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

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

Docket No. RM2017-3

REPLY COMMENTS OF THE NATIONAL POSTAL POLICY COUNCIL,
THE MAJOR MAILERS ASSOCIATION,
THE NATIONAL ASSOCIATION OF PRESORT MAILERS,
AND THE ASSOCIATION FOR MAIL ELECTRONIC ENHANCEMENT

Robert Galaher
Executive Director and CEO
NATIONAL ASSOCIATION OF PRESORT MAILERS
P.O. Box 3552
Annapolis, MD 21403-3552
(877) 620-6276

Todd Haycock
President
MAJOR MAILERS ASSOCIATION
5220 Robert J Mathews Parkway
Eldorado Hills CA 95762
631-708-4258
Todd.Haycock@broadridge.com

Steve Krejcik
President
ASSOCIATION FOR MAIL ELECTRONIC ENHANCEMENT
1260 E 88th Street
Newaygo, MI 49337
(708) 485-4764
AMEE.President@gmail.com

William B. Baker
POTOMAC LAW GROUP, PLLC
1300 Pennsylvania Avenue, N.W.
Suite 700
Washington, D.C. 20004
(571) 317-1922
wbaker@potomaclaw.com

Arthur B. Sackler
Executive Director
NATIONAL POSTAL POLICY COUNCIL
1629 K Street, N.W.
Suite 300
Washington D.C. 20006
(202) 508-3687

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(March 4, 2020)

The National Postal Policy Council ("NPPC"), the Major Mailers Association ("MMA"), the National Association of Presort Mailers ("NAPM"), and the Association for Mail Electronic Enhancement ("AMEE"), collectively the "First-Class Business Mailers," hereby respectfully reply to the comments on the Revised Notice of Proposed Rulemaking in this proceeding.¹

I. INTRODUCTION AND SUMMARY OF POSITION

In our initial comments² on the Revised NPRM, we urged the Commission to adopt its proposed regulation regarding setting workshare discounts at economically efficient levels, modified slightly in order better to achieve the

¹ Order No. 5337 (Dec. 5, 2019) ("Revised NPRM" or "RNPRM"). NPPC expressly has reserved its full rights regarding Order No. 4257, for which it has filed a Petition for Review. National Postal Policy Council v. Postal Regulatory Commission, Case No. 17-1276 (D.C. Cir. order holding in abeyance Feb. 15, 2018).

² Comments of the National Postal Policy Council, the Major Mailers Association, the National Association of Presort Mailers, and the Association for Mail Electronic Enhancement, Docket No. RM2017-3 (Feb. 3, 2020) ("First-Class Business Mailers Comments").
Objective 1 goals of maximizing the incentives to reduce costs and improve efficiency. Such a step is long overdue and received strong support from other commenters.

In contrast, we urged the Commission to abandon its several proposals to confer additional rate authority on the Postal Service because they exceed its legal authority under the Postal Enhancement and Accountability Act (“PAEA”) and the Constitution and its role as a regulatory agency, and because they offer little hope of better achieving Objectives 1, 3, and 5 than the current system. ANM et al. reiterated that point in their comments.

Furthermore, we also pointed out that the Commission’s failure to evaluate its proposed revised system against all of the statutory Objectives set forth in 39 U.S.C. §3622(b), taking into account the Factors set forth in 39 U.S.C. §3622(c), violates the PAEA and is unreasoned decision-making. The Commission has not provided any explanation as to how the system if changed as proposed would continue to meet the Objectives that are successfully being achieved

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3 Id. at 15-19.

4 As explained in previous rounds of this proceeding, the Commission simply does not have legal authority to allow the Postal Service to exceed the statutory price cap except in exigent circumstances. See Comments of the Major Mailers Association, The National Association of Presort Mailers, and the National Postal Policy Council, Docket No. RM2017-3 (Mar. 20, 2017); Comments of the National Postal Policy Council, the Major Mailers Association, and the National Association of Presort Mailers, Docket No. RM2017-3, at 19-41 (Mar. 1, 2018) (“First-Class Business Mailers Phase II Comments”). See also National Postal Policy Council v. Postal Regulatory Commission, Case No. 17-1276 (D.C. Cir. order holding petition for review in abeyance Feb. 15, 2018).

5 ANM el al Comments at 10-11 & 90-101.

6 In its comments, the Postal Service makes the same error, arguing that the problem to solve is a failure to achieve Objectives 5 and 8 while ignoring the other Objectives. USPS Comments at 5.
under the current system. It cannot simply assume that Objectives achieved by the current system would continue to be achieved by the very different system proposed in the Revised NPRM.

Our comments also demonstrated that the Revised NPRM’s failure to consider the effects of the cumulative rate increases on mailers is arbitrary and capricious. The Postal Service itself acknowledges that volumes will decline in response to price increases. Although the Postal Service seems to expect only the losses predicted by its calculated price elasticities, those elasticity models are of questionable usefulness because they are calculated from inflation increases that on average simply tracked inflation. Neels & Powers Declaration at 12. The lack of any real price change over the period from which the estimate is made means that there has been no opportunity to fit the model by observing “how mailers will respond to large and sustained price increases” because as prices move outside of the range over which the estimates are based, the parameters necessarily become less reliable. Id. at 12-13.

But mailers know. And the record demonstrates that the impacts of the proposed changes, if adopted, would be large and material. Even the relatively

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7 USPS Comments at 19.

8 The NALC’s belief, apparently based on the exigent surcharge, that volumes would barely change in reaction to a 6 percent “reset” is similarly unfounded. NALC Comments at 8. Not only did volumes decline for years after the exigent surcharge was imposed, that rate was known to be temporary. A permanent increase of that or larger size would have deeper and permanent consequences. Neels & Powers Declaration at 13, n.21. And the 19.3 percent increase sought by NALC (even before adding the several new proposed authorities) is far beyond the range of the elasticity estimate but certainly would have a catastrophic effect on volumes.

9 See, e.g., ACMA Comments at 2 (Postal Service elasticity estimates are inaccurate); Meredith Comments at 2 (32% reduction in its volume if all of the rate authorities are included);
smaller 4.3 percent exigency surcharge set in motion large and permanent declines in First-Class Mail volume, which due to the lag effect fell by more than 4 percent in FY2017 after the exigent surcharge was removed.\(^\text{10}\)

As the many billions of pieces of volume represented by ourselves, the joint comments of ANM et al. and others, and the supporting declaration from The Brattle Group demonstrates using a variety of scenarios, the cumulative effects on volumes of the Revised NPRM's various rate authority proposals would be profound and completely defeat the stated purpose of the rationales. See ANM et al. Comments at 28 & 43; Neels & Powers Declaration at 11-19 & 37 (forecasting more than double the volume losses that would occur over five years compared to current rates).\(^\text{11}\) Yet the Revised NPRM "fails to make any projections whatsoever regarding volume impacts of the price increases the order would authorize." ANM et al. Comments at 29.\(^\text{12}\)

Unfortunately, even the mere consideration of the proposals in the Revised NPRM has already accelerated efforts by mailers to move mail out of

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\(^\text{10}\) First-Class Business Mailers Comments at 23, n.22. The lagged effect of First-Class Mailers' full implementation of strategies to reduce mail volume in response to the surcharge took lasting hold in FY2017. First-Class Presort volumes have never recovered from the reductions mailers felt compelled to implement due to the exigent surcharge.

\(^\text{11}\) The Berkshire Company (at 2) asserts that rates will be predictable for up to 8 months before new rates take effect. That both assumes that the Postal Service would continue to file notices of rate adjustments in October, for which there is no assurance, and ignores that the large increases that new rate authorities would allow violate the "stability" of rates part of Objective 2. Neels and Powers (at 16) assume new rates would be implemented in September each year.

\(^\text{12}\) Given the extraordinary nature of the rate increases under consideration and mailers' repeated concerns about the consequences on volumes, it is unfortunate that the Commission has not proposed any mechanism to throttle the use of these rate authorities if volumes plummet.
the system. *Mailers Hub Comments* at 8.\(^{13}\) If adopted, the various rate authority proposals would fuel the very “death spiral” of rising rates and declining volumes that the Postal Service and Commission have long sought to prevent.

The First-Class Business Mailers also identified numerous problems with the specific rate authority proposals. We noted that the proposed density factor:

- Is premised on the incorrect assumption that network costs are unavoidable, a notion refuted by the past 12 years;
- Would recover far more “delivery costs” than are calculated by the established rollforward model, a straightforward sanity test that the *Revised NPRM* did not even consider;\(^{14}\)
- Would conflict with Objective 1 by reducing the Postal Service’s current incentive to reduce costs;
- Would create a death spiral by its very formula;
- Should be reduced if volume rises, due to the same rationale that justifies its increase if volume falls; and
- If adopted, logically means that volume losses should be excluded as a possible justification for an exigency increase.

Regarding the proposed retirement benefit rate authority, we showed that:

- Only Congress can rectify the funding problem;
- Mailers currently pay $3.1 billion annually for the same purpose which the Postal Service diverts to other purposes;
- It would have no effect on the Postal Service’s “financial stability”;
- It could impose potentially unlimited rate increases on the remaining market-dominant mail, creating a second death spiral; and

\(^{13}\) At least one NPPC member reduced its use of the mail by more than 16 percent between December 2018 and January 2020 in partial response to the notices of proposed rulemakings in this proceeding.

\(^{14}\) *Accord American Bankers Association Comments* at 10.
- A failure by the Postal Service to remit the collected funds to the Treasury should result in a total forfeiture of all such rate authority.

As for the revised proposal for additional rate authority based on “service performance,” our comments:

- Supported the proposal in the Revised NPRM to require satisfaction of both the productivity and the service components of the proposed additional authority based on service performance;

- Explained that Total Factor Productivity (“TFP”) is not effective in minimizing costs or maximizing efficiency for several reasons;  
  
\[15\]  

- Noted that the proposal gives no assurance that productivity would improve over time and rate authority reduced if TFP declines;

- Stated that, consistent with the statutory Factors, the Postal Service should not receive any “service”-related rate authority unless it actually meets its service standards; and

- Agreed that the Revised NPRM’s proposal to require satisfaction of the Postal Service’s operational business rules improves upon the previous proposals but requires more transparency regarding when and how those business rules may be changed.

Finally, we:

- Recommended the Commission sequence the order in which the various new rate authorities might be used in order to prevent banking;

- Urged the Commission to adopt stronger regulatory sanctions; and

- Opposed the Revised NPRM’s attempt to evade the Court of Appeals’ decision in Carlson v. Postal Regulatory Commission, 938 F.3d 337 (D.C. Cir. 2019), pointing out that the Commission cannot avoid its statutory responsibility to consider the Objectives and Factors during rate adjustment cases simply by no longer asking the Postal Service to address them in its notice.  
  
\[16\]  

\[15\] These include that TFP is a poor metric when considered year-to-year, and that it does not ensure that greater revenue leads to greater efficiency.

\[16\] Accord GCA Comments at 2.
The First-Class Business Mailers will now address the most salient issues raised in the initial comments on Order No. 5337.

II. THE COMMISSION LACKS THE JURISDICTION AND THE TOOLS NECESSARY TO “FIX” THIS SITUATION

The initial comments reflect a consensus that the Postal Service’s current situation is almost entirely the consequence of three factors: (1) insufficient cost reductions; (2) steadily declining volume; and (3) the retirement funding obligations. The price cap is not the cause of these factors, and the Postal Service’s balance sheet and cash flow are merely symptoms of those more fundamental problems. Put differently, had the Postal Service done more since the PAEA was enacted to reduce costs and improve efficiency, encourage volume retention and growth, or not been subject to the retiree prefunding obligations, this proceeding undoubtedly would have taken a different course.

Although cost control, volume loss, and retirement funding are the biggest problems facing the Postal Service, the Commission is a regulatory agency with little authority to address those underlying fundamental problems. There is an aphorism that to a hammer every problem looks like a nail. Perhaps therefore it is unsurprising that apart from the proposed workshare discount rule the Commission’s Revised NPRM focuses entirely on higher rates. But that does not

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17 Had volumes remained at 2006 levels and the Postal Service reduced costs appropriately, there is no reason to believe that the price cap would independently be any problem. When the postal unions (e.g. APWU Comments at 2) assert that the price cap is “the problem,” they essentially absolve the Postal Service (and their contracts) from any responsibility for the actual problems.
mean that it is an appropriate tool to use.\textsuperscript{18} Unfortunately, the Commission’s attempt to address these problems by simply allowing the Postal Service to charge higher postage rates will not better achieve the Objectives, taking into account the Factors.

A. Retirement Funding

Consider first the retirement benefit funding obligations. All parties recognize that those were imposed by Congress. Because the Postal Service ceased making payments to the Treasury after FY 2011, accounting rules dictate that its default paints the balance sheet in a bad light. But the Postal Service’s failure to make those payments since FY2011 has had no negative effect other than on its balance sheet and has only improved its cash on hand. That the Postal Service has not made “required” payments is a matter between the Service, the Treasury, and the Congress.\textsuperscript{19}

The Commission has no authority to repeal the statutory language. And the Postal Service disputes whether the Commission even has authority to direct the Service to use its cash to make the payments, a matter that the Postal Service contends is reserved to the Governors.\textsuperscript{20}

\textsuperscript{18} Accord Discover Comments at 9 (stating that although volume loss and cost control are the two biggest problems facing the Postal Service, so that is what any revisions should address. Instead, Order No. 5337 focuses on revenue increases). To date, the Commission has been distressingly reluctant to exercise regulatory authority over Postal Service cost reduction and investment strategies due to an excessive deference to postal management’s operational prerogatives.

\textsuperscript{19} The Congressional Budget Office no longer expects those payments to be made. CBO Cost Estimate, H.R. 2382 (Jan. 31, 2020).

\textsuperscript{20} The Postal Service even opposes the Commission conditioning the retirement benefit rate authority on the Service’s actually remitting the money to the Treasury. It may be hinting that
There is also consensus that even were the Postal Service to make the payments, it would see little or no benefit. The Postal Service itself concedes that its “retirement and RHB programs continue to be relatively well-funded.” The amount of money that the retirement factor would raise, while large to the mailers that would pay it, is small compared to the nominal deficit and would take decades to cover the obligation. And because it would be remitted to the Treasury, the Postal Service concedes its “benefit” would mostly be theoretical.

Yet while the record provides little reason to believe that the retirement rate authority would do good, there is substantial reason to expect that it would do significant harm by raising rates by potentially unlimited amounts. The Commission itself would have little oversight of the amount (which would be driven primarily by OPM actuarial calculations). Although the prospect of unlimited rate increases sounds like something a regulatory agency should refrain from allowing, the Commission has made no attempt to estimate how much volume would be lost either immediately due to price elasticity effects or over a longer term as business mailers adjust to the permanently higher rates.

In short, the retirement funding obligation is a matter between the Postal Service Governors, Congress, and the Treasury. For a regulatory agency to authorize still higher rates in a vain effort to fund it would do far more harm than good.

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it would challenge the Commission’s authority to so condition the rate authority in court as an infringement upon the Governors’ prerogatives.

21 USPS FY2020 Integrated Financial Plan at 8 (stating that the CSRS and FERS obligations are both approximately 85 percent funded and the RHB program approximately 39 percent funded).
B. Declining Volume

The Postal Service undeniably has experienced a significant loss of volume since enactment of the PAEA. The associated loss of revenue can explain why it has been unable to make the retirement benefit funding payments for nearly a decade. The Commission’s focus on declining “per delivery unit” cost contribution is merely one way of looking at vanishing volume.

The Commission has no direct role with respect to volume itself. The Postal Service bears responsibility for this decline, as the notion that volume declines are “out of the Postal Service’s control” and thus “exogenous” disregards the Service’s responsibility to make the mail valuable, easy to use, and affordable.22

There is much that the Postal Service could and should do to improve the value of mail and encourage volume retention, growth, and a more profitable mail mix. For example, in First-Class Presort Mail, it could offer more attractive and efficient prices, reduce the complexity of entry requirements, and improve actual service. It could also experiment with negotiated agreements, innovative public-private partnerships, and other marketing initiatives designed to improve the value and attractiveness of the product and make greater efforts to market its products. As is, it is unclear to us what the Postal Service’s marketing objectives or value proposition is for its most profitable product – First-Class Presort Mail.

22 See Willig Declaration at 13 (Postal Service could limit density declines by improving service and enhancing its marketing efforts); American Forest & Paper Association Comments at 5: “While it is true that the Postal Service does not directly control the volume of mail entered into its network, it can influence that volume by the degree to which it delivers value, and meets or exceeds the expectations of its customers relative to that of mail alternatives.”
The Commission can affect volume indirectly by setting regulations that encourage mail value. There is no reason for it to shy away from proposing pro-active measures, such as setting rules to encourage volume discounts, making negotiated service agreements less difficult to approve, and approving innovative new rate categories. Unfortunately, despite the widespread consensus that the stark and steady decline in volume since the PAEA was enacted is a large problem for the Postal Service, nothing in the Revised NPRM addresses any of these.

At the least, the Commission should avoid making volume declines worse. Yet the Revised NPRM does precisely that by proposing a density formula as the remedy for volume losses that would, just like the other proposed rate authorities, discourage volume growth and harm the value of mail by allowing the Postal Service to raise rates substantially above inflation. That doing so would accelerate the Postal Service’s volume losses is indisputable.23

C. Insufficient Cost Reduction

Order No. 4257 concluded that the current system has not achieved the goal of maximizing the Postal Service’s incentives to reduce cost and increase efficiency. The Revised NPRM proposes to address this by adopting rules designed to move discounts closer to economically efficient levels. That proposal will have a beneficial effect on cost reduction and efficiency. The

23 In contrast, the Revised NPRM’s proposal to require more efficient pricing of workshare discounts would have a positive effect on volumes as well as efficiency. It would be unfortunate if the positive effects of that change would be overwhelmed by the adverse effects of higher rates.
Commission should adopt those rules pursuant to its general rulemaking authority, with the modification proposed by the First-Class Business Mailers and Pitney Bowes intended to ensure that they achieve the desired effect.24

The Revised NPRM also attempts to address this by establishing a service performance additional rate incentive partly based on whether the Postal Service can improve its TFP. The comments cast considerable doubt on both the consistency of this approach with price cap theory and whether TFP is even an appropriate metric for that purpose.25 Notably, the Postal Service does not contend that an additional one percent of service performance authority would give it a stronger incentive to reduce costs (although it eagerly would take the money immediately if no conditions were attached).26 And the record provides substantial basis to expect that giving the Postal Service more money would far more likely dampen its current incentive to reduce costs, and thus be counterproductive to one of the primary goals of the PAEA.

An alternative way to address cost reduction would be a more assertive role in regulating costs. But the Commission has never tested its authority to regulate the Postal Service’s cost reduction efforts directly. Instead, as it has for

24 We address this proposal further infra in Section III.

25 See Willig Declaration at 15-18; Fisher Declaration at 28-29 (noting lack of transparency). Indeed, the Postal Service itself argues against the Revised NPRM’s proposal to base rate authority on improvements in TFP (instead, it simply wants the additional rate authority with no meaningful conditions). A review of the comments indicates that almost no one thinks that the TFP criterion is either appropriate or likely to have the desired effect.

26 It is difficult to see, for example, how more revenue would incentivize the Postal Service to reduce its labor costs. Labor costs remain stubbornly above 75 percent or more of total postal costs and have risen in recent years as volume fell. Authorizing more revenue is unlikely to put pressure on postal management to get this enormous part of its costs under much better control.
years, it proposes to rely exclusively on still more reporting requirements. While these have a useful purpose in promoting transparency, history gives little reason to expect that they likely will prove successful.\textsuperscript{27} We urge the Commission to consider asserting greater regulatory authority over Postal Service cost reduction and investment decisions.

Unless it does, however, the Commission’s proposed solution once again is to raise rates on mailers, but with no clear understanding as to how doing so would result in permanent productivity improvements or enhanced value. The First-Class Business Mailers and others pointed out numerous flaws in the proposal in the Revised NPRM. Nor, as in the case of all of the proposed new rate authorities, has the Commission considered the effect of these increases – which, unlike the retirement benefit authority, would not sunset after five years but would remain a permanent part of the system – on mail volumes. On the record before the agency, retaining the current price cap remains the most effective way to maximize the Postal Service’s incentive to reduce costs.

\textbf{D. The Definition Of Financial Stability}

Commenters including the Postal Service and certain postal unions offer various proposals – based on a motley assortment of arguments – to grant the Postal Service more money. These share in common a lack of clear statutory basis for the amount urged. This is because they are based on a construct, adopted initially in Order No. 4257 but reused in the Revised NPRM, of Objective

\textsuperscript{27} For example, despite many years of effort by both the Commission and the Service, the cost problems associated with flats and with Periodicals remain unresolved.
5 that is not based on the text of the PAEA. Instead, Order No. 4257 looked at what it called “short-term,” “medium-term,” and “long-term” financial stability, finding the first has been achieved but not the latter two. Although the Commission had used that construct several times in the Annual Compliance Review process pursuant to Sections 3681 and 3882, it is found nowhere in the PAEA and is not appropriate for this review being conducted under the separate legal authority of Section 3622(d).

Instead, as the First-Class Business Mailers pointed out previously, the only definition of “financial stability” based on the language of the PAEA appears in Section 3622(d)(1) – the exigency provision. That authorizes the Commission to approve above-cap rate adjustments due to extraordinary or exceptional circumstances where:

Such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

39 U.S.C. §3622(d)(1)(E). This is a “safety valve” that allows the Postal Service to “compensate[s] for the net adverse financial impact of the exigent circumstances.” Order No. 864, Docket No. R2010-4R, at 25 (Sept. 20, 2011); Alliance of Nonprofit Mailers v. Postal Regulatory Commission, 790 F.3d 186, 189 (D.C. Cir. 2015). Because the exigency provision allows a rate adjustment

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to “match the amount of the revenue lost as a result of the exigent circumstance,” *United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263, 1268 (D.C. Cir. 2011), the exigency standard provision logically defines the baseline financial condition. Although Order No. 4257 (at 154) rejected the Section 3622(d)(1)(E) standard on the grounds that it does not address “retained earnings,” that conclusion is unfounded. Matching the revenue lost due to the exigent circumstance, and “developing” postal services, inherently includes the opportunity to generate retained earnings.

Thus, the only statutorily-based definition of financial stability under Objective 5 is sufficient funding that, under best practices of honest, efficient, and economical management, enables the Postal Service to maintain and continue the development of postal services of the kind and quality adapted to the needs of the nation.

At no point in this proceeding has the Commission attempted to identify the amount of funding that this would require. Instead, the Commission has tried to fit its proposals in both Phase II and the *Revised NPRM* into its construct of “medium-term” and “long-term stability.”

But because those are untethered to the statute, it leaves the door wide open for the Postal Service and the postal unions to demand ever-more money based on any number of creative theories. And this is seen in the comments of the Postal Service and its unions on the *Revised NPRM*, which pay lip service to those constructs but in fact look to how much money the Postal Service has “lost”
over the years and assume that the Service is entitled to recoup them now.\footnote{The Postal Service is supposed to operate in a business-like manner, and businesses are not able to charge higher rates to recoup prior year losses and expect to stay in business. The reason that the Postal Service and unions think it can do so is because the Service retains a valuable legal monopoly.} There is no statutory basis for such an approach.

In addition to being based on statutory text, the Section 3622(d)(3)(E)-based definition of financial stability also has the virtue of being forward-looking, rather than reminiscing on less relevant issues as how much cash or retained earnings the Postal Service had on hand in 2007, 2002, 2017 or 2019. And, as we have shown previously, if the Commission were to apply the only definition based on the statute, it would have to conclude that the Postal Service is financially stable because it has, in fact, “maintained and developed” postal services suitable for the nation. The mail has been delivered, the network redesigned, and innovations such as Informed Delivery implemented.

The Commission should reconsider its non-statutory definition of “financial stability” and the misguided direction to which it has led. Instead, it should consider afresh what revenue the Postal Service needs to “maintain and continue to develop” the nation’s postal services.

That the Commission “may” modify the system to better achieve the Objectives does not mean that it \textit{must} make changes. Because Congress directed the Commission to design a system to achieve all of the Objectives, taking into account the Factors, if the Commission cannot devise a system that
does, in fact, better achieve the Objectives, it should not make any modifications just for the sake of doing so.

Nevertheless, if the Commission believes that it must modify the current system, we respectfully recommend that it adopt the proposed rule regarding worksharing discounts, as modified per our suggestion and by Pitney Bowes, and withdraw the supplemental and additional rate authority proposals. Instead, it should retain the CPI-U price cap and consider new ideas that better achieve efficiency and encourage the Postal Service to improve the value proposition of mail (through pricing innovations, negotiated service, and high quality service) which would lead to growth, and to improve its finances through sound and effective cost reductions and volume retention and growth.

III. THE COMMISSION SHOULD ADOPT ITS WORKSHARE DISCOUNT PROPOSAL WITH THE MODIFICATIONS SUGGESTED BY OURSELVES AND PITNEY BOWES

Our initial comments recommended that the Commission adopt its proposed workshare discount rule, pursuant to its general rulemaking authority (and not using its purported authority under Section 3622(d)(3)) but with a modification intended to ensure that workshare discounts move closer to efficient passthrough levels. In particular, our comments explained that the Commission should revise Proposed rule § 3010.282(a) to read:

For a workshare discount that is equal to the cost avoided by the Postal Service for not providing the applicable service, no proposal to adjust a rate associated with that workshare discount may cause the discount not to equal the costs avoided.
This recommendation would enforce the Commission’s intention that discounts that passthrough 85 to 99 percent of avoided costs should be increased in the same manner as the Revised NPRM proposes for other passthroughs in order to attain the goal of economically efficient pricing signals. We also recommended that 85 percent serve as the minimum passthrough applicable to any waiver request by the Postal Service.

Pitney Bowes made a similar recommendation. See Pitney Bowes Comments at 1. It noted that the rule as initially proposed could in practice readily allow 85 percent to become a de facto maximum passthrough. Id. at 5.

It is evident from the Postal Service’s comments that our recommended improvements are well-founded. For example, the Postal Service asks the Commission to weaken the proposed rule 3010.282(a) to allow it to reduce discount passthroughs to 85 percent in any instance. USPS Comments at 48. Such a “safe harbor” would, in practice, gut the central goal of this proposal to move discounts to fully efficient levels. The Postal Service’s so-called safe harbor would allow 85 – not 100 – percent passthroughs to become the standard in contravention of Objective 1’s directive to maximize the incentives for efficiency and cost reduction. The Postal Service’s suggestion demonstrates the need to adopt the modification proposed by the First-Class Business Mailers and Pitney Bowes.

The Postal Service also objects to the proposed workshare rules on the ground that they might “foreclose adjusting prices for other reasons.” USPS Comments at 46. But Congress has itself foreclosed this by directing the
Commission to "maximize" the incentives for efficiency and cost reduction. Indeed, Congress deemed worksharing to be so vital to the success of the Postal Service that it devoted an entire subsection in the market-dominant rate regulation provision to workshare discounts. 39 U.S.C. §3622(e).

Nor should the Commission accept the Postal Service’s request to permit waivers when increasing discounts could raise benchmark prices. USPS Comments at 48. In practical effect, this amounts to a request to maintain the status quo in setting worksharing discounts that the Commission has already found has not achieved Objective 1. This is precisely what has caused excessive markups for the most efficient mail in the system.

The Commission also should not accept the Postal Service’s proposal to approve a waiver when a proposed costing methodology change is pending. USPS Comments at 47. That opens a potential loophole that would be rife for abuse. Not all costing methodology changes necessarily are adopted. It would be more prudent for the Commission to require that a proposed change actually be adopted before it may be used as the basis for a discount.

Finally, the Postal Service also makes the curious argument that passthroughs of less than 100 percent may warranted if attributable costs “are not as volume-variable as measured.” USPS Comments at 50. That amounts to a request that the Commission ignore established costing principles when the Postal Service says it does not trust its own analyses. If the Postal Service does

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30 Although Congress did not mandate that the Postal Service passthrough 100 percent of avoided costs, it did address the importance of economically efficient rates by establishing a presumption against passthroughs that exceed 100 percent.
not believe in the accuracy of its volume variability cost avoidance methodologies, it should propose a correction and demonstrate the need on the record in a proceeding. It should not be an excuse to violate Efficient Component Pricing.

The Service states that if the avoided costs are over-estimated, then a 100 percent passthrough could “unnecessarily” transfer work from the Postal Service to a workshare partner in a manner inconsistent with optimizing efficiency. Id. That ignores the likelihood that the workshare partner may still be more efficient than the Postal Service. If the Postal Service thinks that there are economies of scope here, it should demonstrate their existence; it should not be allowed to just assert ipse dixit that economies exist.

In short, to achieve Objective 1, workshare discounts should always move towards 100 percent passthroughs, not 85 percent, and requests for waivers by the Postal Service should meet a high standard.

IV. THE POSTAL SERVICE AND UNIONS’ REQUEST FOR AN IMMEDIATE SIX PERCENT OR HIGHER “BASELINE RESET” MUST BE REJECTED AS ILLEGAL AND CONTRARY TO SOUND ECONOMIC THEORY

Reflecting an attitude of entitlement, the Postal Service asks for a $6 billion increase in baseline rates as a “reset,” based on its 2018 and 2019 financial results. USPS Comments at 2 & 12 (excluding workers’ compensation but including retirement funding defaults.) The National Postal Mail Handlers Union concurs, arguing that the Postal Service lost $6 billion annually from FY2013 through FY2017. NPMHU Comments at 3. More extravagantly, the
National Association of Letter Carriers argues that the Commission should permit a 19.14 percent increase in rate authority based on density declines alone. *NALC Comments* at 6-7. Although the theories differ, all assume that the Postal Service is somehow entitled to a level of revenues based on greater volumes over the years than the Service has actually delivered and therefore should be immune from the financial effects of its changing business environment and its failure to cut costs sufficiently or increase the value of its service.

The Commission should completely reject the requested resets.\(^3\)\(^1\) These requests seek illegal retroactive ratemaking. And, as a matter of policy, these requested resets also reflect a fundamental misunderstanding of what the price cap required of the Postal Service and the Service’s failures to meet its business responsibilities under the PAEA.

### A. The Commission Cannot Legally Engage In Retroactive Ratemaking

In arguing for the reset, the NALC states that the goal is to make the Postal Service “whole” by putting it in the position it would have been had the declines in volume not occurred. *NALC Comments* at 1 & 5. And the NALC also seeks further retroactive increases dating back to the start of this proceeding, claiming there is no reason to “deprive” the Postal Service of a density

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\(^3\)\(^1\) Total market-dominant revenue in FY 2019 totaled $45.895 billion. Docket No. ACR2019, *USPS Public FY19-1 CRA Expanded* (Tab Summary). A 6 percent increase would be more than triple the increase allowed in Docket No. R2020-1 and would amount to $2.75 billion added permanently to the base. The Docket No. R2020-1 rate increase was designed to increase market-dominant revenue by slightly less than $1 billion.
adjustment for those years simply because the Commission had not proposed it until now. *Id.* This would be illegal on its face.

A reset based on past losses would constitute improper retroactive ratemaking.\(^{32}\) It has long been the law that a regulated entity may not set rates to recoup past losses, nor may a regulatory agency prescribe rates on that principle. *Galveston Electric Co. v. Galveston*, 258 U.S. 388, 395 (1922) (past losses are not to be considered in determining rates); *Nader v. Federal Communications Commission*, 520 F.2d 182, 202 (D.C. Cir. 1975).\(^{33}\)

Furthermore, past losses have no role in setting a rate regulatory system going forward. This is a “rulemaking proceeding, and any rules adopted herein may have only future effect.” 5 U.S.C. §551(4); see also *Clark-Cowlitz Joint Operating Agency v. Federal Energy Regulatory Commission*, 826 F.2d 1074, 1082 (D.C. Cir. 1987) (when a regulatory agency employs rulemaking procedures, its orders should have only prospective effect). Basing future rates on past losses, as the Postal Service and unions urge through the reset request, is improper.

These requests fundamentally reflect a view that the Postal Service is entitled to a certain amount of revenue regardless of how its business is doing. The Postal Service is simply not entitled to an amount of revenues based on the

\(^{32}\) The prohibition of retroactive ratemaking is a corollary of the filed rate doctrine, which underpins the PAEA’s prohibition against refunds of rates later found unlawful. 39 U.S.C. §3681.

\(^{33}\) See also *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 (1981); *Old Dominion Electric Cooperative v. Federal Energy Regulatory Commission*, 892 F.3d 1223, 1227 (D.C. Cir. 2018). A regulatory commission may not impose a rate increase based on items already sold (or delivered).
mail volumes delivered in past years; rather, it and its employees must adjust to changing market conditions just as any business must. Mailers cannot “reset” their revenues, and the request by the Postal Service and unions to reset postal rates to recover “lost” revenues in past years must be rejected.

**B. Resetting The Baseline Would Convert The Price Cap System Into A Deferred Cost-Of-Service System**

Resetting the baseline in order to “make the Postal Service whole” or to allow it to “recoup” losses, as urged by the Postal Service and its unions, would also be inconsistent with the theory of price caps. As Professor Willig states in his declaration: “backward looking true-ups are to be strongly discouraged in an optimal system on incentive grounds.” *Willig Declaration* at 7. In a true price cap system, “the prices that are allowed to be charged do not rise with increases in the costs incurred by the firm” nor “with diminutions in the consumer demand for the firm’s outputs.” *Id.* at 6.

The Postal Service states that a price cap system must have (1) a compensatory baseline rate and (2) a going-forward formula governing how rates change from the baseline. *USPS Comments* at 7-8. In fact, both were included in the PAEA: the baseline rates arising from Docket No. R2006-1\(^\text{34}\) were compensatory and going forward prices were governed by the price cap (for market-dominant products) or an even lighter standard (for Competitive

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\(^{34}\) The PAEA authorized the Postal Service to file an additional one-time omnibus rate case under the prior regulatory regime if the Governors believed higher “starting” rates were necessary. 39 U.S.C. §3622(f). The Governors chose not to do so. The labor unions now, more than 12 years later, ask the Commission to overturn that decision. A clearer example of impermissible retroactive ratemaking would be difficult to conjure.
Thus, the Postal Service began operations under the PAEA with fully compensatory rates and clear going-forward regulations. Unfortunately, over the ensuing years it simply failed to adjust sufficiently to changes in its business. It still has not cut costs sufficiently, it has not priced its market-dominant prices efficiently, it has made its offerings less desirable by adding burdensome mail entry requirements, and it has reduced service quality. It has made no serious effort to improve the value of market-dominant mail, to retain volume or to monetize its enormous real estate assets, and it has not held the line sufficiently in its labor contracts.

Instead, the Postal Service (and the unions) seem to view mailers as piggybanks. The Postal Service has shown no restraint in raising rates under PAEA, using all of the cap space practically available in every rate adjustment, seeking to make permanent the temporary exigent surcharge, and in this proceeding arguing for rate deregulation. Accord Neels & Powers Declaration at 12. Requests for a 6 or 19 percent reset in the comments are simply more of the same.

Resetting the rates for market-dominant postal products to recoup past losses would mean that the past 13 years have not actually been a price cap system, but rather a deferred cost-of-service approach under which the Postal Service can recover its costs regardless of whether it has undertaken any serious or sustained cost reductions at all. This would be improper as a matter of policy as well as of law.
V. THE COMMENTS IDENTIFIED SERIOUS THEORETICAL AND PRACTICAL FLAWS IN THE PROPOSED RATE AUTHORITY FACTORS

A. Density Factor

Our February 3 comments pointed out numerous problems with the density formula proposed in the Revised NPRM. *First-Class Business Mailers Comments* at 25-40. Others noted problems as well.

Most notably, Professor Willig, perhaps the nation’s leading authority on regulatory economics today, explained that the density formula is “highly inconsistent with price cap theory,” stated that by compensating the Postal Service “every year for any mail volume losses during the prior or previous years” it would “eliminate any Postal Service incentives to operate efficiently and appealingly to stem further volume declines. *Willig Declaration* at 3; see also *ANM et al. Comments* at 49. In reality, the proposed density rate adjustment is effectively a cost-of-service component masquerading as a price cap adjustment, because it would entitle the Postal Service to full recovery of its delivery costs through an automatically adjusting annual factor tacked on to the putative price cap system.

In fact, the density formula would be even worse than cost-of-service regulation, because as our comments showed, the density formula would grossly over-recover non-volume variable delivery costs. *First-Class Business Mailers Comments* at 30-33. That analysis compared delivery costs calculated using the proposed formula with the same costs calculated by using the well-established (and repeatedly tested in regulatory proceedings) rollforward methodology.
ANM et al. also arrived at a similar conclusion using a different methodology. ANM et al. Comments at 44. Their methodology quantified the contribution loss from volume declines, taking into account the different unit contributions from each class of mail (including the high unit contribution from Competitive packages). They concluded that the impact on mail volume changes on postal finances has been about $1,000,000 since FY2011. Compare that to the $6.3 billion in revenue from the density authority over the same period, as drawn from the Revised NPRM, and it is evident from this perspective that the density factor would grossly over-recover the purported losses. See ANM et al. at 45, n.8. Their conclusion is worth repeating: the Revised NPRM made “no credible effort to quantify the impact of the change in density of postal finances and the size of the adjustment required to offset it.” ANM et al. Comments at 45-46. That two different analysis reached the same conclusion provides strong evidence that the formula is seriously flawed.

A third problem is that mail density per delivery is not itself a cost driver; the issue is one of contribution to cost recovery. Several postal unions apparently misunderstand this point in stating that the price cap has prevented the Postal Service from raising rates in response to “increased costs” due to density declines. See NALC Comments at 2; APWU Comments at 3. Declines in volume have not caused “rising unit costs;” the density factor purports to

35 The Public Representative also criticized the density factor for not taking into account different contribution as mail mix changes and volumes decline. Public Representative Comments at 14.

36 ACMA Comments at 8; ANM et al. Comments at 44.
address decreased per unit *contribution* – a very different thing. In fact, the Postal Service has *reduced* (in real terms) the institutional costs of city and rural delivery. See *First-Class Business Mailers Comments* at 27 & Attachment 2. This shows that the Postal Service in fact has considerable control over these so-called “uncontrollable” delivery costs. And continued conversion to centralized delivery and better use of worksharing could reduce those costs still more.

Several commenters also pointed out that mail volume is not exogenous, although the proposed factor assumes that it is. Professor Willig points out that the Postal Service “can surely influence factors such as product marketing, pricing, and quality of service that directly or indirectly impact mail volume per delivery point.” *Willig Declaration* at 10, n.10; accord *Neels & Powers Declaration* at 8 (density formula does not differentiate between volume changes due to technology and those over which the Postal Service has influence). Despite the Postal Service’s potential ability to influence volume, the density formula assumes that all future volume declines will be due to exogenous reasons. *Discover Comments* at 9. That is incorrect on its face.

Presumably content with the prospect of over-recovery of costs, the Postal Service does not challenge the density formula itself. Instead, it challenges the Commission’s proposal to calculate the density factor using two formulas, one including and one excluding Competitive products. *USPS Comments* at 22-28.

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37 The Postal Service also could address the volume component of density by thinking of ways to generate more revenue when carriers are out on the routes.
The Commission should reject this implicit request to benefit Competitive products at the expense of market-dominant mail.

The NALC would reach back to recalculate the density factor since the PAEA was enacted and on that basis argues that the Postal Service should be awarded 19.3 percent in cumulative density factor authority. _NALC Comments_ at 5-7. That request to recoup past losses is just a variation of retroactive ratemaking and must be rejected.

The Public Representative raised several issues warranting attention. First, it questions whether the formula should use “deliveries” instead of “delivery points,” noting that they derive from different data sources. _PR Comments_ at 14. The measure that includes the largest number of delivery “stops” — including post office boxes — would more appropriately reflect actual “delivery” activities.

Finally, the Public Representative (at 15) also suggests that the density factor should not be available for a market-dominant class that has not experienced year-over-year volume declines. We disagree. Per-class density can fall even if volume grows, if the volume grows more slowly than the number of delivery points. Furthermore, all classes share in any economies that stem from density. If anything, it is the growing classes in which the Postal Service probably would have the greatest ability to raise rates successfully. However, Special Services should not be affected by the density factor, because they do not affect the amount of volume per delivery points.
B. Retirement Funding Factor

With few exceptions, there is widespread agreement that the proposed retirement funding factor would provide trivial benefit to the Postal Service.\footnote{Mailers Hub explained how the PAEA included the prefunding obligation for legislative budgetary “scoring” purposes. Mailers Hub Comments at 4-5. When enacted, postage rates were compensatory with the RHB costs were baked in. As noted previously, the Congressional Budget Office does not expect the retiree funding payments to be made.} Even the Postal Service concedes that the “sole benefit” to it of the proposal is a modest “relative improvement in the funded position of its long-term liabilities.” USPS Comments at 18. The Commission should abandon this proposal.

First, the Commission should recognize that the Postal Service’s retirement plans are already comparatively well-funded. The Postal Service reports that its “retirement and RHB programs continue to be relatively well-funded, with the CSRS and FERS obligations both approximately 85 percent funded and the RHB program approximately 39 percent funded.” USPS FY2020 Integrated Financial Plan at 8.

Second, as a number of parties pointed out, there “are currently no consequences for failure to pay OPM the amortization amount except for a book entry liability on the Postal Service’s financial statements.” Public Representative Comments at 33. This fact must be weighed against the adverse consequences of the rate authority.

Third, the Postal Service supports adoption of the retirement factor, but with the caveat that the condition that the money collected be remitted to the Treasury should be deleted because it “usurps the Postal Service business
discretion.” *USPS Comments* at 18. “Whether limited liquidity should be devoted
to that aim or other business needs in the near term is a decision vested in the
Postal Service Board of Governors, not the Commission.” *Id.* Put simply, that
means that the Postal Service wants to collect that money *without any obligation
to remit it to the Treasury.* In other words, it sees the retirement formula as just
another way to raise rates for operational purposes. That also means is that the
Postal Service does not share the Commission’s belief that funding the
retirement benefits is important. In short, it rejects the premise upon which the
*Revised NPRM* proposed the retirement rate authority.

The Commission should reject the Postal Service’s request for
unconditional rate authority. There is no assurance that the funds collected
through the use of the retirement rate authority would be used as intended. The
Postal Service makes it quite clear that it wishes to have the right to spend the
money elsewhere if it sees fit. *USPS Comments* at 18.

And nearly a decade of history has proven beyond any doubt that, if given
the chance, the Postal Service would divert funds collected for this purpose to
other ends. Why? Because the Postal Service *today already* diverts to other
purposes the $3.1 billion annually that it has collected since Docket No. R2005-1
to pay retirement obligations. *See First-Class Business Mailers Comments* at
44-46. For the Commission to create yet another way for the Postal Service to
do the same thing would be unconscionable.

The Public Representative’s contention (at 38) that the Postal Service
“has an incentive to collect as much as possible of its mandatory retirement
obligation costs” is refuted by the Postal Service itself. The Public Representative does not say that the Service has any incentive to remit it to the Treasury. *PR Comments* at 37. But the Public Representative also says (at 32) that the condition that the Postal Service remit all of the money collected would provide little incentive for the Postal Service to raise rates to do so and, indeed, creates a disincentive to doing so because of it would lose volume due to the price increase.

Even were the *Revised NPRM*’s formula adopted, decades would pass before the Postal Service would come close to satisfying the legislated obligation. But while the retirement rate authority (even if paid to the Treasury) would have but a minor impact on the amount owed, it would have a substantial and adverse effect now and permanently in the future on mailers and, derivatively, the Postal Service. And that adverse effect would exacerbate the payment difficulty because the rate increases would have the entirely predictable effect of driving still more mail out of the system, in turn causing the formula to ratchet rates still higher.

The Public Representative also opposes allocating a portion of the retirement funding obligation to Competitive products as inconsistent with prior Commission treatment of institutional costs. *PR Comments* at 20. Setting aside whether retirement funding costs are truly institutional (instead of attributable on the basis of employees), the Public Representative appears to be arguing that mailers of market-dominant products should bear all of the

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39 The Postal Service apparently shares this view. *USPS Comments* at 16, n.6.
retirement obligation. To the extent the Public Representative is stating that the Competitive product category’s “appropriate share” should be viewed as including a share of the retirement obligations, then there should be some way of offsetting the market-dominant category’s burden accordingly. But no such method currently appears in this record.

In our initial comments, the First-Class Business Mailers explained that if the Postal Service diverts money specifically collected for the retirement obligation and diverts it to other purposes, it should forfeit all of such authority upon which it was collected. Simple honesty and fairness require nothing else. The Public Representative and Postal Service, however, argue that no forfeiture is appropriate at all because “If anything, forgoing supplemental rate authority in one year creates all the more need for the foregone rate increase in future years even though the Postal Service will not be able to make up the revenue lost during the foregone year.” PR Comments at 37; accord USPS Comments at 21-22. By that logic, the Postal Service could simply refuse to make the payments for years and collect unlimited authority – just as it does with the $3.1 billion annually currently baked into the rate base. That would be unreasonable on its face.

The Public Representative also asserts that the Commission has a “duty to address exogenous retirement benefit costs” that “was not eliminated by the possibility that Congress may at some future date enact legislation that reduces the financial impact of those costs.” PR Comments at 29. The Commission has addressed those costs, stating that it “considers the RHBF payments a statutory
obligation that must be considered in analyzing the market dominant ratemaking system’s success and includes RHBF as an additional consideration where relevant.” Order No. 4257, at 180. But considering them does not mean that the retirement benefit obligation must be funded at all costs when circumstances have so differed from the expectations that prevailed when it was enacted.

Finally, the Postal Service correctly notes that the price elasticity effects of the higher rates means that the retirement formula likely overstates revenue. *USPS Comments* at 19.\(^{40}\) A proposal that fails to solve one problem (the paper costs of retirement obligations) but worsens another (volume declines) should not be adopted.

### C. Service Performance

The Postal Service opposes requiring satisfaction of the minimal requirements for both the elements of Total Factor Productivity and service quality as a precondition for receiving the additional one percentage point of rate authority, asserting “tying the two elements together worsens the problem.” *USPS Comments* at 30; *accord NPMHU Comments* at 4. But that is true only if the “problem” is how to extract more money from mailers without real, material, substantial improvement in productivity and service. For the mail to have sustained value in the future, both productivity and service quality must improve.

\(^{40}\) Its solution, unsurprisingly, would be to add more to the death spiral by adjusting the factor still higher to make up for the revenue lost due to the volume loss induced by the retirement authority itself. *See USPS Comments, Appendix A* at 2. It also notes that volume losses caused by the retirement authority could also lead to higher rates via the density factor. *Id.* at n.1.
The Postal Service and unions also demand to get the additional money immediately and before it satisfies the two-part service performance standard, saying that it needs the money in order to make the investments necessary to improve productivity and service quality. E.g., USPS Comments at 33. The Postal Service's pleas to get the money before showing improvement – which it styles the “cart before the horse” -- must be denied.

First, the Postal Service contradicts itself only a few pages later, stating that “[e]ven without a price cap, the Postal Service has a strong, inherent incentive to reduce costs and improve efficiency given market realities and persistent volume and density declines.” Id. at 566. Given that “strong, inherent incentive,” it does not explain why it must have the cash up front.

Second, the Postal Service in fact already has plenty of horsepower in the form of ample cash on hand. At the end of FY2019, it had $8.8 billion in unrestricted cash and $4 billion in available borrowing authority. USPS FY2020 Integrated Financial Plan at 8. This is significantly more available cash than the amount upon which the Commission based its Order No. 4257 (see Order No. 4257 at 164-165, showing total of $8.077 billion cash and zero borrowing authority in FY2016). It has continued to make capital investments in its vehicle fleet. ANM et al. Comments at 67. And the Postal Service plans to increase its capital commitments to $2.6 billion and capital outlays to $2.3 billion in FY2020, an amount well within the cash on hand, and it has room for additional capital
spending if the Governors so choose. It should be recognized that these sums nearly double the average amount of capital outlays during the 2014-2018 period, the time when this proceeding began amid fears of inadequate capital investment. And this does not even consider the capital that could be made available if it monetized some of its extensive real estate holdings.

Third, as Discover Financial pointed out, the Commission (and, we would add, the Postal Service) "has not identified how a lack of capital investment has led to declining service or loss of volume, and it has not identified capital investments that would reverse this trend." Discover Financial Comments at 6.

Fourth, nor has the Postal Service, despite repeated references to “insufficient capital,” identified what capital investments it has been unable to make, or what capital investments it might make in the future. It simply cites its lack of “retained earnings” as though that alone suffices to establish its capital requirements. But that the Postal Service may be investing less than its Competitive product competitors should not be viewed as a reason for mailers of market-dominant products to pay more.

Finally, as several commenters pointed out, under the system in place today the Postal Service keeps for itself every single penny it gains from improved productivity. Unlike nearly every other price cap system, the current market-dominant regulatory system contains no factor forcing the Service to share the benefits of greater productivity with its customers. Willig Declaration at

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41 The planned Next Generation Delivery Vehicle production investment would be in addition to these amounts. USPS FY2020 Integrated Financial Plan at 6.
8. As ANM et al. note, if the Postal Service has failed to respond to the productivity incentive of the current system, no one has explained why it would respond to an additional reward. ANM et al. Comments at 53 & 68.

1. TFP

The Commission should acknowledge that almost no one supports the Revised NPRM’s proposed use of TFP as a partial basis for additional “service performance” rate authority.

First, Professor Willig explained how the proposed TFP formulation contradicts basic price cap theory. Willig Declaration at 14-18. He explained that it would eliminate the Postal Service’s incentives to operate efficiently or to offer attractive products, and that it is “poorly designed” and “vulnerable to gainful counterproductive manipulation” while failing to provide an incentive for the Postal Service to maximize its productivity. Id. at 3.

Second, the Fisher declaration identifies important technical flaws in TFP, including the risk of false positives. Most importantly, he concludes that “TFP is not a valid and accurate productivity measurement” for an operational efficiency-based requirement in a performance-based rate authority. Fisher Declaration at 2 & 33. He also points out that currently the Postal Service’s TFP calculation is not publicly transparent and cannot be validated independently (id. at 28), which renders it a poor choice as a basis for rate authority. Accord Neels & Powers Declaration at 24.

Third, even the Postal Service agrees that TFP is flawed for this purpose, stating that TFP is affected by endogenous “operational-efficiency gains
unrelated to capital spending.” *USPS Comments* at 39. It also faults the lack of “tiering” of rewards, the absence of which can create an incentive for management to manipulate some improvements until later years in order to maximize the rewards. *USPS Comments* at 40. On this point, mailers agree with the Postal Service. *See ANM et al. Comments* at 65.

However, the Postal Service’s request for partial credit for decreasing productivity must be rejected outright. *USPS Comments* at 40, n.24. There must be no reward for doing worse, even if “less bad” than expected. This is even more the case where there is no visibility into “expectations” which postal management obviously could easily manipulate before achieving “better” productivity.

2. **Service Quality**

The Commission also should reject the Postal Service’s multiple efforts to water down the service quality component of the proposed additional authority for service performance.

As we explained in our initial comments, the proposal should be modified to measure the reward on actual performance, not a lack of changes to published standards. *First-Class Business Mailers Comments* at 61-63. Other comments agreed. *E.g., eBay Comments* at 4 (high-quality service means actual service, *citing* 39 U.S.C. §3691).

Also, we supported the *Revised NPRM*’s proposal to expand service quality to include the Service’s business rules. The Postal Service did not address the hat modification therefore should be adopted.
However, the Postal Service seeks to weaken the Revised NPRM’s already inadequate proposal still more. First, it seeks to make it worse by moving the goalpost from the proposed (inadequate) goal of not reducing published service standards. Instead, the Postal Service wants to redefine “high quality” to allow for even slower service than the standards today that it consistently has not met. *USPS Comments* at 42-43. This is a clear signal that the Postal Service intends to let service standards deteriorate still further.

The Postal Service even says that if it reduces service standards with the Commission’s approval, then it should earn a service performance award. *USPS Comments* at 2. The Commission should firmly reject the notion that the Postal Service should be awarded rate authority for reducing its service standards.

Next, the Postal Service argues that the proposed service standards rule would be “exercising unprecedented and undue influence over decisions that Congress expressly delegated to the Postal Service” citing 39 U.S.C. §3691. *USPS Comments* at 30. It says that the rule “infringes on authority Congress gave to USPS” and “would create a permanent deterrent against changes that might make the mail more efficient and effective.” *USPS Comments* at 30-31.

The Postal Service overstates its argument. Section 3691 requires the Service to consult with the Commission when establishing and revising service standards. 39 U.S.C. §3691(a). Nothing about that, however, would prevent the Commission from conditioning the availability of additional rate authority on the Service not reducing service standards or, better, for not in fact achieving the published standards.
If the Postal Service is contemplating reducing service standards, it should file a case with the Commission with full justification. This should include a persuasive explanation of why mailers should receive even worse service but pay more for the privilege. If, however, the Postal Service truly believes that conditioning extra rate authority on service quality infringes unduly on postal management’s prerogatives, then the Commission should withdraw the proposal.

Finally, the Postal Service argues that service performance authority should be awarded on a class by class basis. *USPS Comments* at 62. The Commission should deny this modification. Any award should be measured on the basis of overall service performance because all mailers are important. Doing so on a per-class basis would create an incentive for postal management to focus all of its managerial attention to one class at the expense of others.

In Order No. 4257, the Commission stated that the Postal Service’s service performance, or consistent achievement of service standards, remains an important factor in considering Objective 3 and is implied by the general policy of Title 39 as well as the universal service obligation. Order No. 4257 at 263. Weakening this proposal in the ways suggested by the Postal Service would be contrary to this interpretation.

VI. OTHER POSTAL SERVICE AND UNION ARGUMENTS LACK MERIT

A. Price Cap Regulation Remains Fully Justifiable

The Postal Service asserts that the Commission “still has not adequately justified the maintenance of a price cap.” *USPS Comments* at 65. If anything, the Postal Service’s own demands in this proceeding for baseline resets and still
more rate authority unfettered by conditions or limitations, if not complete
deregulation, demonstrate the need for retaining the price cap system.

The Postal Service continues to hold legal and *de facto* monopoly over
hardcopy correspondence. The legal monopoly alone, conferred by the Private
Express Statutes, would prohibit the transfer of First-Class Mail to the less-
regulated Competitive category under 39 U.S.C. §3641. The same reasoning
would prohibit achieving the same pricing result through *de facto* deregulation
while nominally retaining market-dominant classification.

And despite the Postal Service’s plea that “market pressures and other
business considerations may place considerable limits on the extent to which the
Postal Service could actually use” any additional pricing authority that the
Commission may purport to grant in this proceeding (*USPS Comments* at 4 &
n.5), the Postal Service’s own demand equations provide evidence that it retains
considerable market power over correspondence and transactional mail. For
example, its most recently filed demand forecast models presents a price
elasticity of -0.189996 for Single Piece Letters and -0.319843 for Presort Mail.
See Postal Service, *Econometric Demand Equations for Market Dominant
Products as of January 2020*, at 4 & 30. These inelastic demand elasticities
indicate that the Postal Service in fact possesses market power.

Despite its references to “market pressure,” the Postal Service also
asserts in the very same comments that higher rates are urgently needed,
including in the form of an immediate 6 percent “reset” of baseline rates.
Nowhere does it reconcile this “urgent need” for immediate higher rates with the purported “market pressures” to restrain price increases.

Law, market facts, and history all show that regulation is necessary to prevent the Postal Service from exercising market power over its captive mailers. Price cap regulation remains necessary, and without any of the supplemental and additional authorities proposed in the Revised NPRM.

B. Both Amortized And Normal Retirement Costs Are Endogenous

The Postal Service, its unions, and the Public Representative argue that the normal costs of retirement funding should be treated as exogenous costs. *USPS Comments* at n.7; *APWU Comments* at 4-5; *NALC Comments* at 9; *PR Comments* at 19. They argue that the normal cost portion is exogenous because both OPM’s calculations of the RHB invoices and the statutory mandate itself are beyond the Postal Service’s control.

Doing so would likely double the size of the retirement factor. This request should be rejected.

First, Congress has specifically addressed this issue by making personnel-related costs endogenous when it enacted the RHB prefunding obligation. The PAEA contained no provision of collection of RHB funds outside of the price cap. Indeed, the PAEA recognized that the Postal Service was
already collecting $3.1 billion annually in its base rates and earmarked that money for retiree benefits.\textsuperscript{42}

There was nothing unusual about making personnel-related costs endogenous; they are a normal cost of operations for any business. Employee benefits should be considered endogenous costs under a price cap system both for that reason and, additionally, for the policy reason that the cap serves as a restraint against excessive labor cost increases. And nothing in legislation since the PAEA has altered the statutory treatment of such costs.

The concept of “exogenous” costs is not the same as “controllable costs,” which itself is a concept of the Postal Service’s own devise. Any entity subject to collective bargaining may lose some control over its costs, but the costs imposed due to a collective bargaining agreement are endogenous to the firm.\textsuperscript{43} Nothing about retirement-related benefits for employees should be deemed exogenous; they are a normal cost of operating the enterprise.

Here, both the amortized and the “normal” cost payments are endogenous to the Postal Service. The Postal Service has some control over the size of its labor force, and in that way can influence its costs.

\textsuperscript{42} The Commission recognized previously in this proceeding that “Congress anticipated that the CPI-U price cap would enable the Postal Service to achieve sufficient revenues to cover all of its operating costs and statutorily mandated obligations.” Order No. 4287 at 3.

\textsuperscript{43} The Postal Service advocates for an extremely broad definition of “exogenous” as essentially any cost set by someone else. By that logic, the price of gasoline for its vehicles and the rent it pays for use real estate that it does not own would be exogenous costs. To state the proposition is to see its absurdity.
C. Inbound Letter Post Should Remain Subject To The Cap

For what is at least the fourth time, the Postal Service asks the Commission to remove Inbound Letter Post from the price cap and instead apply a *sui generis* regulatory review. *USPS Comments* at 44. The Commission should again reject this request for the reasons it has done so previously.

Although portions of what used to comprise ILP recently were reclassified as Competitive Products, some ILP remains in the market-dominant category. Of that, the Postal Service recently raised rates pursuant to the terminal dues arrangement by 13.376 percent. These actions are expected to improve the financial performance of this product.

However, now that the Postal Service may be making progress to make these products compensatory, it is asking to remove from the current price cap system those market-dominant ILP rates that are set by the Universal Postal Union’s terminal dues process. The Commission may not do so.

As a legal matter, Section 407(c)(1) provides that international market-dominant rates are subject to Section 3622. Furthermore, Section

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45 *E.g., Order No. 43, Docket No. RM2007-1, at 88.*


47 *United States Postal Service Notice of Market-Dominant Price Change, Docket No. R2020-1, at 17 (Oct. 9, 2019).*

48 Section 407(c)(1) directs the Secretary of State, before concluding any international postal treaty, convention or amendment that establishes a rate or classification for a market-
3622(d)(2)(A) provides that the statutory price cap “shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect” on the date of the enactment of the PAEA, subject to subsequent transfers to the Competitive category pursuant to 39 U.S.C. §3642, and ILP was included in First-Class Mail at that time. Consistent with these statutory requirements, the Commission in Order No. 43 expressly rejected a request by the Postal Service to exclude single piece international mail such as ILP from the price cap. Order No. 43 at 88. And it has regulated the Postal Service’s market-dominant ILP rates pursuant to the price cap since the PAEA was enacted.

Nothing is different now. If anything, the transfer of substantial portions of ILP to the Competitive Product category has removed money-losing mail from ILP and should improve upon the product’s longstanding negative contribution. It should be noted that other First-Class Mailers have been cross-subsidizing ILP for more than a decade, and thus have had to the pay higher rates than might otherwise have been the case had ILP been priced at compensatory levels. There is no reason why, if ILP may become compensatory, that other First-Class Mailers should not benefit from ILP’s positive contribution to the class’s revenue.

D. There Is No Reason To Change The Index From CPI-U

The National Association of Postal Supervisors repeat their previous request to change the price cap index to something other than CPI-U. NAPS Comments at 2-3. Not only is this outside of the scope of the current round of

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dominant product, to ask the Commission whether the rate or classification “is consistent with the standards and criteria established by the Commission under section 3622.” 39 U.S.C. §407(c)(1).
this proceeding, but the Commission lacks jurisdiction to do so. Congress in the PAEA specified the use of the CPI-U and did not give the Commission power to change it. 39 U.S.C. §3622(d)(1)(A). Even if the Commission could, however, it should not do so. It is important that the price cap consist of a metric that the Postal Service lacks any real power to affect, and the CPI-U index meets that criterion.

E. Legacy Mail Classifications Could Be Modernized

The Postal Service asks that the Commission consider modifying the current market-dominant product regulatory system to allow modernization of what it calls “legacy mail classes.” USPS Comments, at 65. Discovery urges the Commission to modernize the regulations applicable to market-dominant product negotiated services agreements. Discovery Comments at 1. The First-Class Business Mailers agree that review of the NSA rules with a view toward updating, simplifying, and streamlining the entire process would be in the mutual interests of mailers and the Postal Service. There may well be room for improvements that would decrease the discouraging effect of the current rules upon prospective NSA candidates.49

However, no such proposal is pending. If the Commission is inclined to consider updating the products and mail classes inherited through the PAEA, due

49 However, the First-Class Business Mailers oppose the Postal Service’s previously-expressed desire to repeal or modify Section 3622(d)(2)(A) in order to apply the price cap over all market-dominant classes instead of on a per-class basis.
process dictates that it should start a separate phase of this proceeding – with ample public notice -- to do so.

VII. THE POSTAL SERVICE’S ATTEMPTS TO WATER DOWN THE PROPOSED NEW REPORTING REQUIREMENTS SHOULD BE REJECTED, BUT THE COMMISSION SHOULD ADOPT MORE EFFECTIVE ENFORCEMENT TOOLS

In general, the First-Class Business Mailers regard the Commission’s emphasis on reporting requirements rather than on more assertive mechanisms to be a mistake. The Postal Service’s inadequate progress in reducing costs to efficient levels is not a problem of transparency, it is a problem of managerial effectiveness and lack of sustained focus. Despite the Postal Service’s claims that it has ample incentive to reduce costs, more must be done. Mailers do not need more reports to know that the Postal Service is not reducing costs sufficiently; instead, what is needed is a firm price cap coupled with a firm financial penalty in the form of reduced rate authority when the Postal Service fails to improve its efficiency or when it cuts service instead of cutting costs.

The Postal Service opposes any Commission review of its capital investments and cost reduction plans as inappropriate in a price cap system. 

*USPS Comments* at 59: But its own suggestions, if adopted, would effectively convert the regulatory system into a cost-of-service system having none of the cost reducing incentives of a price cap system. To the extent the Commission attaches cost-of-service factors, such as the density and retirement factors) onto the nominal structure of a price cap system, it adopts cost-of-service regulation.
That, in turn, requires a commitment by the regulator to the regulatory reviews appropriate in a cost-of-service system.

The Commission should also reject the Postal Service’s opposition to submitting Decision Analysis Reports for capital investments above $5 million. *USPS Comments* at 60. The Postal Service’s repeated failures to achieve anticipated returns on major investments is a long-standing problem,\(^50\) and mailers’ patience has worn thin. The Service simply does not have the type of history of successfully-implemented capital investments that would warrant the level of deference it wants.

**VIII. CONCLUSION**

For the foregoing reasons, the Commission should adopt the proposed worksharing regulations, which it has authority to do under the PAEA without affecting the price cap. We suggest that it do so in a separate order.

However, the Commission lacks legal authority to adopt, and as a matter of regulatory prudence should not adopt, the proposals relating to supplemental or additional rate authority due to density, retirement prefunding, or productivity

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and service. Those proposals are not well tailored to the stated objectives and would set the stage for a death spiral of declining volumes and increasing rates.

Respectfully submitted,

By: /s/ William B. Baker

Robert Galaher
Executive Director and CEO
NATIONAL ASSOCIATION OF
PRESORT MAILERS
PO Box 3552
Annapolis, MD 21403-3552
(877) 620-6276

Todd Haycock
President
MAJOR MAILERS ASSOCIATION
5220 Robert J Mathews Parkway
Eldorado Hills CA 95762
631-708-4258
Todd.Haycock@broadridge.com

Steve Krejcik
President
ASSOCIATION FOR MAIL
ELECTRONIC ENHANCEMENT
1260 E 88th Street
Newaygo, MI 49337
(708) 485-4764
AMEE.President@gmail.com

William B. Baker
POTOMAC LAW GROUP, PLLC
1300 Pennsylvania Avenue, N.W.
Suite 700
Washington, D.C. 20004
(571) 317-1922
wbaker@potomaclaw.com

Arthur B. Sackler
Executive Director
NATIONAL POSTAL POLICY COUNCIL
1629 K Street, N.W.
Suite 300
Washington D.C. 20006
(202) 508-3687