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POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

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

Docket No. RM2017-3

REPLY COMMENTS OF THE PUBLIC REPRESENTATIVE REGARDING REVISED NOTICE OF PROPOSED RULEMAKING

March 4, 2020

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On February 3, 2020, the Public Representative filed comments on the Commission's revised proposal to modify the system for regulating rates and classes of market dominant products.[1] Pursuant to Order No. 5337,[2] the Public Representative files these reply comments in response to the comments of other participants.

I. INTRODUCTION

Throughout this proceeding, the Public Representative has advocated retention of the CPI-U price cap and has supported the Commission's assertion of its statutory authority to modify the cap. The Public Representative has also consistently urged the Commission to base modifications of the price cap on well-established price cap principles as discussed in the declarations of experts.[3]

The price cap principles relied upon by the Public Representative support adjustments to the cap for exogenous factors that are, by definition, outside the Postal Service's control. Two of the exogenous factors requiring adjustment of the price cap are declining demand for postal services and certain specific statutorily mandated payments for employees' retirement benefits.[4] Price cap principles also permit periodic corrections to the price cap that address the chronic revenue shortfalls from non-compensatory products and mail classes.

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[1] Comments of the Public Representative on Revised Notice of Proposed Rulemaking, February 3, 2020 (2020 PR Comments).

[2] Order No. 5337, Revised Notice of Proposed Rulemaking, December 5, 2019 (Order No. 5337 or RNOPR). In its notice, the Commission designated the undersigned to serve as Public Representative. Order No. 5337 at 277.

[3] A complete list of the declarations submitted by the Public Representative in this proceeding is attached as Appendix A to these comments.

[4] In its current proposal, the Commission has identified increases in delivery points as an additional exogenous factor driving increased costs. RNOPR at 71.

The Public Representative's reply comments address (1) claims by other commenters that the Commission's proposals are inconsistent with price cap principles or otherwise unlawful: (2) issues raised by opponents of supplemental rate authority for declines in mail density; (3) issues raised by commenters who challenge the proposed supplemental rate authority for actuarially determined retirement obligations; (4) objections to rate adjustments and rate resets for non-compensatory products; (5) arguments regarding the potential impacts of the proposed price cap adjustments; and (6) arguments that the proposed modifications will not achieve the statutory objectives that the Commission is required to observe. Finally, these comments reassert the need, in light of the comments by other participants, for commencing the next Commission review of the market dominant rate system in three years.

II. THE PRICE CAP ADJUSTMENTS DO NOT CONSTITUTE ABROGATION OF THE CPI-U PRICE CAP

The Public Representative agrees with Joint Commenters[5] and others that the Postal Service's market dominant products and services require continued application of the CPI-U price cap.[6] However, he disagrees with their claims that adjustments of the price cap constitute an unlawful "elimination" or "abrogation" of that cap. *E.g.* Joint Commenters at 92 ("Nor may it [the Commission] amend the system to abrogate the CPI cap.").

The CPI-U cap would not be eliminated and the types of proposed adjustments fall within traditional price cap theory as it was presented to Congress during the legislative sessions leading up to the enactment of the PAEA. In fact, an entire hearing

[5] Comments of the Alliance of Nonprofit Mailers, *et al.*, February 3, 2020, at 85-86 (Joint Commenters).

[6] Throughout this proceeding, the Public Representative has advocated continued implementation of the price cap. E.g., Comments of the Public Representative, March 20, 2017, at 30 (2017 PR Comments).

before the House Committee on Government Operation and Oversight received testimony from six witnesses on the theory of price-cap regulation.[7]

In the declarations accompanying the Public Representative's comments earlier in this proceeding, Dr. John Kwoka and Dr. Robert Wilson discussed traditional types of adjustments to price caps, including CPI-U price caps.[8] One such adjustment, an X-Factor adjustment, can be used to reflect the annual rate of change in a company's productivity relative to economy-wide productivity.[9] A second type of price cap adjustment, a Y-Factor adjustment, can be made for certain regulatory costs that are expected to be passed on to customers dollar-for-dollar. Kwoka/Wilson Decl. at 8. A third type of adjustment, a Z-Factor adjustment, can be made for costs that a firm is responsible for covering but which are outside its control.[10] Both Y-Factors and Z-Factors are exogenous to the firm and, because they are not under its control, are not subject to efforts at efficiencies. *Id.*

The adjustments described by Dr. Kwoka, Dr. Wilson, and Dr. Brennan are the types of adjustments now being proposed by the Commission. The supplemental rate authority proposed by the Commission for declining mail density and statutorily mandated payments for retirement obligations are both Z-Factor adjustments.

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[7] One of the witnesses who appeared at the April 16, 1997 hearing was Dr. John Kwoka, whose sworn Declaration for this proceeding accompanies these comments. *Hearing Before the Subcomm. on the Postal Service of the H. Comm. on Government Oversight and Reform,* 105th Cong. 33-51 (April 16, 1997). (Kwoka Congressional Testimony).

[8] Declaration of John Kwoka, March 1, 2017 (Kwoka Decl.); Declaration of John Kwoka and Robert Wilson, March 1, 2018, at 8 (Kwoka/Wilson Decl.).

[9] Companies whose productivity is exceeds those in the general economy as a whole have negative X factors. Responses by John E. Kwoka, Jr. to Questions Pursuant to Hearings on H.R. 22, Response to Question 2(a), July 1, 1997, as reprinted in *Hearing Before the Subcomm. On the Postal Service of the H. Comm. On Government Oversight and Reform,* 105th Cong. At 156 (April 16, 1997) (Kwoka Congressional Testimony). Adjustments for the X-Factor can be negative, zero, or positive. The CPI-U cap established by the PAEA had no X-Factor adjustment, or, in other words, it had an X-Factor adjustment of zero.

[10] *Id.*; Supplemental Declaration of Timothy J. Brennan for the Public Representative, March 1, 2018 (Brennan Supp. Decl.).

Neither X-Factor adjustments, Y-Factor adjustments, nor Z-Factor adjustments are precluded by 39 U.S.C. § 3622(d)(3). Nor is the adjustment proposed by the Public Representative for non-compensatory products and mail classes. In fact, the only adjustments to the CPI-U price cap that are expressly excluded are adjustments for seasonal variations. *See* 39 U.S.C. § 3622(d)(1) ("The system for regulating rates and classes for market-dominant products shall—(A) include an annual limitation on the percentage changes in rates…unadjusted for seasonal variation over the most recent available 12-month period….").

The need for adjustments to price caps arises from the fact that price cap formulae are based upon predictions of costs and, over time, divergences between prices and costs are inevitable. *Id.* at 9. For this reason, price cap systems are subject to periodic review and adjustment. *Id.* Other reasons for review and adjustment include defects in the original plan, changed circumstances, and unforeseen issues. *Id.* at 4-5.

Established price cap principles generally call for a review of the price cap system every 4 to 5 years. Kwoka Decl. at 9. Such reviews are conducted to ensure that the price cap plan is adjusting "the level of price[s] to reflect the changes over time in the economic factors that cause underlying costs to change." *Id.* Without periodic reviews and adjustments to the plan, it can produce "windfalls or shortfalls that compromise plan objectives…" *Id.* The general rule of periodic plan reviews on a 4 to 5 year cycle is subject to exceptions when required by specific circumstances.

III. THE PROPOSED SUPPLEMENTAL RATE AUTORITY MECHANISMS ARE INTENDED TO PERMIT THE RECOVERY OF COSTS IMPOSED ON THE POSTAL SERVICE BY EXOGENOUS FACTORS AND ARE NOT BARRED BY THE PROHIBITION ON RETROACTIVE RATEMAKING

Both the proposed adjustment for declines in mail density and the proposed adjustment for retirement obligations are intended to permit the recovery of uncontrollable costs. Joint Commenters seeks to characterize the recovery mechanisms as mechanisms for the recovery of "cost-control shortfalls through excessive pricing." Joint Commenters at 17. This is, of course, incorrect. The costs that are to be recovered are not costs that can be controlled through cost-control measures. The density declines, for which recovery may be sought, are declines due to exogenous factors, such as migration to digital forms of communication or changing societal preferences. The costs associated with those declines are uncontrollable. The retirement obligations for which recovery could be sought are also uncontrollable.

Nor does the prohibition on retroactive ratemaking recognized by the courts in the cases cited by Joint Commenters prohibit the Commission from adopting a properly designed supplemental rate authority mechanism. Indeed, one of the cases cited by Joint Commenters expressly recognizes the distinction between impermissible retroactive ratemaking and permissible rate adjustment mechanisms that use formulae of which customers are aware and which specify cost components with variables that change over time, In *Old Dominion Electric Cooperative v. FERC,* 892 F.3d 1223, 1231 (D.C. Cir. 2018), the Court explained that:

> …no violation of the filed rate doctrine occurs when 'buyers are on adequate [advance] notice that resolution of some specific issue may cause a later adjustment to the rate being collected at the time of service." [citation omitted] When the very terms of the filed rate warn customers, at the time they contract for service, that the price charged will fluctuate based on an identified formula with specified cost drivers, then the rate is allowed to change when fluctuations in those cost drivers occur. That after all, is how formulae work. And that comports with the filed rate doctrine because the rate changes are foreordained, not retroactive.

The existing price cap, with its provisions for price cap adjustments based on past period changes in the CPI-U, is itself an example of a lawful rate adjustment mechanism.

IV. THE COMMISSION MUST CAREFULLY CONSIDER OBJECTIONS TO THE COMMISSION'S PROPOSED SUPPLEMENTAL RATE AUTHORITIES AND MAKE ADJUSTMENTS AS NECESSARY TO ENSURE IMPLEMENTATION CONSISTENT WITH STATUTORY REQUIREMENTS

While adjustments to the price cap can be made for exogenous factors, those adjustments must be made in conformity with the objectives. 39 U.S.C. § 3622(d)(3) ("the Commission may, by regulation, make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.").

In their comments, several participants argue that the Commission supplemental rate authorities fail to satisfy important objectives established by 39 U.S.C. § 3622(b). The principal objectives which they allege the Commission has failed to satisfy are Objective 1 (maximize incentives to reduce costs and increase efficiency), Objective 2 (create predictability and stability in rates), Objective 8 (establish and maintain a just and reasonable schedule for rates and classifications), and Objective 5 (assure adequate revenues, including retained earnings, to maintain financial stability).

As discussed below, some of the claims that have been presented are consistent with deficiencies the Public Representative has identified. The Public Representative submits that price cap adjustments are necessary and that adjustments, which satisfy the statutory objectives, can be fashioned.

A. Supplemental Rate Authority for Declines in Density

Joint Commenters opposes the proposed Supplemental Rate Authority for declines in density. Joint Commenters at 39-49. It argues that the proposal is theoretically flawed (*id.* at 40-41); that the proposal would compensate the Postal Service for volumes within its control (*id.* at 41-43); that the Commission fails to account for the large cumulative impact of the proposed price increases (*id.* at 43-44); and that the density rate authority (DRA) is not rationally related to the impacts of declining density (*id.* at 44-49). Some of the points raised by Joint Commenters warrant modifications to the Commission's proposal, but they do not justify rejection of an exogenous factor adjustment.

1. Claims That The Density Rate Adjustment Is Theoretically Flawed Can and Should Be Addressed

Joint Commenters's argument that the Commission's proposal is theoretically flawed is grounded on claims that the proposal "violate[s] basic tenets of price cap and industrial organization theory." *Id.* at 40. Joint Commenters bases its claims on the assertions of Dr. Robert D. Willig, whose declaration was among the supporting documents filed with its comments.[11] Dr. Willig acknowledges that it is reasonable "[i]n certain circumstance for a system of regulation to account for exogenous volume decliners." *Id.* at ¶ 20. However, he asserts that the Commission's proposal is not reasonable because it is "based on actual, measured volume loss every year…and would confer dysfunctional incentives on the regulated entity." *Id.* He suggests that the proposed adjustment mechanism is a "true-up" mechanism that rewards the Postal Service for density declines without providing an incentive to limit such declines. *Id.* at ¶¶ 21, 24. The mechanism should, instead, be "based on the predicted future decline in mail density." *Id.* at ¶ 21.

Unlike Dr. Willig, the Public Representative does not believe that reliance upon annual volume losses in the Commission's formula should be replaced with predicted future declines in volume losses. Reliance upon predicted declines in mail density caused by exogenous factors will undoubtedly be controversial. For the price cap system to reduce administrative burdens as provided in Objective 6, it should not generate annual controversies that require Commission resolution. The use of actual

[11] Expert Declaration of Robert D. Willig, PhD., February 3, 2020 (Willig Decl.).

measured changes in mail density provides an objective anchor for the adjustment which can be used without the need for Commission intervention.

The Public Representative does, however, agree that a forward-looking element is needed in the Commission's formula that will address concerns that the mechanism will, in reality, prove to be an annual true-up that is inconsistent with statutory objectives, particularly Objective 2 (predictability and stability) and Objective 8 (establishment and maintenance of just and reasonable rate schedules). It will also prevent excessive rate increases that undermine incentives to reduce costs and increase efficiency as set forth in Objective 1. Finally, it will make additional revenues available to the Postal Service that are needed for financial stability.

A forward-looking element should be objective and readily available without the need for Commission intervention. One such element that the Commission should consider is Dr. Brennan's proposed method for adjusting volume declines for price elasticity of demand. Brennan Supp. Decl. at 4-5. The Public Representative believes Dr. Brennan's proposal is worth considering notwithstanding the Commission's rejection of the proposal on the grounds that it "adds a level of complexity to implementation without adding any precision." RNOPR at 75. Dr. Brennan's proposed methodology can be adopted for the Commission's density rate adjustment.[12]

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[12] It is worth noting that during September, 2019, the Government of Sweden changed the Postal Ordinance regarding price cap rules to permit price cap adjustments for declining demand. The revised ordinance is based on the Brennan-Crew model. The revised ordinance can be found at the following link. https://www.riksdagen.se/sv/dokument-lagar/dokument/svensk-forfattningssamling/postforordning-20101049_sfs-2010-1049 Section 9, para. 2 permits the adjustment. Section 9a authorizes the Post and Telecom Agency to re-determine the adjustment factor at least every three years. Currently, the only available documentation of this development is in Swedish. However, the documentation includes references to publications by Brennan & Crew. *See* https://www.pts.se/globalassets/startpage/dokument/legala-dokument/beslut/2019/post/pts-beslut-om-faktor-enligt-prishojningstak-19_8911.pdf at 2, n. 2; 4, n. 4. and an examination of the formulas clearly shows that the adjustment factor for declining mail volume is identical to the one proposed by Dr. Brennan. *Compare Id.* at 2, 4-7 w*ith* Brennan Supp. Decl. at 5.

2. Modifications to the Commission's Density Rate Authority Formula Can Limit Adjustments to Uncontrollable Volume Losses

Joint Commenters attacks the Commission's proposed declining density adjustment formula for failing to "differentiate between density declines resulting from exogenous volume decreases…and those that result from rate increases or other factors within Postal Service control. Joint Commenters at 42.

In support of its argument, Joint Commenters cites the statement of Dr. Brennan, whose declaration was presented by the Public Representative. *Id.* at 41-42, in his declaration, Dr. Brennan took the position that price cap adjustments for volume declines should be based upon events outside the Postal Service's control and not upon declines produced by reduced service quality. Joint Commenters at 41-42. To this, Joint Commenters adds a list of other factors within the Postal Service's control that could produce volume declines. *Id.* at 42-43.

By definition, an exogenous factor adjustment should not be subject to Postal Service control. By accounting for price elasticity impacts it should be possible to differentiate between controllable and non-controllable volume losses. If controllable volume losses resulting from additional price increases were excluded from the base for density rate authority, this would make the estimates of non-controllable losses much more precise.[13] If proven to be reliable, other potential adjustments to actual volume declines that will prevent overstatement of non-controllable volume declines should also be considered.

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[13] As discussed in the following section, adjustments for elasticity are also needed to prevent the cumulative impact of volume declines from being inflated and contributing to further and avoidable volume declines.

3. Cumulative Impacts Need to Be Considered and Mitigated

Joint Commenters also opposes the proposed density adjustment mechanism on the grounds that it "can be expected to accelerate future volume declines…[which]…will accelerate decreases in density."[14] This, Joint Commenters asserts, will create a "positive feedback loop" that will have a large cumulative impact of proposed price increases.[15]

The Public Representative agrees with commenters that by ignoring price elasticity impacts on mail volumes, the proposed density adjustment will significantly overstate the magnitude of the future volume losses caused by uncontrollable factors. When proposing the DRA, the Commission states that "the Postal Service does not have any direct control over density [because the Postal Service] "does not directly control the volume of mail entered into its network nor the number of delivery points it must service." RNOPR at 64. Even when price increases are limited by CPI-U, this statement is only partially true.

When the Postal Service increases prices for its mail products, it should always expect some volume losses. That is because the demand for mail products is not perfectly inelastic and any price increases lead to some additional volume losses.[16] These volume losses should not be treated as directly uncontrollable because the Postal Service's own price elasticities make it is possible to estimate the amount of volume losses caused by the price increases.

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[14] Joint Commenters at 43 (quoting Expert Declaration of Kevin Neels and Nicholas Powers, February 3, 2020, at ¶ 31 (Brattle Declaration or Brattle Decl.)).

[15] *Id.* at 43 (quoting Brattle Decl. at ¶ 32); Comments of the National Postal Policy Council, *et al.*, February 3, 2020, at 36-37 (FCBM Comments).

[16] The Commission previously provided the comprehensive review of price elasticities for Market Dominant mail products. *See* Order on the Findings and Determination of the 39 U.S.C. § 3622 Review, December 1, 2017 at 128-129 (Order No. 4257).

The consideration of price elasticity impacts in the DRA formula is especially important because of the recurring implementation of the proposed additional rate authorities. Each subsequent year there will be a growing share of volume losses subject to the declining density adjustment. By ignoring the price elasticity impacts, all additional volume losses would be treated as "not directly controllable." As noted above, this approach is incorrect because price increases themselves cause additional volume losses, which in each subsequent year will trigger additional density rate authority that can lead to additional price increases. Finally, as commenters correctly point out, these price increases will "be baked into the rate base" and stay forever because the Commission's proposal does not consider eliminating the additional price authorities. FCBM Comments at 12.

In his response to the NOPR, the Public Representative thoroughly discussed the effects of price elasticities on mail volumes and revenues.[17] PR Initial Comments at 20-27. He also brought the Commission's attention to the fact that "higher annual price increases will lead to higher volume losses due to the elasticity effect." *Id.* at 50. Using the Postal Service's own price elasticities, the Public Representative estimated that supplemental rate authority proposed in the NOPR "would bring approximately 10 percent less in additional revenues than the Commission anticipate[d] by its proposal."[18]

Considering that the RNOPR proposes new rate authorities, such as retirement rate authority and density rate authority, which were not proposed in the NOPR, the potential price increases are higher and elasticity impacts on volumes and revenues are more substantial. If all additional rate authorities proposed in the RNOPR are

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[17] Initial Comments of the Public Representative, March 1, 2018 (refiled March 7, 2018), at 20-27 (2018 PR Comments).

[18] *Id.* at 25. *See also* Library Reference PR-LR-RM2017-3-1, file Supporting Calculations.xlsx, Worksheet "Elast Effect."

implemented, the portion of controllable volume declines could be quite significant and could grow notably from year-to-year.

Using the examples provided by the Commission, Dr. Neels and Dr. Powel estimate that the average magnitude of additional rate increases is 3.17% a year for compensatory classes and 5.17% a year for non-compensatory classes. Brattle Decl. at 35. Based on their analysis, they also state that the proposed adjustments to price cap would bring between 4.7% and 8.5% of additional cumulative volume losses at the class level over the next five years. *Id.* at 39. Based upon his own analysis, the Public Representative reaches similar conclusions for three Market Dominant classes of mail. *See* Table 1. For First-Class Mail, USPS Marketing Mail and Periodicals, 5-year cumulative volume losses constitute 4.7 percent, 8.5 percent and 5.5 percent, respectively. *Id.* For Package Services, the anticipated volume losses from the above-cap price increases are substantially higher, 12.5 percent, due to the higher elasticity of the products included in this mail class. *Id.* The elasticity impacts of such substantial price increases cannot be ignored because they are directly associated with additional, and controllable, volume losses.

Table 1: Impacts of the Proposed Rate Authorities on Volume Losses*

Market Dominant	FY 2019 Volume	FY 2019 Average	5-year Cumulative		
Mail Classes	(million pieces)	Price Elastciity	Price Increase	Volume Losses	
		of Demand	(%)	Million Pieces	%
	1	2	3	4	
First-Class Mail	**55,630**	**-0.277**	**16.89%**	**-2,599**	**-4.7%**
USPS Marketing Mail	**75,690**	**-0.502**	**16.89%**	**-6,417**	**-8.5%**
Periodicals	**4,635**	**-0.193**	**28.66%**	**-257**	**-5.5%**
Package Services	**622**	**-0.741**	**16.89%**	**-78**	**-12.5%**

*Average price elasticity for each Market Dominant Mail class is calculated as a weighted average (by volume) of own price elasticities of all products included in this mail class.

Sources: [1]: FY 2019 Annual Compliance Report (FY 2019 ACR), Library Reference USPS-FY19-1, worksheet “Volume1;” [2] Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2019, January 21, 2020, folder “Volume Forecasts,” file vf-Jan2019(md).xlsx, worksheets "Forecast Vols" and "Elasts;" [3] Brattle Decl. at 10, Table 1, column “Average;” [4] all that are used for [1} through [3].

The proposed price increases might also result in volume losses that cannot be directly estimated using currently available data on price elasticities of demand. This is because price elasticities of demand are not constant and might change from year-to-year.

The Postal Service recognizes the importance of mail volume forecasts and prepares class-level forecasts as part of its annual financial plan.[19] As illustrated in Table 2 below, even without the additional price increases that would be authorized by the Commission’s proposal in the RNOPR, volume is expected to fall by the end of the FY 2020 for all Market Dominant mail classes. The magnitude of mail volume declines is between 1.52 percent for First-Class Mail and 4.50 for Periodicals. *See* Table 2.

Table 2: Current and Projected Mail Volumes for Market Dominant Mail Classes

Mail Classes	FY 2019	FY 2020	(%)
	1	2	
First-Class Mail	**55,630**	**54,786**	**-1.52%**
USPS Marketing Mail	**75,690**	**72,433**	**-4.30%**
Periodicals	**4,635**	**4,426**	**-4.50%**
Package Services	**622**	**601**	**-3.29%**

Sources: [1]: FY 2019 ACR, Library Reference USPS-FY19-1; [2]: Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2019, January 21, 2020, folder “Volume Forecasts,” file vf-Jan2019(md).xlsx, worksheet "Forecast Vols."

[19] *See, e.g.,* United States Postal Service, Fiscal Year 2020 Integrated Financial Plan at 3, available at https://www.prc.gov/docs/112/112380/FY2020%20IFP%20FINAL.pdf.

This analysis confirms that when proposing additional rate authorities the Commission should apply a forward looking approach and assess potential impacts of the proposed price adjustments on mail volumes. This forward looking approach is especially important considering that the proposed price increases could be quite substantial.

It is also reasonable to suggest that certain mail products will become more elastic as a result of substantial year-over-year price increases. Brattle Decl. at 13. The Commission previously stated, and the Public Representative and other commenters noted in the current proceeding, that elasticities might change when volume levels are "substantially outside the range of actual experiences."[20]

To assist the Commission with an assessment of potential impacts of the proposed price increases, the Public Representative has performed additional analysis of potential elasticity effects. As the Public Representative discussed previously, many First-Class Mail products tend to become more elastic. 2018 PR Comments at 27. As shown in Table 3, Single-Piece letters consistently become more elastic year-over-year. Considering the very high per-piece contribution level of these mail products/categories, any decline in their volumes is always associated with some loss of contribution. However, if the Postal Service implements price increases for declining density on First-Class Single-Piece letters, it will very likely prompt more-and-more customers to reduce their mailings and thereby further aggravate "the [already] ongoing migration of communications and transactions out of First-Class Mail into electronic media."[21]

[20] Docket No. RM2016-2, Order Concerning United States Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three), Updated October 19, 2016 at 8. *See also* 2018 PR Comments at 26, n. 25; Brattle Decl. at 13.

[21] United States Postal Service, Fiscal Year 2020 Integrated Financial Plan at 3, available at https://www.prc.gov/docs/112/112380/FY2020%20IFP%20FINAL.pdf.

Table 3: Own Price Elasticities for Single-Piece Letters (FY 2016 – FY 2019)*

	Market Dominant Demand Analysis				Cost and Revenue Analysis
Market Dominant Mail	**Price Elasticity of Demand:**				**Per Piece Contribution**
First-Class Mail:	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2019**
	1	2	3	4	5
Single-Piece Letters.......................................	**-0.100**	**-0.130**	**-0.143**	**-0.190**	**$0.189**
Average for Single-Piece Letters and Cards.....	**-0.116**	**-0.145**	**-0.151**	**-0.193**	**$0.182**

*Increased price elasticities are denoted in "red." Average price elasticity for Single-Piece Letters and Cards category is calculated as a weighted average (by volume) of own price elasticities of both products included in this mail category.

Sources: [1]: Market Dominant Demand Analyses, FY 2016, January 23, 2017, folder "Volume Forecasts," file vf-Jan2017(md).xlsx, worksheets "Forecast Vols" and "Elasts;" [2}: Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2017, January 19, 2018, folder "Volume Forecasts," file vf-Jan2018(md).xlsx, worksheets "Forecast Vols" and "Elasts;" [3]: Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2018, January 28, 2019, folder "Volume Forecasts," file vf-Jan2019(md).xlsx, worksheet "Forecast Vols" and "Elasts;" [4]: Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2019, January 21, 2020, folder "Volume Forecasts," file vf-Jan2019(md).xlsx, worksheets "Forecast Vols" and "Elasts;" [5]: FY 2019 ACR, Library Reference USPS-FY19-1, Revised on January 10, 2020, file Public_FY19CRAReportRev.1.10.2020, worksheet "Cost1".

In addition, it is important to point out that, for all Market Dominant mail products that make up at least 5 percent of Market Dominant mail volume (with the exception of First-Class Single-Piece letters discussed above), their own price elasticities of demand are in the range between - 0.3 and -0.7 percent. *See* Table 4. The average price elasticity for all Market Dominant Mail is approximately - 0.4 percent. *Id*. If, for example, annual price increases for High Density and Saturation Letters were 1 percent, the product would experience a volume loss of approximately 0.5 percent due to this price increase alone. This is based upon data from Table 4 and the definition of the price elasticity of demand. Considering that all these products provide positive contribution to institutional costs, any such volume losses would result in some revenue losses that the RNOPR seems to ignore.

Table 4: FY 2019 Price Elasticities of Demand for Selected Market Dominant Mail Products and Price Categories*

Data Source:	Market Dominant Demand Analysis	Cost and Revenue Analysis	
Variable:	Price Elasticity of Demand	Per Piece Contribution	Volume Share
Market Dominant Mail	**FY 2019**	**FY 2019**	**FY 2019**
	1	2	3
First-Class Mail:			
Presort Letters........	**-0.320**	**$0.256**	**25.7%**
Average for Presort Letters and Cards..............	**-0.301**	**$0.251**	**27.1%**
Average for First-Class........	**-0.277**	**$0.220**	**40.6%**
USPS Marketing Mail:			
High Density and Saturation Letters..................	**-0.505**	**$0.084**	**5.3%**
High Density and Saturation Flats and Parcels	**-0.646**	**$0.049**	**8.5%**
Letters........	**-0.407**	**$0.100**	**33.6%**
Average for USPS Marketing Mail........................	**-0.502**	**$0.061**	**55.3%**
Average for Market Dominant Mail......................	**-0.401**	**$0.119**	**100.0%**

* Price elasticities higher than 0.3 in absolute value are denoted in “red.” Average price elasticity for each Market Dominant Mail category is calculated as a weighted average (by volume) of own price elasticities for all mail products included in this mail category. Free Mail and Market Dominant NSAa are excluded from calculations.

Sources: [1]: Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2019, January 21, 2020, folder “Volume Forecasts,” file vf-Jan2019(md).xlsx, worksheets "Forecast Vols" and "Elasts;" [2] and [3] FY 2019 ACR, Library Reference USPS-FY19-1, Revised on January 10, 2020, file Public_FY19CRAReportRev.1.10.2020, worksheets “Cost1” and “Volume1.”

To address the problems that could be created by the overstatement of non-controllable volume losses, the Commission should provide an adjustment for price elasticity of demand in its density rate adjustment formula. Once again, the Public Representative recommends the density adjustment mechanism be refined by using the methodology proposed by Dr. Brennan for incorporating price elasticity of demand into the price cap adjustment formula. This modification to the density adjustment mechanism will foster Objective 1 (maintenance of incentives for cost reduction), Objective 3 (creation of rate predictability and stability), Objective 8 (establishment and maintenance of just and reasonable schedules of rates and classifications), and Objective 5 (assurance of adequate revenues to maintain financial stability).

While the Public Representative believes that the Commission will, by accounting for price elasticity effects, significantly approve its DRA formula, there might be different practical approaches to estimating the price elasticity to be included in the formula. For example, Dr. Brennan estimated weighted (by volume) class-level elasticities. Brennan Supp. Decl. at 7, n. 17 and 8. A similar approach to calculating elasticities for mail product categories was pursued by the Commission in the current proceeding.[22] The Public Representative suggests that to account for price elasticity impacts in the DRA, the Commission could apply the average price elasticity of demand for all Market Dominant mail (or for all mail) as a weighted average (by volume) of each product's own price elasticity.[23] Although this method would provide some approximation of the price elasticity of demand, the other parts of the DRA formula also approximate the impact of density declines on increases in per unit costs, as stated by the Commission. RNOPR at 71-72.

If the Commission decides against incorporating the price elasticity of demand into the density rate authority formula, there is a potential alternate solution. To mitigate the issue of the rapidly increasing portion of controllable volume losses in the DRA formula, the price cap could be adjusted for density declines on a one-time basis with further adjustments, if any, made by the Commission in its new market dominant system review. This would prevent rapid cumulative increases in controllable volume losses and reduce the risk of the so-called death spiral predicted by commenters who opposed the declining density adjustment. During its next review of the rulemaking system, the

[22] Order No. 4257 at 129. *For details see* Library Reference, PRC-LR-RM2017-3/1, file prc-lr-rm2017-3-1.xlsx, worksheet "Table II-5."

[23] Own price elasticities for competitive mail products are also reported by the Postal Service and available on the Commission's website as non-public reports. *See e.g.,* https://www.prc.gov/docs/111/111936/Letter_FY%202019.pdf.

Commission would be able to analyze the magnitude of new density declines and determine whether another price cap adjustment is reasonable or necessary.

4. The Alleged Lack of a Rational Connection Between Declining Density and the Density Adjustment Authority

Joint Commenters asserts that the Commission's density 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." Joint Commenters at 44. It bases this claim, in part, on a methodology previously employed by the Commission to quantify the impact of volume changes on postal finances. *Id.* at 45 (*See* Figure C – Contribution Loss (FY 2011 – FY 2018). It concludes that the impact of volume changes was minimal. *Id.*

It appears from an examination of the information displayed in Figure C that Joint Commenters's conclusion that the impact on postal finances would be minimal is based upon the negative contributions of Market Dominant mail being almost completely offset by the positive contributions of Competitive mail. *Id.* (*See* Figure C – Contribution Loss (FY 2011 – FY 2018, column 6). The Public Representative opposes using Competitive mail class revenues to offset the Market Dominant mail class losses. As a matter of arithmetic, the Competitive mail revenues may offset Market Dominant mail losses, but allowing the offset is nothing more than a means of hiding the Market Dominant losses to deny the Postal Service any relief from density declines that are beyond its control. *See also* 2018 Public Representative Comments at 20-23 (discussing regarding the allocation of uncontrollable retirement obligations to competitive products.

B. Supplemental Rate Authority for Statutory Retirement Obligations

The Commission's proposed mechanism would provide the Postal Service with additional authority to generate revenues to amortize unfunded liabilities for three statutorily mandated retirement obligations: the unfunded liabilities for Retiree Health

Benefits (RHB), the Civil Service Retirement System (CSRS), and the Federal Employee Retirement System (FERS). RNOPR a 91. The amount of the additional authority would be determined annually and would be phased-in over 5 years. *Id.* In order to be eligible for the full rate authority, the Postal Service would be required to make minimum amortization payments toward its unfunded retirement liabilities based upon the amount of revenue raised from the additional rate authority during the previous fiscal year. *Id.*

In his comments responding to the Commission's NOPR, the Public Representative advocated adjustments to the price cap that would enable the Postal Service to recover uncontrollable costs for unfunded RHB, CSRS, and FERS liabilities. PR Initial Comments at 43-55. These costs are statutorily mandated, actuarially determined, and billed and collected by the Office of Personnel Management (OPM). As such, these are exogenous costs and the authority to collect them by means of an adjustment to the price cap is fully supported by established price cap theory[24] and the record in this proceeding.[25]

In their February 3, 2020 comments, opponents of the proposal present a series of objections. They argue that the Commission should wait for Congress to deal with the Postal Service's retirement obligations (FCBM Comments at 43-44); that the Commission's proposal is theoretically deficient (Joint Commenters at 51-53); that the proposal should be adjusted to take into account $3.1 billion of rate authority that is allegedly included under the existing CPI-U cap (FCBM Comments at 44-46); that the proposal would constitute unlawful retroactive ratemaking (Joint Commenters at 51-53); that the proposal will impose unlawful rate increases on mailers (Joint Commenters at 18-22; FCBM Comments at 20-24); that the proposal will have no effect on the Postal

[24] Kwoka/Wilson Decl. at 7-10.

[25] RNOPR at 88-91.

Service's financial stability (FCBM Comments at 46-48); and that the additional rate authority is unnecessary (Joint Commenters at 59-60).

1. Deferral to Congress

The argument by FCBM that the Commission should defer to Congress regarding the Postal Service's retirement obligations has been adequately addressed by the Commission in the RNOPR. As the Commission correctly concluded, it has a duty to address the impacts of the Postal Service's retirement obligations pending any action by Congress. *See* RNOPR at 94. Until action is taken by Congress, the Commission has an obligation to review the current market dominant rate system and take whatever actions it has the authority to take to achieve the objectives of 39 U.S.C. § 3622(b). If and when Congress acts, the Commission will be required to take whatever additional steps are necessary to carry out Congress's directives.

2. Alleged Theoretical Deficiencies in the Proposal

Joint Commenters sets forth several grounds to support its claim that the proposed supplemental rate authority for retirement obligations is contrary to the principles of price cap regulation. It alleges that "greater rate authority reduce[s] incentives to operate efficiently and … [does] not do a good job of replicating competitive forces that protect customers from excessive pricing." Joint Commenters at 51. While that may be true as a general proposition, price cap principles allow adjustments that permit increased prices that cover costs that are outside the control of the regulated entity. Kwoka/Wilson Decl. at 8.

Joint Commenters argue further that "this evaluation [the 10 Year Rate System Review] is not designed to true-up for past cost changes—those risks were already shared when the cap was initially established." Joint Commenters at 52. Joint Commenters refer to the statement by its expert Dr. Willig that "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." *Id.* at 53 (quoting Willig Decl. at ¶ 24, n.16).

The costs to be recognized by the Commission's proposed supplemental rate authority for retirement obligations are not costs in existence at the time the cap was originally imposed in 2006. The costs at issue were not actuarially determined and imposed until 2017, shortly after the proceedings in this docket began. At the time the price cap was imposed, these costs could not have been included because no one knew what they would be. The proposed rate authority to permit prospective collection of the actuarially determined and statutorily mandated retirement costs that came into being in 2017 is consistent with price cap principles. Kwoka/Wilson Decl. at 8.

3. Adjustment to Account for Alleged $3.1 Billion Already in Rates

In an argument similar to Joint Commenters's price cap theory argument above, FCBM asserts that the amount of any additional supplemental rate authority for retirement obligations should be adjusted downward to account for $3.1 billion of rate authority it alleges is already included under the price cap. FCBM Comments at 44-46. This amount was originally agreed to by the parties to a settlement approved by the Commission in 2005. *See Opinion and Recommended Decision,* Docket No. R2005-1 at ¶¶ 3001, *et seq.* (November 1, 2005) (R2005-1 Opinion). The purpose of this rate authority was to fund an escrow related to the Civil Service Retirement System (CSRS). FCBM alleges that this $3.1 billion has grown in the years since with CPI-U adjustments and that it would cover most of the amortization payments due. FCBM Comments at 45. FCBM urges the Commission to require the Postal Service to account for this money and, if it finds that the money was spent on other purposes, no additional rate authority would be appropriate.

The Public Representative agrees that the Commission needs to determine whether the proposed supplemental rate authority for retirement obligations is already provided for under the CPI-U price cap. In his initial comments in this proceeding, the Public Representative discussed the $3.1 billion rate adjustment approved in Docket No. R2005-1 and noted that the Commission might, or might not, conclude that the Postal Service's rates already include a portion of retirement obligation amortization costs. 2017 PR Comments at 38-39.

The issue of whether the $3.1 billion rate adjustment approved in Docket No. R2005-1 covers current retirement obligation amortization payments requires consideration of a number of factors, including the unique history of the proceedings in that docket.

The Postal Service's request for the $3.1 billion rate adjustment in Docket No. R2005-1 was occasioned by the Postal Civil Service Retirement System Funding Act of 2003, Pub.L. 108-18, 117 Stat. 624, April 23, 2003. Pub.L. 108-18 required the Postal Service to place $3.1 billion in escrow beginning in FY 2006. In order to have the funds necessary to make the annual escrow payments, the Postal Service requested a $3.1 billion rate increase. R2005-1 Opinion at 12. The request was unique. This was the first time the Postal Service sought a rate increase "for the sole purpose of meeting a single financial commitment…." *Id.* at 12-13.

The Postal Service's request in Docket No. R2005-1 was also unique because it did not seek rate authority to cover an indicated $2.88 billion test year before-rates revenue deficiency. *Id.* at 23. This latter fact is of potential importance because it was relied upon by the Commission in concluding that the Postal Service would not experience a significant windfall if the escrow requirement were later removed. *Id.* at 36 ("Further, in light of the estimated $2.88 billion revenue deficiency for the test year, relief from the escrow requirement would likely yield no significant windfall to the Postal Service."). In other words, the Commission appears to have left open the possibility that the $3.1 billion might later be used to meet a traditional revenue deficiency and applied to other costs. This could explain why the Commission never required the Postal Service to account separately for the $3.1 billion.

Based on the foregoing facts, the Commission could conclude that the $3.1 billion rate adjustment that it approved was initially intended to meet the escrow requirement in Pub.L. 108-18 but that, thereafter, the use of the funds was unrestricted and not dedicated to satisfaction of retirement obligation payments.

But even if the Commission were to conclude that the $3.1 billion is dedicated to the payment of retirement obligations, that would not be the end of its inquiry. The $3.1 billion rate adjustment approved in Docket No. R2005-1 was more than $2 billion below the annual retiree health benefit lump sum payment obligations established by the PAEA as demonstrated by comparison with the lump sum payment obligations set forth in the following table:

Table 5: PAEA Schedule of Payments into the Retiree Health Benefits Fund

FY	PAEA Payment Schedules ($ billion)
2007	5.4
2008	5.6
2009	5.4
2010	5.5
2011	5.5
2012	5.6
2013	5.6
2014	5.7
2015	5.7
2016	5.8

Source: PAEA, section 803.

According to FCBM, the $3.1 billion rate adjustment approved in Docket No. R2005-1 (as adjusted by the CPI-U) produced “a cumulative amount in excess of $39 billion over the ten-year period from 2007 through 2016.[26] The difference between the $55.8 billion statutorily scheduled payment obligation and the $39 billion Docket No. R2005-1 rate authorization is $16.8 billion. In addition, the Postal Service has, to date, been obligated to pay approximately $10.7 billion toward current statutorily mandated costs of retirement benefits.[27] The total outstanding amount is over $27 billion. Even if the rate adjustment approved more than 14 years ago in Docket No. R2005-1 were assumed to cover these new obligations, it would take over 7 years to recover existing obligations. In the meantime, with each passing year, the Postal Service will continue to incur additional statutorily mandated annual payment obligations of approximately $3 billion for RHB, CSRS, and FERS.

4. Alleged Unlawful Retroactive Ratemaking

Joint Commenters allege that the Commission's retirement-based supplemental rate authority is "a transparent attempt to retroactively correct the price cap to recover costs that the Postal Service failed to recoup since 2006. Joint Commenters at 51-53.. The Public Representative has addressed the retroactive ratemaking argument in Section III., *supra.*

5. Detrimental Impacts on Mailers

Commenters criticize the proposed supplemental rate authority for failing to consider the detrimental impacts it will have on mailers. E.g., Joint Commenters at 18-22; FCBM Comments at 20-24. The Public Representative agrees that the Commission

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[26] FCBM Comments at 45. For purposes of the current discussion, the Public Representative accepts FCBM's estimate.

[27] *See* Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 of Fiscal Year Ended September30, 2017, at 17 ($$4.140 billion); Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 of Fiscal Year Ended September30, 2018, at 20 ($3.351 billion); and Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 of Fiscal Year Ended September30, 2019, at 18 ($3.240 billion).

has an obligation to consider those impacts. In this case, the Commission has implicitly done so by phasing in this new rate authority. A more explicit explanation of how the Commission considered the impact of this one rate authority should be provided using, for example, demand elasticities and by reviewing and discussing information provided by mailers in their comments.

6. Alleged Failure to Have an Impact on the Postal Service's Financial Stability

Several commenters argue that the proposed retirement-based supplemental rate authority will not put the Postal Service in any better financial shape. Joint Commenters at 51; FCBM Comments at 46-48. FCBM refers to the fact that the Commission would require the Postal Service to pay the revenues it collects under the supplemental rate authority to the Treasury and will not be able to use the revenue for operations. FCBM Comments at 46.

The Public Representative agrees and has for that, and other reasons, opposed the Commission's imposition of a requirement that revenue collected by the Postal Service be paid to Treasury. 2020 PR Comments at 32-35. In fact, the payment requirement could deter the Postal Service from attempting to collect any revenue under the new supplemental rate authority for the simple reason that any such attempt could cause mail volumes to decline without benefit to the Postal Service.[28]

[28] *Id.* The payment requirement has other problems as well. First, it intrudes into the Postal Service's prerogative to run its business. Second, it sets a precedent for further micromanaging of Postal Service operations. Third, it is inconsistent with the concept that under a price cap regime, the regulated entity generates revenue not earmarked for any particular purpose and assumes responsibility for how it spends the revenues it receives. Without the Commission's condition, the Postal Service can, of course, use additional revenues for operational purposes and default on its retirement payment obligations. If the Postal Service does that, as it has already defaulted on the lump sum payments for retiree health care, it is the Postal Service's responsibility. The ultimate resolution of that possibility will remain for another day and could well require resolution by Congress.

7. Alleged Absence of Any Need for the Additional Rate Authority

Joint Commenters asserts that supplemental rate authority should not be authorized because '[t]he proposed authority will have little impact on whether the Postal Service will actually be able to make promised payments to its retirees…[and]…because the Postal Service already has the ability to fund its retirement obligations." Joint Commenters at 59. Joint Commenters states further that "[i]n 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." *Id.* at 60. These arguments are companions to an earlier Joint Commenters argument that the Postal Service should stop making the lump sum retiree health benefit payments that were statutorily required until 2016 because no one would do anything to enforce the Postal Service's obligation. Reply Comments of ANM, *et al.,* March 30, 2018, at 19. The Commission did not accept this latter argument and it should reject its latest variants. *See* RNOPR at 88-94.

The Postal Service's legal obligation to make these payments remains, whether or not the Postal Service defaults on them and whether or not these payments are currently needed to meet the Postal Service's obligations to its retirees. The Postal Service's annual amortization payments for retiree health benefits and for CSRS and FERS retirement benefits are legal obligations, whether or not they are needed to meet current obligations to retirees. The purpose of these funds is to ensure that future retiree benefits will be honored without taxpayer funding. Whether or not the funding mechanism should be changed is a matter for Congress to decide. In the meantime, the Postal Service's obligation to make these payments creates an uncontrollable, or exogenous, cost which the supplemental rate adjustment is intended to address.

V. COMMISSION'S PROPOSALS TO ADDRESS NON-COMPENSATORY PRODUCTS AND CLASSES OF MAIL

The Commission has proposed giving the Postal Service an additional 2 percentage points of rate authority for any class of mail with attributable costs that exceed revenue. RNOPR at 174. The Postal Service's use of the additional pricing authority would be voluntary. *Id.* at 168.

Mailers who would be affected by the proposal object on a variety of grounds.[29] One of their principal arguments is "that serious questions exist about the validity of many of the costs being reported."[30] Another is that they are unable to absorb the proposed price increases. *E.g.,* NNA Comments at 4-10.

The Public Representative's position throughout this proceeding has been that the Commission should reset the price cap for non-compensatory classes to permit the Postal Service to collect rates as near as possible to estimated costs. 2020 PR Comments at 49. The Public Representative, supported by the declaration of Dr. John Kwoka and Dr. James Wilson, is consistent with generally applicable price cap principles. *Id.* (citing Kwoka/Wilson Decl. at 15-17).

As they explain in their joint declaration, general price or price cap resets that adjust prices or rate caps to levels that cover 100 percent of costs are generally disfavored because such resets resemble cost-of-service regulation and reduce or eliminate incentives for cost reductions or efficiency improvements. However, there are exceptions to this general rule. One such exception is presented when the gap between prices and costs produces large and persistent revenue shortfalls that threatens the financial viability of the business. *E.g.* Kwoka/Wilson Decl. at 16-17. The serious revenue shortfalls produced by non-compensatory products and mail classes

[29] Comments of the National Newspaper Association, January 31, 2020 (NNA Comments); Initial Comments of the American Catalogue Mailers Association, February 3, 2020 (ACMA Comments).

[30] ACMA Comments at 3; *see also* NNA Comments at 10-14; Joint Commenters at 43.

presented in this case justify general price and rate cap resets for those postal products and rate classes.

There is nothing inherently wrong with expecting a customer to pay the full costs of the service it receives. If customers need a subsidy because of the perceived societal benefits they provide, such subsidies should come from taxpayers, not the Postal Service or other customers.

While the Public Representative supports a price reset as near as possible to estimated costs, the questions regarding the validity of the costs reported for non-compensatory classes need to be examined and addressed by the Commission. In the meantime, as the Public Representative has previously stated, a multi-year phase-in mechanism could be used to moderate the impact of any increase in the cap for non-compensatory classes. In that connection, the Public Representative submits that unless record support exists for the 2 percent increase proposed by the Commission, phase-in of a cap reset aimed at full cost recovery would be more transparent and defensible. Finally, the Public Representative again notes that an adjustment to the cap for non-compensatory classes, like adjustments to the cap for any other class, will not, by itself, raise prices. It is the Postal Service that must decide whether to exercise its pricing authority.

VI. IMPACTS AND MEASURES TO AMELIORATE

In preceding sections, the Public Representative discussed the impact of the Commission's proposed supplemental rate authority for declining demand and for statutorily mandated payments for retirement obligations. *See* Section IV. A. 3. and IV. B. 5, *supra.* He also discussed the impact of those proposals and identified available means of mitigating the impacts of those rate authorities. *Id.* In Section V., *supra,* the Public Representative addressed the impact of proposed additional rate authority and mitigating measures for non-compensatory mail classes.

Joint Commenters argues that the Commission has an obligation to consider the cumulative volume and price impact of all the proposals. Joint Commenters at 22-39, 56-58. *See also* NNA Comments at 5-6 (identifying the cumulative effect of the Commission's proposals on rates); FCBM Comments at 36-38, 48-49. The Public Representative agrees that the Commission must consider the cumulative effects of its proposals before it can adopt them. This is particularly important in light of the analyses presented in the Brattle Declaration.

The tables set forth below present comparisons of the Commission's proposals and alternatives discussed by the Public Representative in his February 3, 2020 comments and in his reply comments set forth above. These comparisons are presented solely for illustrative purposes to demonstrate the relative differences in cumulative impact on prices and volumes produced by varying certain basic parameters.

As indicated in the note to the Table 6, information regarding the Commission's RNOPR proposal comes from the Battle Declaration and were originally provided by the Commission. The Public Representative's alternatives presented in these tables differ from the Commission's RNOPR proposals in three important respects. First, to reflect the fact that the Public Representative has opposed the Performance-Based rate authority, the Public Representative's alternatives do not include that authority or the effects of that authority. Second, both the Public Representative's Scenario 1 and Scenario 2 operate over a 4 year period, reflecting the Public Representative's proposal to phase-in the retirement-based supplemental rate authority over 4 years. Third, Scenario 1 and Scenario 2 differ by the limiting the density rate authority adjustment in Scenario 2 to a one-time adjustment to the price cap. Further density rate adjustments, if any, would not occur until the Commission's next market dominant system review.

The Public Representative would also note that both of his scenarios limit adjustments to the Periodicals Class to 2 percent. Although the Public Representative advocates a larger adjustment, he has included a 2 percent adjustment to avoid unduly complicating comparisons to the Commission's proposals. The 2 percent limitation in the Public Representative's scenarios can be viewed a form of mitigation measure.

Table 6 and Table 7 provide a comparison of annual and cumulative price increases for Market Dominant Mail by class. Table 8 shows the cumulative impacts of these price increases on mail volumes.

Once again, the tables are presented as illustrations of the comparative price increases and relative cumulative impacts that result from varying the parameters of the price cap adjustments.

Table 6: Additional Hypothetical Rate Authorities

Market Dominant	RNOPR Proposal	PR Scenario 1	PR Scenario 2	
Mail Claases	Over 5 years	Over 4 years	Over 4 years	
	Per year	Per year	In Year 1	In Years 2, 3,4
First-Class Mail	3.17%	2.17%	2.17%	0.94%
USPS Marketing Mail	3.17%	2.17%	2.17%	0.94%
Periodicals	5.17%	4.17%	4.17%	2.94%
Package Services	3.17%	2.17%	2.17%	0.94%

Sources: RNOPR Proposal: Brattle Decl. at 10, Table 1, column "Average." These price increases were originally provided by the Commission. *See* RNOPR at 80 (Table IV-3), 100 (Table IV-6), 149 and 174. PR Scenario 1, uses the same rate authorities, but excludes performance rate authority. PR Scenario 2 not only excludes performance rate authority, but also applies density rate authority in Year 1 only.

Table 7: Cumulative Price Increases

Market Dominant	Cumulative Above-Cap Price Increases		
Mail Classes	Over 5 years	Over 4 years	
	RNOPR Proposal	PR Scenario 1	PR Scenario 2
First-Class Mail	16.89%	8.97%	5.08%
USPS Marketing Mail	16.89%	8.97%	5.08%
Periodicals	28.66%	17.75%	13.63%
Package Services	16.89%	8.97%	5.08%

Sources: The cumulative price increases are calculated using additional rate authorities from Table 6 above and phasing them over 5 or 4 years.

Table 8: Cumulative Volume Losses (assuming that the Postal Service exercises all additional rate authorities)

Market Dominant	Additional Cumulative Mail Volume Losses		
Mail Classes	Over 5 years	Over 4 years	
	RNOPR Proposal	PR Scenario 1	PR Scenario 2
First-Class Mail	-4.7%	-2.5%	-1.4%
USPS Marketing Mail	-8.5%	-4.5%	-2.5%
Periodicals	-5.5%	-3.4%	-2.6%
Package Services	-12.5%	-6.6%	-3.8%

Sources: The cumulative volume losses are calculated using additional rate authorities from Table 5 above, volume data from FY 2019 ACR, Library Reference USPS-FY19-1, worksheet “Volume1” and average elasticity estimates by class computed as a weighted average by volume using data from Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2019, January 21, 2020, folder “Volume Forecasts,” file vf-Jan2019(md).xlsx, worksheets "Forecast Vols" and "Elasts;"

VII. A REVIEW OF THE MARKET DOMINANT SYSTEM SHOULD COMMENCE IN THREE YEARS

In his initial comments on the Commission’s revised proposal, the Public Representative urged the Commission to conduct the next review of the market dominant system in 3 years. 2020 PR Comments at 50-53. The Pubic Representative relied upon 5 reasons for his recommendation. *Id.* First, any delays in implementing the revised system will delay commencement of the next assessment. Second, delays in the commencement of the next review will delay its conclusion. Third, three years should provide the Commission with enough rate cycles and data to begin to perform a reliable assessment, and the review period could be extended if it appeared that more experience with the system is needed. Fourth, a prompt assessment of the system is important to protect stakeholders. Fifth, a 3-year review period will better position the Commission to react promptly to any perceived problems with the system.

All five of the reasons given by the Public Representative for initiating a 3-year review period remain valid. However, the allegations by several parties that the proposed system will result in serious injury to themselves and to the Postal Service provide additional support for two of the five reasons cited by the Public Representative to support a 3-year review period—the need to protect stakeholders and the enhanced apply of the Commission to respond to any perceived problems with the system.

Although the Public Representative takes seriously allegations that the revised system will harm mailers and other stakeholders, he continues to believe that the mitigation efforts discussed above and in his earlier comments can provide adequate protection to the potentially affected interests consistent with the requirements of title 39. These mitigation measures, when coupled with a 3-year review period will provide stakeholders more certainty and ensure better protection than the same measures coupled with a 5-year review period.

VIII. CONCLUSION

The 10 Year Rate System Review presents the Commission with the first opportunity to comprehensively examine the system's performance and to make changes needed to ensure the system will achieve the PAEA's statutory objectives. The Commission's actions are, of course, only part of the broader spectrum of actions that need to be taken to address problems with our postal system. Congress, the Postal Service, and stakeholders also have important roles to play. The responsibilities of others does not, however, relieve the Commission of its duty to act.

Throughout this proceeding, the Public Representative has focused on measures needed to address problems with the operation of the CPI-U price cap. Along with others, the Public Representative has asserted the Commission's authority to make adjustments to the market dominant system, including, most importantly, adjustments to the price cap. The Public Representative has consistently urged the Commission to base adjustments to the price cap on recognized price cap principles. The Public Representative supports the decision by the Commission in its revised proposal to use price cap principles as the foundation for adjustments to the price cap.

Price cap principles must, of course, be implemented consistent with statutory requirements—more specifically, within the framework created by the objectives and factors in 39 U.S.C §3622(b)(2) and (b)(3) and in accordance with the requirements of § 3622(d)(3). As demonstrated by the comments filed in response to the Commission's most recent proposal, implementation of price cap principles within the statutory framework and consistent with statutory requirements will be difficult. But the Commission does have the tools, within the boundaries of its authority, to make needed improvements to the system.

In its previous comments, the Public Representative has:

- ➢ Supported the Commission's assertion of Its statutory authority to modify the CPI-U price cap, 2017 PR Comments at 30;
- ➢ Supported the Commission's proposal to provide the Postal Service with supplemental rate authority based upon exogenous factors, 2020 PR Comments at 5-6;
- ➢ Supported the Commission's effort to address the adverse effects that declines in mail density have on the Postal Service's ability to achieve net income and presented a detailed analysis of the Commission's Density Rate Authority mechanism suggesting measures to eliminate potential problems, *Id.* at 6-19;

- Supported an adjustment of the price cap that would provide the Postal Service an opportunity to generate additional revenue based upon statutorily mandated retirement payment obligation, *Id.* at 3;
- Opposed a revenue-based allocation of retirement obligation costs to Competitive products, but offered an alternative that would limit the allocation to no more than the minimum Competitive product contribution percentage required by 39 CFR § 3015.7 (c)(1), *Id.* at 19-23;
- Proposed modifications to the mechanism for making price cap adjustments for statutorily mandated payments for retirement obligations that would provide for earlier revenue collection and for a shorter, 4-year, phase-in period, *Id.* at 27-30;
- Opposed various requirements that would be imposed on the Postal Service's use of revenues from the supplemental authority due to the retirement obligation adjustment, *Id.* at 31-38;
- Opposed the proposed Performance-Based Adjustment, *Id.* at 39-47;
- Accepted the Commission's proposal to require a minimum rate increase of 2 percentage points for non-compensatory products that are in a compensatory class, *Id.* at 47-48;
- Proposed a one-time price cap reset for non-compensatory mail classes that would permit the collection of rates closer to estimated costs, *Id.* at 49-50; and
- Urged the Commission to adopt a 3-year review period, *Id.* at 50-53.

In these reply comments, the Public Representative:

- Opposes claims that adjustment to the price cap constituted an unlawful elimination or abrogation of the cap, at 2-4;
- Supports the proposed supplemental rate authority mechanism as properly based on price cap principals and opposes claims that the mechanisms are legally barred as retroactive ratemaking, at 5-6;
- Supports the density rate adjustment proposal, but recommends changes to ensure consistency with statutory objectives, at 6-19;
- Supports supplemental rate authority for certain statutorily mandated retirement payment obligations, at 19-26;

- Supports increased prices for non-compensatory products in compensatory mail classes and increased rate authority for non-compensatory mail classes, subject to mitigation measures, at 27-28;

- Addresses combined cumulative impacts of price cap adjustments and measures to ameliorate those measures, at 29-32;

- Renews the Pubic Representative's recommendation that the next market dominant system review commence in three years, at 32-33.

For the reasons given above, the Public Representative submits that the system for regulating rates and classes for market dominant products should be modified as recommended herein and in the Public Representative's prior comments in this proceeding.

Respectfully submitted,

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APPENDIX A

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

   A. Comments of the Public Representative, March 20, 2017 (PR 2017 Comments)

   B. Declarations:

      1. Declaration of John Kwoka, March 20, 2017 (Kwoka Decl.)
      2. Declaration of Timothy J. Brennan for the Public Representative, March 20, 2017 (Brennan Decl.)
      3. Declaration of Lyudmila Bzhilyanskaya, March 20, 2017 (Bzhilyanskaya Decl.)

II. Order No. 4258, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, December 1, 2017 (NOPR)

   A. Initial Comments of the Public Representative, March 1, 2018 (2018 PR Comments)

   B. Declarations:

      1. Declaration of John Kwoka and Robert Wilson, March 1, 2018 (Kwoka/Wilson Decl.)
      2. Supplemental Declaration of Timothy J. Brennan for the Public Representative, March 1, 2018 (Brennan Supp. Decl.)
      3. Supplemental Declaration of Lyudmila Y. Bzhilyanskaya for the Public Representative, March 1, 2018 (Bzhilyanskaya Supp Decl.)

   C. Reply Comments of the Public Representative, March 30, 2018 (PR Reply Comments)