat them in paragraph (d)(3). Indeed, it would have been superfluous for Congress to have done so. Congress is not expected to identify a requirement of a regulatory system and then explicitly reaffirm that requirement’s existence in an adjacent paragraph in the same section of the statute. The requirement remains a requirement until Congress says otherwise. It is paradoxical that the Commission lauds its “holistic interpretation” of the statute when it reads paragraph (d)(3) in such isolation here. Order No. 5337 at 35.

Commission’s attempt to overcome this presumption by claiming that it “relents when a word used has several commonly understood meanings” appears hollow when the Commission itself cited to a singular dictionary definition of the word “system” only pages earlier. *Compare* Order No. 5337 at 35, n.71 *with id.* at 39.

As to the second point, the Commission has it backwards: Congress *did* restrict the scope of review or action under paragraph (d)(3)—those restrictions are found in (d)(1) and (d)(2). Again, there is no reason for Congress to repeat these restrictions in the immediately next paragraph. The only reason why Congress would have felt compelled to mention the (d)(1) or (d)(2) requirements in (d)(3) would be to exempt them as statutory “requirements” for purposes of the ten-year review. In fact, Congress knew how to do this in the very same section of the statute: section 3622(d)(1)(E)—the exigency provision—begins “notwithstanding any limitation set under subparagraphs (A) and (C) . . .” Congress knew precisely how to carve out the CPI price cap when it wanted to. Its failure to do so in paragraph (d)(3) must be regarded as its intention to keep the price cap a requirement of whatever system emerges from the ten-year review. *See generally* Phase II Comments at 24.

B. The Commission’s Appeal to Statutory Ambiguity Cannot Save It: Its Interpretation is Unreasonable and is not Entitled to Deference

The Commission posits an alternative argument that PAEA is “at most ambiguous” on the question of whether section 3622(d)(3) permits it to modify the CPI price cap. “To the extent that paragraph (d)(3) may be ambiguous,” claims the Commission, its “interpretation is reasonable and thus would be entitled to *Chevron* deference.” Order No. 5337 at 44.

Of course, a reviewing court will not accept the Commission’s assertion that PAEA is ambiguous merely because the Commission says so. “The first question, whether there is such an ambiguity, is for the court, and we owe the agency no deference on the existence of ambiguity.” *American Bar Ass’n v. FTC*, 430 F.3d 457,

468 (D.C. Cir. 2005). As we explain above and expounded on in our prior submissions, the statutory language is unambiguous: “The system of regulating rates and classes for market-dominant products *shall* . . . include an annual limitation . . . equal to the change in the [CPI].” 39 U.S.C. § 3622(d)(1)(A). Paragraph (d)(3) says absolutely nothing that could conceivably override this requirement—In fact it does not reference the CPI cap at all.

Even if the statute were ambiguous, the Commission’s interpretation of paragraph (d)(3) would not be entitled to deference. Courts “recognize that the existence of ambiguity is not enough per se to warrant deference to the agency’s interpretation. The ambiguity must be such as to make it appear that Congress either explicitly or implicitly delegated authority to cure that ambiguity. ‘Mere ambiguity in a statute is not evidence of congressional delegation of authority.’” *Am. Bar Ass’n*, 430 F.3d at 469 (citing *Michigan v. EPA*, 268 F.3d 1075, 1082 (D.C. Cir. 2001)). “The deference mandated in *Chevron* ‘comes into play, or course, only as a consequence of statutory ambiguity, and then *only* if the reviewing court finds an implicit delegation of authority to the agency.” *Id.* (citing *Sea-Land Serv., Inc. v. Dep’t of Transp.*, 137 F.3d 640, 645 (D.C. Cir. 1998)) (emphasis in original).

To find the Commission’s statutory interpretation deference-worthy in this case, a court would first have to find that the plain language of paragraph (d)(3)—which makes no reference to abrogating the CPI cap whatsoever—ambiguous. Then, the court would have to deduce that Congress implicitly delegated to the Commission the authority to abolish one of the fundamental statutory requirements of the system,

which would require a level of deference far beyond that required under *Chevron*. To make this leap, a court “would have to conclude that Congress not only had hidden a rather large elephant in a rather obscure mousehole, but had buried the ambiguity in which the pachyderm lurks beneath an incredibly deep mound of specificity, none of which bears the footprints of the beast of any indication that Congress even suspected its presence.” *Am. Bar Ass’n*, 430 F.3d at 469.

Furthermore, if a court were to review whether the Commission’s interpretation of PAEA is reasonable, it would not do so in a vacuum. “This rule reflects the idea that a statute should not be read in an atmosphere of sterility, but in the context of what actually happens when humans fulfill its purpose.” *See* 2A Sutherland Statutory Construction § 45:12 (7th ed.). To interpret PAEA as the Commission does would mean that the Postal Service’s captive customers—including charities who use the mail to fulfill their missions and publishers who use the mail to distribute educational, cultural, scientific, and informational material—would be crushed beneath the weight of unprecedented price increases *even though PAEA’s drafters intended for a price cap to protect mailers*. It would also result in a rapid acceleration of volume loss from the mail to the Postal Service’s detriment, which is precisely the dilemma the Commission is trying to avoid. Such results simply do not square with a reasonable interpretation of the statute. *See Bechtel Const., Inc. v. United Broth. Of Carpenters & Joiners of America*, 812 F.2d 1220, 1225 (9th Cir. 1987) (court should avoid construction establishing illogical, unjust, or capricious statutory scheme).

* * *

The Commission offers three justifications for its claim that its expansive interpretation of paragraph 3622(d)(3) entitling it to rupture the CPI cap merits judicial deference.

(1) First, the Commission simply falls back on its plain text analysis. It argues that “if paragraph (d)(3) is determined to be ambiguous, the foregoing plain language analysis would be equally applicable to explain how the Commission’s reasonable interpretation is consistent with the text, context, structure, and purpose of the PAEA.” Order No. 5337 at 45.

This argument gets the Commission nowhere. If a reviewing court finds that the Commission’s analysis of PAEA’s plain text is correct, then that ends the matter. There would be no need for the court to resort to a reasonableness analysis if the plain meaning of the statute is as apparent as the Commission says because “it is not allowable to interpret what has no need of interpretation.” *Ruggles v. Illinois*, 108 U.S. 526, 534 (1883). On the other hand, if the Commission’s plain language analysis lacks merit—as we believe it does—then that analysis will not be given deference by a reviewing court in any event.

(2) Second, the Commission states that “to the extent that any ambiguity exists with regard to paragraph (d)(3), it is also permissible for the Commission to use Senator Collins’ floor statement as an interpretive aid and reasonable for the Commission to conclude that paragraph (d)(3) would allow the Commission to make

additional rate adjustment authority available to the Postal Service.” Order No. 5337 at 45-47.

The Commission’s continued reliance on Senator Collins’ single floor statement remains unpersuasive. This is especially so because—regardless of what Senator Collins said on the Senate floor—the statute that Congress actually enacted *does not* state that the CPI cap in paragraph (d)(1)(A) shall be subject to modification or elimination during the ten-year review. As we explained in our previous comments, Senator Collins’ floor statement cannot override the plain text of the statute. *See* Phase II Comments at 25-27; *see also Carlson*, 938 F.3d at 350 (“legislative history cannot provide the express statement necessary to eliminate the reasoned decisionmaking required by the APA.”).

(3) Third, the Commission attempts to defend its abandonment of its earlier interpretations of the CPI cap as resting atop PAEA’s statutory hierarchy and as being the “indispensable” “centerpiece” of the market-dominant rate regulation scheme. The Commission justifies walking away from its previous statements extolling the sanctity of the PAEA price cap by noting that those statements were made in different contexts than as part of the ten-year review mandated by paragraph (d)(3).

For the reasons stated above (*see* § II(A)(2), *supra*) and explained in our previous comments (*see* Phase II Comments at 27-29), there is nothing in PAEA’s language—whether under paragraph (a)’s general review authority, or paragraph (d)(1)(E)’s exigency provision, or (d)(3)’s ten-year review—that permits the

Commission to assign different levels of importance to the price cap. Moreover, nothing in the statute’s legislative history even suggests this. Section 3622(d)(1)(A) makes the CPI cap a requirement of the system in *any* context. Congress did not make the price cap a malleable entity that is somehow “mandatory” under section (a), “central” during exigency cases, but disposable during the ten-year review.

Thus, the Commission cannot repudiate its longstanding interpretation by distinguishing its authority under paragraph (d)(3) as somehow unique. “An agency cannot typically abandon an earlier position simply by subsequently terming the case in which it was applied ‘sui generis,’ but is instead ‘obligated to supply a reasoned analysis for the change.’” *Trunkline LNG v. FERC*, 921 F.2d 313, 320 (D.C. Cir. 1990) (citing *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Ins. Co.*, 463 U.S. 29, 42 (1983)); *see also U.S. v. Paddack*, 825 F.2d 504, 512 (D.C. Cir. 1987) (“We do not normally defer to a vacillating agency position.”).

VI. CONCLUSION

Joint Commenters want a healthy, vibrant Postal Service to exist. In large part, it currently does. The Postal Service is meeting its universal service obligation. Its retirees’ benefits are well-funded. Market-dominant mailers, like our members, want to stay in the mail. The sky could perhaps be a bit bluer, but it is hardly falling.

It is thus critical that any proposed changes to the market dominant system of ratemaking – particularly changes as radical as those proposed here – account for the fact that the Postal Service’s continued health depends on its customers. Any

modified system must galvanize the Postal Service to do what Congress intended when it enacted PAEA: act like a reasonable business, make sensible management decisions, and price market dominant products flexibly but also *justly, reasonably, stably, and predictably*. These are not mere suggestions. They are Congressionally-mandated objectives.

After it reviews and considers the voluminous public comments that will be submitted in response to Order No. 5337, the Commission should withdraw the Order. Its proposals are illegal. Even if they were legal, they'd be unworkable. As a matter of good public policy and common sense, it cannot be that the solution to declining volumes and uncontrolled costs is to design a system that will drive volumes further down while substantially reducing the incentivize for cost-cutting. The Commission should not gamble the outlook of our postal system on the unproven and suspect hypothesis that large, stand-alone price surcharges will lead to a stable, bright future. These new proposed rules are not what mailers want, not what the Postal Service needs, and not what the Commission can legally or rationally implement.

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