Postal Regulatory Commission
Submitted 3/4/2020 4:04:16 PM
Filing ID: 112580
Accepted 3/4/2020

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

March 4, 2020

I. INTRODUCTION

This docket began as a review of whether the Commission's current system of market-dominant rate regulation is achieving the objectives of PAEA, taking into account the factors of the statute. It quickly went off the rails. The Commission refused to issue information requests about the Postal Service's finances and costs that would have benefitted these proceedings, it outlined vague standards for reviewing the system and then applied (in Order No. 4257) different standards than those included in its Advanced Notice of Proposed Rulemaking, it did not allow mailers to reply to the Postal Service's input into the ANOPR, and it authorized a compressed public comment period for Phase II of this docket. *See* ANM, *et al.* Phase II Comments (Mar. 1, 2018) at 109-110. Over time, the Commission's review has turned into an entirely distinct inquiry: a referendum on price cap regulation, focused on eliminating the one aspect of the current system of regulation that the law requires to remain in place and that was designed specifically to advance all of the statutory objectives in tandem. Any pretense of revising the current system to better achieve all of the objectives has been abandoned, and the focus of the Commission and multiple commenters has turned exclusively to whether the Postal Service is earning enough revenue, and how the Commission might revise its rules to provide the Postal Service with the ability to charge captive mailers much higher postage rates.

The result in Order No. 5337 is a proposal to establish an unnecessarily complicated regulatory system that would severely weaken incentives for the Postal Service to operate efficiently, jettison the stability of postal rates while decreasing their predictability, and increase the administrative burden of the ratemaking processes while decreasing its transparency. In other words, the Commission's newest proposals would move the system farther away from the statutory objectives it must be designed to achieve. The proposals throw Objectives 1, 2, 6, and 8 by the wayside, and the proposed "performance-based" authority would do nothing to satisfy Objective 3. Even Objective 5 suffers, because the proposed rate increases would drive substantial amounts of volume out of the mail and thus will likely fail to ensure, by any definition, the medium and long-term financial stability of the Postal Service.

The Commission's errant approach in this docket has been in evidence since Order No. 3673, when it proposed to assess each of the objectives individually and called for comment on defining and measuring each objective individually. Order No.

3673 at 10-11; ANM, *et al.* Phase I Comments[1] at 13. Then, without providing any opportunity to comment on the definitions it adopted or the approach to evaluating the current system it chose to employ, the Commission issued Order No. 4257, in which it found that the current system was not achieving the objectives primarily because the Postal Service had not been able to achieve retained earnings. This error in definition and priority—that retained earnings are synonymous with financial stability and the ultimate goal of regulation of the Postal Service—has led the Commission not once, but twice, to propose revisions to the system of ratemaking that improperly elevate Objective 5 above all others (rather than balancing them as the law requires) while illegally removing the required CPI-based price cap.

The initial comments filed in response to Order No. 5337 demonstrate that the mailing community universally opposes the radical rate increases the Commission's proposal would authorize.[2] The Postal Service, for its part, criticizes the

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1 Docket No. RM2017-3, Comments of Alliance of Nonprofit Mailers, Association for Postal Commerce, and MPA—The Association of Magazine Media (March 20, 2017) ("ANM, *et al.* Phase I Comments").

2 For just a sampling of such comments, *see, e.g.*, Docket No. RM2017-3, Comments of the National Postal Policy Council, the Major Mailers Association, the National Association of Presort Mailers, and the Association for Mail Electronic Enhancement (Feb. 3, 2020) ("NPPC, *et al.* Phase III Comments"); Docket No. RM2017-3, Comments of Discover Financial Services on Revised Notice of Proposed Rulemaking at 10-14, 16 (Feb. 3, 2020); Docket No. RM2017-3, Initial Comments of the American Catalog Mailers Association (ACMA) (Feb. 3, 2020); Docket No. RM2017-3, Comments of eBay, Inc. (Feb. 3, 2020); Docket No. RM2017-3, Comment of Small Business & Entrepreneurship Council (Feb. 3, 2020); Docket No. RM2017-3, Comment of ANA Nonprofit Federation (Feb. 3, 2020); Docket No. RM2017-3, Comments of American Bankers Association (Feb. 3, 2020); Docket No. RM2017-3, Comments of Meredith Corporation (Feb. 3, 2020); Docket No. RM2017-3, Comments of the National Newspaper Association (Jan. 31, 2020).

Commission's proposal to grant it a permanent 17 percent above-CPI price increase (or 29 percent for noncompensatory products) by complaining that the Commission's largesse *is not generous enough*. The Postal Service has lots of cash on hand, billions of dollars available in borrowing authority, valuable real estate assets, alternative revenue generation streams, is meeting its universal service obligations, and is in no danger of ceasing operations any time soon. Yet, in its initial comments the Postal Service seeks what is tantamount to deregulation, the virtual abrogation of the CPI-cap, and extra price hike power granted unconditionally. The Postal Service's requested revenue grab would allow it to recover $6 billion from its captive customers and, on top of the Commission's proposals, would amount to a total rate increase over five years of 23 percent above inflation.[3] For noncompensatory products, the Postal Service's proposal would mean a 33 percent above-inflation price hike on captive mailers.[4]

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[3] Calculated by taking the $6.0 billion as a percentage of the $69.9 billion in FY 2019 Revenue (Docket No. ACR2019, USPS-FY19-1, Public_FY19CRAReportRev.1.10.2020.xlsx, "Cost3", cell D26) and then compounding 3.2% (ANMetalRM2017-3 Comment Wkpapers.xlsx, "Authority", cell D9) for 4 years. The estimated increase under the Postal Service and union proposals would be higher if the supplemental authority began in Year 1. Additionally, the estimated increase under the Postal Service proposal would be higher if the entire $6.0 billion would come from Market Dominant product rate increases rather than from both Market Dominant and Competitive products.

[4] Calculated by taking the $6.0 billion as a percentage of the $69.9 billion in FY 2019 Revenue (Docket No. ACR2019, USPS-FY19-1, Public_FY19CRAReportRev.1.10.2020.xlsx, "Cost3", cell D26) and then compounding 5.2% (ANMetalRM2017-3 Comment Wkpapers.xlsx, "Authority", cell F9) for 4 years. The estimated increase under the Postal Service and union proposals would be higher if the supplemental authority began in Year 1. Additionally, the estimated increase under the Postal Service proposal would be higher if the entire $6.0 billion would

Labor union commenters, predictably, want even more. Postal Service retiree benefit programs remain better funded than the vast majority of public and private sector programs. An arbitration panel was persuaded that "the package of economic benefits received by bargaining unit employees – retirement benefits, retiree health care, paid leave, low employee health care contributions, and a no-layoff provision – are superior to those typically available to private sector employees." *In re USPS v. APWU*, Interest Arbitration Decision and Award (effective date: July 8, 2016) at 11. Nevertheless, the National Association of Letter Carriers and the American Postal Workers Union propose their own revenue grab that is even greater than that proposed by the Postal Service.[5] When combined with the Commission's proposals, the NALC/APWU plan would result in price hikes of 35 percent above inflation over five years (compensatory), or 46 percent above inflation over five years (noncompensatory). The present value of the additional costs that would be imposed on mailers by the Postal Service and labor union proposals is staggering: $301 billion and $457 billion, respectively. These massive proposed rate increases are depicted in Figures 1 and 2, below:

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come from Market Dominant product rate increases rather than from both Market Dominant and Competitive products.

5 The Postal Service asserts that certain labor costs, such as the number of postal employees, are beyond its control "due to conditions imposed in binding labor arbitration." USPS Phase III Comments at 17, n. 7. This deflection of responsibility does not withstand scrutiny. The neutral arbitrator awarded the APWU its compensation and benefits package after "look[ing] favorably" at the recent agreement the Postal Service had *voluntarily* entered into with the much-smaller National Rural Letter Carriers' Association. *See APWU* at 12. The Postal Service's failure to control labor costs, therefore, is a mess of its own making.

Figure 1. Cumulative Above-Inflation Rate Increases for Compensatory Products

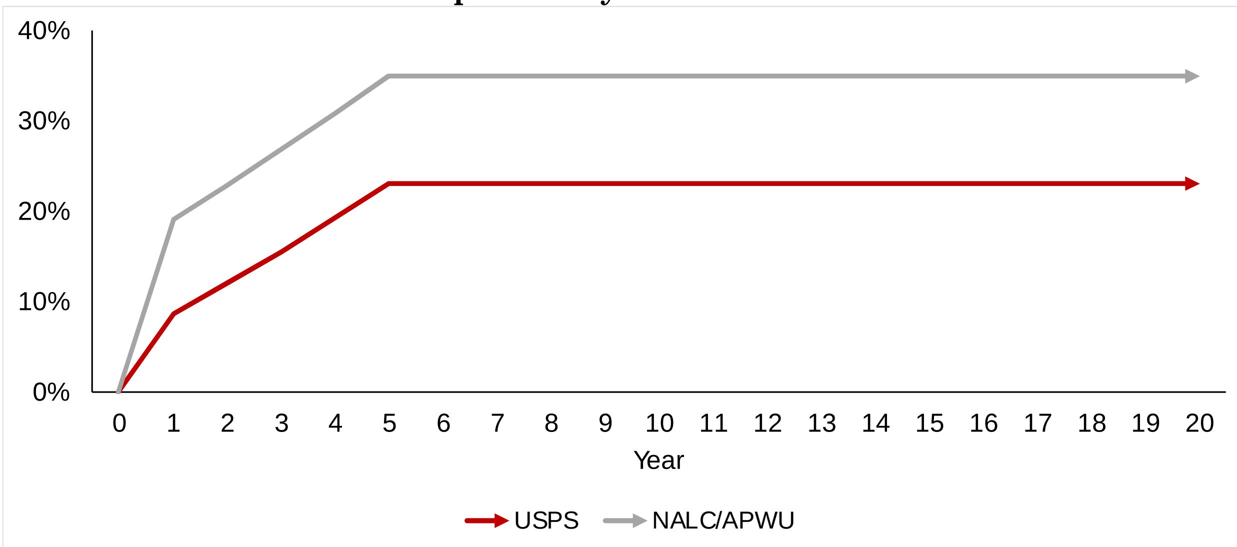
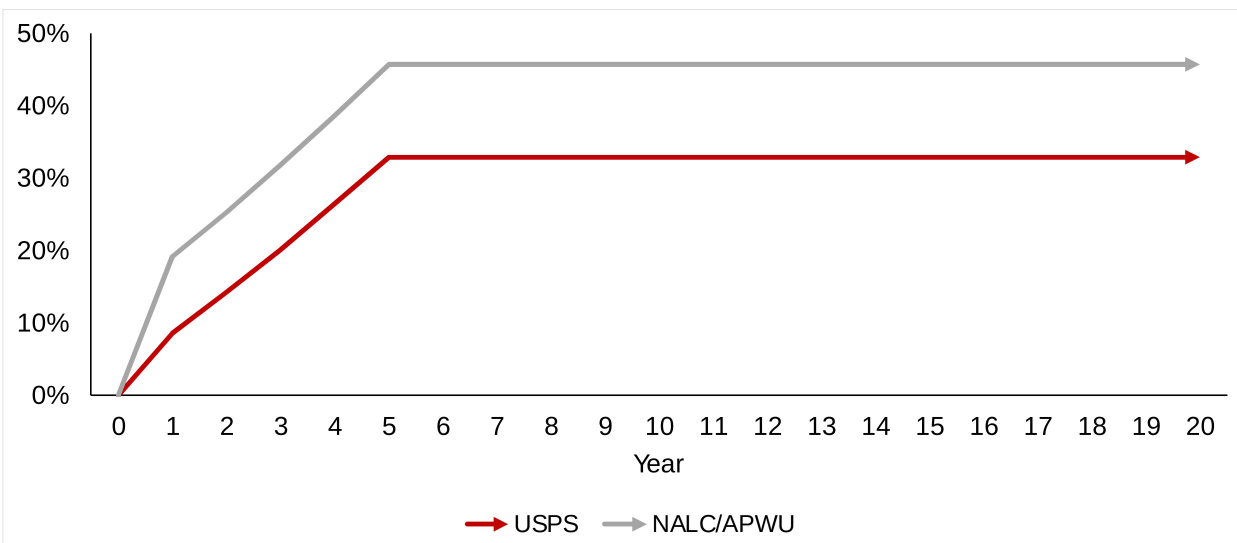


Figure 2. Cumulative Above-Inflation Rate Increases for Non-Compensatory Products



The Commission should ignore these entreaties, withdraw its proposed rules, and reevaluate its entire approach to this proceeding. In so doing, the Commission should build on positive developments facilitated by the price cap while refining the system of regulation in ways that will encourage the Postal Service to be more innovative, more efficient, and more effective. Most importantly, the Commission must recognize that postal ratepayers must be protected, not only for their own sake, but for the long-term prospects of the Postal Service itself.

II. A STRICT PRICE CAP IS NECESSARY TO BALANCE THE OBJECTIVES OF PAEA

ANM, PostCom, and MPA began their initial comments in this proceeding with a simple statement: "The Postal Service is a regulated monopoly." ANM, *et al.* Phase I Comments at 2. This truism seems to have been lost as the Commission has proceeded in this docket. The Postal Service's comments, in particular, ignore its status as a statutory and *de facto* monopoly and argue as if it is operating in a purely competitive environment. *See, e.g.*, USPS Phase III Comments[6] at 65 ("[A] price cap is unnecessary, given that there are market alternatives for every product that we offer, which effectively constrain our ability to adjust all of our prices.").[7] The Postal

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6 Docket No. RM2017-3, Initial Comments of the United States Postal Service in Response to Order No. 5337 (Feb. 3, 2020) ("USPS Phase III Comments").

7 Even ignoring the Postal Service's statutory monopoly, the logical flaw in this argument should be obvious. The Postal Service never identifies the *degree to which* this alleged competition constrains its ability to raise prices, which is the key consideration when evaluating market power. *See, e.g.*, Docket No. MC2013-57, Order No. 2306, *Order Denying Request* at 17-18 (explaining in the course of denying a product transfer request premised on multi-channel competition that product substitutes, and market power, are identified by assessing whether postal customers would engage substitutes in response to a small but significant and non-transitory increase in price). Obviously, the Postal Service must think competition constrains its prices at some level far above what it is currently charging; otherwise, the price cap would not pose a meaningful restriction on its pricing authority. The question the Commission must answer, then, is how far above current levels could the Postal Service raise prices before such increases would become unprofitable? And is that price level equivalent to what a firm would charge in a competitive market, or does it represent a monopoly price level? Even a monopolist cannot profitably raise prices to any level it wants, but that does not mean that it has not already or easily could exercise super-competitive pricing power *before* substitution hinders it furtner. *See*

Service's claim rings hollow: while it assures the Commission (and mailers) that "market pressures and other business considerations may place considerable limits on the extent to which the Postal Service could actually use such pricing authority," *id.* at 4, the Postal Service simultaneously complains that the considerable extra pricing authority the Commission *did* propose to grant it "still falls far short" and asks for more. *Id.* at 1.

The importance of the Postal Service's market power to this review cannot be overstated: because the Postal Service is a monopolist, Congress enacted a system of regulation to protect mailers from abuse of that market power (*i.e.*, from rate increases and service declines) while establishing incentives that allow the Postal Service to benefit from good management and encouraging the Postal Service to operate as if it were facing competition. The objectives of PAEA reflect these principles while simultaneously directing the Commission to develop a system of regulation that eases the administrative burden on both mailers and the Postal Service.

A. Congress' Price Cap Balances Postal Service and Mailer Interests

While there is, superficially, some tension between the "pro-mailer" and "pro-Postal Service" objectives, in fact, the pricing flexibility afforded within classes under the price cap, combined with solid management decisions by the operator, allows for

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Eastman Kodak Co. v. Image Tech. Servs., 504 U.S. 451, 471 (1992) ("The existence of significant substitution in the event of *further* price increases or even at the *current* price does not tell us whether the defendant *already* exercises significant market power") (quoting Areeda & Kaplow ¶ 340(b)) (emphasis in original).

all objectives to be met. As ANM, PostCom, and MPA explained in their Phase I comments, Congress recognized this and intentionally established a CPI-based price cap as a requirement of the statute because it would best satisfy the objectives as a whole. *See* ANM, *et al.* Phase I Comments at 18-22. As the Commission explained in 2010:

> In December 2006, bipartisan legislation reformed the process for changing postal rates. The centerpiece of this reform is a price cap limiting increases to the rate of inflation which ensures rate stability and predictability for the nation's mail users, and provides incentives for the Postal Service to reduce costs and operate efficiently.

Order No. 547 at 1.

The D.C. Circuit likewise recognized this design, explaining that "the inflation-based price cap protects mailers from the 'unreasonable use of the Postal Service's statutorily-granted [and de facto] monopoly power while creating new pricing flexibility, incentives for the Postal Service to reduce costs, and the opportunity for the Postal Service to earn a profit." *USPS v. PRC*, 785 F.3d 740, 745 (D.C. Cir. 2015) (quoting S. Rep. No. 108-318, at 19 (2004)). Congress, the Commission, and the courts have therefore all recognized that a CPI-based price cap is the best approach to achieve the sometimes-competing objectives of PAEA.

B. Initial Comments Do Not Show That the Current System is Failing to Meet PAEA's Objectives

The Commission determined in Order No. 4257 that despite this design, the current system of regulation, including the price cap, has not achieved PAEA's objectives. But the Commission's analysis is entirely results-based—that is, it focuses solely on whether the Postal Service has achieved efficiency gains or realized retained earnings—and lacks any analysis of *causality*. The Commission has not demonstrated that the current *system*, including the CPI-based price cap, has *caused* the losses the Postal Service has suffered. *See* ANM, *et al.* Phase II Comments at 55, n. 31. Similarly, commenters such as the Postal Service, NALC, and the Public Representative seem to take it as a given that if the Postal Service has losses on its balance sheet, the current system must not be achieving the objectives. Absent from these comments is any analysis of what actions the Postal Service could have taken under the existing system to improve its financial performance or whether the costs incurred by the Postal Service were prudently incurred (or are even real costs in a practical sense).

Where commenters do find fault in the current system, their critiques do not withstand scrutiny. The Postal Service in its Phase III comments claims that "the legacy price cap produced enormous annual net losses and decimated the Postal Service's financial health," but this claim is absurd on its face. USPS Phase III Comments at 2. "[N]et losses" are a function of both revenues and costs. While the price cap limited price increases, it did not prevent the Postal Service from reducing costs. In fact, it should have encouraged the Postal Service to focus on cost-cutting to achieve retained earnings under the price cap. But instead, the Postal Service, with the support of NALC and APWU, has been merely waiting out the cap in order to eliminate it all together.

Indeed, the Postal Service has been lobbying to weaken or eliminate the Congressionally-mandated price cap for a decade now. Within only a few years of

PAEA's enactment, the Postal Service began crying foul and asking Congress to reverse course. In 2010, the Postal Service published an "action plan" outlining, among other topics, its efforts to sidestep the Congressionally-mandated CPI-based price cap.[8] Since then, in every year beginning in FY 2010, the Postal Service stated, "We believe growth in volume and associated revenue, along with continuing productivity improvements, will not be sufficient to address the challenge presented by our current financial situation and the regulatory price cap."[9] At the start of the Ten-Year Review, the Postal Service stated for two consecutive years in its 10-K, "We continue to assert that the price cap should be eliminated, and that the PRC should engage in after-the-fact, light-touch review of the Market-Dominant prices we set to ensure that those prices are just and reasonable."[10] The Postal Service has spent more effort arguing for the cap to be removed than focusing on what actions it could take to operate profitably, such as simply restraining its cost increases to the average experienced by all other entities operating in the United States economy. The Commission, unfortunately, has adopted the Postal Service's fatalism and "throw-up-our-hands" approach by lamenting that the "Postal Service's cost reduction efforts have been unsuccessful," Order No. 5337 at 156, without requiring the Postal Service to make better operational decisions.

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8 "Ensuring A Viable Postal Service For America: An Action Plan For the Future," (Mar. 2010) at 13-14.

9 United States Postal Service, 2010 Report on Form 10-K, at 7.

10 United States Postal Service, 2019 Report on Form 10-K, at 42; *see also* United States Postal Service, 2018 Report on Form 10-K, at 44.

C. The Price Cap is Not "Inflexible"

The Postal Service also criticizes the CPI-based cap's "inflexibility, which leaves the system incapable of dealing with significant changes in circumstances." USPS Phase III Comments at 1. But this claim simply emphasizes that the Postal Service's concept of "flexibility" can be reduced to the ability to impose significant rate increases on captive mailers. The Postal Service transparently believes that the only way to deal with "significant changes in circumstances" is to raise prices—not to examine its pricing structure, right-size its operations, abandon wasteful investments like the FSS, focus on providing better quality service, engage in market tests and develop experimental products better suited to its customers' needs, restructure workshare discounts to more rationally reflect avoided costs, or take any other variety of actions that are permitted (indeed encouraged) under the price cap system. *See, e.g.*, ANM, *et al.* Phase I Comments at 6-7. In truth, the price cap has provided the Postal Service with far more pricing flexibility than the previous rate system. While the Postal Service has not taken full advantage of this flexibility, that is a problem of management, not of regulation.

Moreover, the Postal Service's definition of flexibility is directly contrary to the statutory language. Factor 7 requires the Commission to take into account "the importance of pricing flexibility *to encourage increased mail volume and operational efficiency*" when designing its system of regulation. 39 U.S.C. § 3622(c)(7) (emphasis added). The price cap is obviously not "inflexible" in this sense. By limiting price increases, it encourages retention and growth of mail volume. As thoroughly explained in our Phase III initial comments, the Commission's proposals—and the

Postal Service and union proposals that urge even larger price increases—would have the opposite effect. *See* ANM, *et al.* Phase II Comments at 28-39.

D. The Postal Service's Idea of "Flexibility" – A Massive Revenue Grab – Will Cause Significant Volume Declines

The Postal Service concedes in its initial Phase III comments that it is "well known" a given amount of above-inflation pricing authority "will result in a smaller percentage increase in revenue, because the price increase will induce some decrease in the quantity demanded." USPS Phase III Comments at 19. The Postal Service's concession is certainly "well known" by mailers who lived through the exigency rate surcharge and experienced volume declines. Nonprofit Marketing Mail and nonprofit Periodicals volume, for example, fell by a combined 1.3 billion pieces (or 9 percent) from the three-year period immediately preceding the exigency surcharge to the three-year period following the surcharge. Reductions in Marketing Mail and Periodicals volume do not occur in a vacuum: they trigger further mail volume declines, such as in single-piece First Class Mail. And we explained in our initial Phase III comments that the 4.3 percent temporary surcharge imposed during exigency cannot possibly predict the volume impacts that will be caused by the massive and permanent rate authority increases proposed here. But it is a near-certainty that the proposals lobbed by the Commission or, even worse, by the Postal Service and the labor unions would exacerbate the death spiral. The Commission's density-based authority would further exacerbate this vicious cycle by awarding the Postal Service with more and more authority to increase rates as volume declines accelerate.

E. Management Decisions, Not the Price Cap, Have Caused the Postal Service's Financial Problems

Other commenters blame the price cap for limiting the Postal Service's ability to raise rates to keep up with rising costs. *See* NALC Phase III Comments[11] at 4; Public Rep. Phase III Comments[12] at 49 (advocating for a "reset" to a higher price cap for Periodicals to "permit the Postal Service to collect rates as near as possible to estimated total costs."). In fact, the Public Representative has blamed the price cap in other dockets as well, claiming that "as price increases are limited by the price cap, it is difficult for Postal Service [*sic*] to make significant improvements in Periodicals cost coverage." *See* Public Rep. Comments in Docket No. ACR2019 (Jan. 30, 2020) at 43. That is, of course, just as much a *cost* problem as a rate problem. The Public Representative seems to recognize this but, like the Commission, simply accepts that "the Postal Service has failed to realize adequate cost reductions." Public Rep. Phase III Comments at 49.

The price cap should solve this cost problem through a structure that allows the Postal Service to retain earnings if it can keep its costs from rising as fast as inflation. The simple fact is the Postal Service has failed to do so. It wasted money on the FSS system. *See* ANM, *et al.* Phase I Comments at 54-56. It failed to adequately restrict growth in labor costs even as the volume of mail requiring labor

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11 Docket No. RM2017-3. Comment of the National Association of Letter Carriers, AFL-CIO (Jan. 30, 2020) ("NALC Phase III Comments").

12 Docket No. RM2017-3, Comments of the Public Representative on Revised Notice of Proposed Rulemaking (Feb. 3, 2020) ("Public Rep. Phase III Comments").

to process and deliver declined. *See id.* at 46-51.[13] It failed to remove institutional costs from the system to right-size its network and operations to reflect declining volumes. Indeed, if the Postal Service had simply limited its cost growth to the average growth in costs throughout the economy, it would have achieved a profit during the PAEA era. The fact that it could not operate within the generous price cap is not a fault of the regulatory system.

In addition to blaming rising costs, NALC complains that the price cap has "severely constrained USPS's ability to address cost increases from exogenous factors like falling mail density" because "inflation has remained stuck at historically low levels for most of the PAEA period." NALC Phase III Comments at 4. Of course, low inflation simply means that the majority of Postal Service costs—endogenous, exogenous, or other—should not have risen much over the PAEA period. Even if some exogenous postal-specific costs did increase faster than inflation, the Postal Service should have been able to cover these costs if it had been able to restrict cost increases in other areas to levels below inflation.

F. "Buyer's Remorse" Does Not Justify Undoing the Price Cap

As we explained above, at 10-11 *supra*, the Postal Service experienced a case of "buyer's remorse" within only a few years of PAEA's enactment and quickly began lobbying for the price cap's repeal. In this docket, the Commission has supported the Postal Service's view by noting that circumstances have changed since PAEA became law, pointing to the "economic downturn" and "emergent technological trends." Order

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[13] This is particularly the case for Periodicals and other flat-shaped mail. *See* MPA Comments in Docket No. ACR2019 (Feb. 18, 2020) at 2-3.

No. 5337 at 6. But arguments that conditions have changed since PAEA was enacted in unanticipated ways that undermine the value of a price cap are unsupportable.

The Commission recognized the ordinary nature of volume declines in Order No. 547, explaining that "the diversion of mail volume to electronic alternatives is a long-term trend that does not qualify as an 'extraordinary or exceptional circumstance.' Both the Postal Service and the Commission agree. Declines in volume that arise from the normal life cycle of a product, or set of products, would not come within the plain meaning of those terms." Order No. 547 at 51.[14] Furthermore, the Commission has specifically stated that "[u]nder the PAEA, the price cap was to operate in situations in which postal volumes were rising, as well as situations in which postal volumes were declining." Order No. 1926 at 175. When volumes are declining, "the Postal Service is expected to respond to the declining volumes by reducing costs and improving efficiencies." *Id.* The Commission and supportive commenters in this proceeding have no reasonable explanation for why the Postal Service should no longer be required to respond to declining volume this way.

As we explained in our initial comments, a CPI-based price cap, better than any other system of regulation, is designed to achieve *all of* the objectives of PAEA. *See* ANM, *et al.* Phase III Comments at 12-14, 85-91. The price cap helps resolve the surface-level tension between several of the objectives. Once a price cap is introduced,

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[14] To the extent that mail volume losses caused by the Great Recession constituted an "extraordinary or exceptional circumstance," the Postal Service has already been compensated for those losses under the exigency provision. *See* Order No. 2623 in Docket No. R2013-11R (July 29, 2015).

the objectives should all work in concert. To the extent that the price cap has not achieved expected cost reductions or led to increased efficiency, that is not a failure of the *system* – it is a failure of the Postal Service, whose internal incentives to reduce costs and operate efficiently have not been maximized because it has been anticipating price cap relief for years. The Commission has compounded this problem by signaling its acceptance of the Postal Service's inability to reduce costs (even though we and many others have identified numerous ways to do so). Of course the Postal Service's cost reduction incentives would not be maximized under these circumstances. But the proposals lobbed by the Commission, the Postal Service, and the labor unions would weaken cost reduction incentives *even further* – that, Congress does not allow. *See* 39 U.S.C. § 3622(d)(3) (modified system must be "as necessary to achieve the objectives").

G. Proposals To Loosen Or Eliminate The Price Cap Move The System Farther Away From Achieving PAEA's Objectives

The harmonious interplay between incentives to reduce costs, pricing flexibility, price predictability and stability, and financial stability that a price cap promotes is completely absent from the alternative proposals put forth by the Postal Service and the unions. NALC's retroactive "true-up" proposal, with the goal of putting the Postal Service in the same position as if the price cap had never existed, would in essence retroactively repeal PAEA. NALC Phase III Comments at 5. NALC's proposal would not only fail to provide the incentives for efficiency going forward that Objective 1 and healthy ratemaking require, *see* ANM, *et al.* Phase III

Comments at 40-41 (citing Willig Decl. ¶¶ 20, 21, 24), but would constitute an after-the-fact rejection of Congress' mandate.

The Postal Service, for its part, continues to push for further deregulation, claiming the proposed system will not provide it with sufficient revenue to remain financially stable, while rejecting out-of-hand the concept that the system of regulation should provide it with incentives to reduce costs and increase efficiency. The Postal Service claims that "considerably more pricing authority would be required for the Commission's proposals to meet its stated goals and achieve the statutory objectives," but it does not identify which objectives—plural—would be served by more pricing authority. USPS Phase III Comments at 4. Essentially unlimited pricing authority certainly would not promote price stability, ensure just and reasonable rates, or maximize *incentives* to reduce costs and increase efficiency. The Postal Service is concerned only with Objective 5, and its proposals reflect that.

In sum, the existing CPI-based price cap has properly balanced the objectives of PAEA, and it will continue to do so going forward. It certainly will better achieve the objectives than the proposals put forth by the Commission and other commenters.

If the Commission is concerned that the Postal Service needs to do more to improve its financial situation, it can revise its system of regulation to help it do so without eliminating the CPI-based price cap. As Discover Financial Services points out, the Commission could help the Postal Service expand the use of NSAs, discounts, and other innovative pricing techniques to encourage volume retention and growth. Docket No. RM2017-3, Comments of Discover Financial Services on Revised Notice of Proposed Rulemaking at 10-14, 16 (Feb. 3, 2020). NPPC, *et al.* and Pitney Bowes explain how modifications designed to bring workshare discounts more in line with avoided costs could improve efficient operations and improve Postal Service finances. NPPC, *et al.* Phase III Comments at 15-18; Docket No. RM2017-3, Comments of Pitney Bowes (Feb. 3, 2020) at 2-7. And we have identified numerous steps the Postal Service could take under the existing system to improve its performance and financial position.[15] *See, e.g.*, ANM, *et al.* Phase I Comments at 11 (recommending discontinuation of FSS processing and resetting workshare discounts); *id.* at 46-59 (recommending moving toward compliance with the pay comparability requirement, reviving cost reduction initiatives, revamping rate structures for flat-shaped mail, developing new NSAs, and seeking additional revenue from leasing space on mail trucks). But all of these solutions only work if a strict price cap, with full Commission backing, is in place to force the Postal Service to take advantage of the tools at its disposal.

III. <u>THE CURRENT SYSTEM IS MEETING OBJECTIVE 5</u>

Comments on Order No. 5337 filed by several parties take as a given that the Commission's task in this proceeding is to help "true-up" the Postal Service losses

[15] One thing the Commission should not do is impose the additional reporting requirements on the Postal Service proposed in Order No. 5337. NPPC, *et al.* explain that increased reporting requirements, in the absence of sanctions for failing to improve performance, do nothing to actually improve performance. NPPC, *et al.* Phase III Comments at 74-76. Without such sanctions, reporting requirements simply increase the administrative burden on the Postal Service and distract from its efforts to improve performance. While additional reporting may be necessary or useful in some instances, the Commission should impose such requirements only where it intends to use its authority to enforce changes in behavior.

over the past decade by providing the Postal Service with some degree of above-CPI pricing authority. The Postal Service "in particular" endorses the Commission's finding that the current system has failed to achieve Objectives 5 and 8 (by failing to establish compensatory rates), USPS Phase III Comments at 1, but it claims Order No. 5337 "still falls far short of remedying the effects of the legacy ratemaking system and of giving the Postal Service a realistic opportunity to maintain financial stability." *Id.* at 1-2. NALC similarly "applauds the Commission's proposals to shore up USPS's finances," and it urges the Commission to "go further," including by giving the Postal Service "additional [supplemental density] rate authority equal to the total increase that USPS would have been allowed had the Commission's proposal been in effect since 2009." *Id.* at 2.

As discussed in the previous section, these comments are deficient because they fail to consider the impact their proposals would have on achieving the other objectives of PAEA, including maximizing incentives for efficiency, creating stability in rates, and maintaining just and reasonable rates that protect mailers from the exercise of the Postal Service's monopoly power. But they are also deficient because the additional pricing authority they seek is unnecessary to achieve Objective 5. The current system of ratemaking has allowed the Postal Service to maintain financial stability, and with smart management actions and sensible regulation by the Commission, a CPI-based price cap will provide the Postal Service with the best opportunity to improve its financial position going forward.

Even if one accepts that the Postal Service has not recovered all of its accrued book costs under the price cap, that does not mean that the current system has failed to achieve the objectives of PAEA. In fact, it does not even mean that the current system has failed to meet Objective 5, "[t]o assure adequate revenues, including retained earnings, to maintain financial stability." 39 U.S.C. § 3622(b)(5). "[F]inancial stability" is not defined in the statute, and as the Commission partially recognizes, the achievement of this objective is not necessarily determined by the Postal Service's current balance sheet. While the Commission further divided the concept of financial stability into "short, medium, and long-term financial stability," *see* Order No. 4257 at 154, nothing in this definition requires a finding that Objective 5 was not met because of reported balance sheet losses.

As ANM, PostCom, and MPA explained in depth in previous comments, the Postal Service's financial condition is far better than what is reflected on its balance sheet. *See* ANM, *et al.* Phase I Comments at 22-46; ANM, *et al.* Phase II Comments at 71-77; ANM, *et al.* Phase II Reply Comments[16] at 17-37; ANM, *et al.* Phase III Comments at 22. The Postal Service is in no danger of stopping mail service. Its retirement funds are well-funded. It has real estate assets that are undervalued on its books. And it has enough cash on hand to fund operations for a long time and billions of dollars in available borrowing authority. Under the CPI-based price cap,

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16 Docket No. RM2017-3, Reply Comments of Alliance of Nonprofit Mailers; American Catalog Mailers Association, Inc.; Association for Postal Commerce; Data & Marketing Association; Idealliance; and MPA—The Association of Magazine Media (March 30, 2018) ("ANM, *et al.* Phase II Reply Comments").

it has achieved "adequate revenues" to meet its statutory obligations related to universal service.

Rather than assess the actual financial condition of the Postal Service in this docket, the Commission has *defined* the Postal Service into financial instability, and certain commenters have embraced this definition. The Commission recognizes the Postal Service has achieved "short-term financial stability," in that it can "meet its operational needs using mail revenue, unused borrowing authority, and accumulated cash reserves." Order No. 4257 at 161. But it nevertheless finds that Objective 5 has not been met because the Postal Service has not achieved "medium-term" or "long-term" financial stability, two categories the Commission has defined from thin air. *See* Order No. 4257 at 168-69 (finding "medium-term" stability was not met because the Postal Service reported net losses each year and lacked sufficient borrowing authority to cover the reported losses in most years), 171 (finding the Postal Service did not achieve "long-term" financial stability because it did not generate retained earnings even though "[t]he accumulated deficit of $59.1 billion includes $54.8 billion in expenses related to prefunding the RHBF").

Not only are the Commission's definitions of "medium-term" and "long-term" financial stability novel, but they would not support additional rate authority under any traditional rate regulation system because the "costs" the Postal Service seeks to recover are illusory. As ANM, MPA, and PostCom have explained since this docket opened, the negative net earnings reported by the Postal Service are largely an artifact of statutory prefunding requirements. *See, e.g.*, ANM, *et al.* Phase I

Comments at 37-39; *see also* Order No. 4257 at 171. Once those requirements are removed, the Postal Service has regularly shown positive operating income during the PAEA era. *See* ANM, *et al.* Phase I Comments at 38, Figure 9 (demonstrating, using data from Postal Service Form 10-k and USPS Annual Reports for Fiscal Years 2005-2015, that operating income absent "non-operating expenses" would have been positive in 6 of 11 years). A Postal Service official recently reported to the Board of Governors that if H.R. 2382, which would eliminate the prefunding requirements of 5 U.S.C. § 8909a, had been in effect over the past quarter, the Postal Service would be in nearly a break-even position. *See* Recording of Feb. 6, 2020 Board of Governors Open Session at 34:40 to 35:54 (Postal Service CFO Joseph Corbett explaining reported net loss would have been reduced from $1.1 billion to $0.1 billion if H.R. 2382 had been in effect during colloquy with Governor David Williams).[17]

Contrary to the Commission's treatment of them and the Public Representative's arguments (see Public Rep. Phase III Comments at 5-6, 19-20), these prefunding costs should not be recovered through price cap adjustment factors designed to account for "exogenous" costs. To the extent they are costs, they are not distinguishable from any other institutional costs faced by the Postal Service. Congress intended them to be recovered within the price cap, and they were built into the rate base from the outset. However, there is no need for the Postal Service to recover them at all.

[17] *Available at* https://about.usps.com/who/leadership/board-governors/briefings/welcome.htm (visited March 3, 2020).

As we have repeatedly explained, the Postal Service is in no danger of defaulting on its retirement obligations. Its retirement funds are better funded than those of other government and private entities and, even if it shut down tomorrow, it could meet its obligations to retirees for decades. *See* ANM, *et al.* Phase I Comments at 39-43. Furthermore, the Postal Service has suffered no penalty whatsoever for failing to make these prefunding payments. If the Postal Service were a private regulated utility, and it asked its regulator for additional rate authority to prefund an already well-funded retirement plan, its request would be summarily denied as an attempt to "gold plate" its retirement plan at the expense of ratepayers. *See, e.g.*, *Nat'l Rural Telecom Ass'n v. Federal Comm. Comm'n*, 988 F.2d 174, 178 (D.C. Cir. 1993) (discussing temptation toward "gold-plating" facilities under rate of return regulation since all costs, unless identified as imprudent, can be passed to ratepayers); *Indianapolis Airport Authority v. American Airlines, Inc.*, 733 F.2d 1262, 1268 (7th Cir. 1984) (finding airport fees unreasonable where fee imposed greatly exceeded cost of providing the service and where airport might use excess revenue for "'gold-plating' improvements). The Commission should take a similar approach to the Postal Service's prefunding payments here.

Overall, the current system of ratemaking has operated much as Congress expected it to and has appropriately balanced the objectives of the statute. Furthermore, it has allowed the Postal Service to remain financially stable and fund the provision of universal service through postage revenue. The price cap allows the Postal Service to recover its prudently incurred costs and provides it with the opportunity to achieve retained earnings. That is all that is required for financial stability, regardless of how the Commission has chosen to define the phrase.

IV. THE COMMISSION MUST RESPOND TO THE INITIAL COMMENTS BY WITHDRAWING THE PERFORMACE-BASED RATE AUTHORITY PROPOSAL

The initial comment period confirms that the Commission must rescind its performance-based supplemental rate authority proposal. Supported by Drs. Willig, Neels, and Powers, and by Mr. Fisher, we explained at length why this proposal should be withdrawn. *See* ANM, *et al.* Phase III Comments at 60-82.

We were not alone: the performance-based proposal was criticized or rejected by all major stakeholder groups who submitted comments during the initial comment round. Other associations and nonprofit organizations representing mailers and mail service providers rebuffed the proposal. *See, e.g.,* NPPC, *et al.* Phase III Comments at 51-72 (stating that the performance-based proposal "remains flawed" and "should not be adopted."). Labor union representatives, although supportive of efforts to award the Postal Service additional rate authority, similarly criticize the specific performance-based system proposed in Order No. 5337. *See* NPMHU Comments at p. 3 ("The NPMHU also urges the Commission to reconsider its revisions to the performance-based rate authority….").

The Public Representative "continues to object to the proposed performance-based rate authority" because it "remains backward-looking and directed at the symptoms of the Postal Service's problems instead of addressing the causes." Comments of Public Representative at p. 39. The Public Representative "believes that any analysis of the Postal Service's capital requirements should be forward-looking and based on the Postal Service's future capital investment needs." *Id.* at 41. The Public Representative's concerns align with our own, as we condemned the Commission's proposal as a "backward looking true-up" and noted that any such performance-based design should tie supplemental pricing authority to anticipated future needs. ANM, *et al.* Phase III Comments at 64-65 (citing Willig Decl. ¶ 30).

Finally, the Postal Service also finds that the performance-based proposal "is in need of further reform." USPS Comments at 29. Although the Postal Service's conclusion is correct, its analysis is unsound. Indeed, the Postal Service's initial comments confirm that the Commission cannot entrust it with additional pricing authority because the Service believes it is entitled to charge mailers higher prices without having to do *anything* to reduce its costs, increase its efficiency, or maintain its service standards as Objectives 1 and 3 require.

The Postal Service's initial comments make this apparent. It grouses that the Commission's proposal will make it harder for the Postal Service to *reduce* its service standards. *See* USPS Phase III Comments at 30 (complaining that "[b]asing any rate authority on maintenance of service standards sets an effective 'price' on reducing service standards."). This, despite Objective 3 requiring that the market-dominant ratemaking system "*maintain* high quality service standards" and Congress mandating that the Postal Service work with the Commission to design market-dominant service standards that "*enhance* the value of postal services to both senders and recipients" and "reasonably assure Postal Service customers delivery reliability, speed, and frequency *consistent with reasonable rates and best business practices*." 39

U.S.C. § 3691(b)(1)(A), (C) (emphasis added). Rather than champion a system designed to achieve these objectives, the Postal Service indicates its preference for a *laissez faire* approach with minimal Commission influence over the Postal Service's ability to lower its service standards. *See* USPS Phase III Comments at 30-31. Even "when the Postal Service has diminished service standards for a given mail class, [it] should be allowed to present a justification for receiving" the additional rate authority anyway. *Id.* at 43. This is precisely why the Postal Service's market-dominant business must remain tightly regulated, and the Commission must not countenance the Service's desire to become an unregulated monopolist. Left to its own devices, the Postal Service will continue to reduce service standards to its customers' detriment.

More drastically, the Postal Service asks that the Commission grant it additional performance-based rate authority *unconditionally* for a period of five years. USPS Phase III Comments at 32-38. Of course, if the Commission were to acquiesce to this request it would not be granting performance-based authority at all because the Postal Service would not have to "perform" anything to receive it. The Commission would be providing the Postal Service with an unearned five-year gift at mailers' expense while simultaneously teaching the Postal Service that any price cap regulation is chimerical.

The Postal Service's initial comments in this regard make clear that it has become wholly uninterested in even feigning interest in a system that achieves Objective 1. It writes that, "[f]or an incentive to work, the regulated entity must be aware of the incentive and capable of acting upon it," and that it would be "irrational" for the Commission to impose a rule that makes additional rate authority conditional on cost reduction and increased efficiency. USPS Phase III Comments at 32. Quite the opposite: it would be "irrational" for the Commission to grant above-CPI rate authority to a monopolist operator who admits its lack of understanding of incentive regulation. As Dr. Willig explained in our initial comments, "productivity improvements provide their own reward: after a percentage of the incremental revenue is shared with consumers, the remainder falls to the bottom line in the form of higher retained earnings." This "provides a strong incentive for the regulated entity to achieve improvements in productivity." ANM, *et al.* Phase III Comments at 61 (citing Willig Decl. ¶ 27).

For this reason, the Postal Service's argument that it must be provided with retained earnings before it can be expected to make productivity improvements must be rejected. *See* USPS Phase III Comments at 35. In reality, retained earnings *are the incentive* to improve productivity—if the Postal Service keeps its cost increases below inflation and limits volume losses by providing a valuable service, it will have the opportunity to achieve retained earnings. The price cap, in fact, is what *allows* retained earnings, unlike the break-even system under which the Postal Service operated prior to PAEA. Thus, while the Postal Service correctly characterizes the Commission's logic, which suggests that retained earnings must be provided to the Postal Service before one can expect it to realize productivity improvements, this discussion simply highlights how the Commission seems to misunderstand the incentives for efficiency provided by a price cap.

It is thus clear that the Postal Service's request for unconditional performance-based rate authority for five years must be soundly rejected. More generally, however, the initial comments to Order No. 5337 show that even commenters with widely divergent opinions uniformly agree that the Commission's performance-based proposal cannot stand and should not be enacted. The Commission would fail its obligation to engage in reasoned decisionmaking if it implemented its proposal in response to the initial round of public comments. *See Carlson v. PRC*, 938 F.3d 337, 351 (D.C. Cir. 2019).

V. CONCLUSION

The comments filed on Order No. 5337 only underscore the flaws in the Commission's proposals. Even the comments of those who support the proposals demonstrate that their primary concern is pursuing Objective 5, and then only as the Commission has erroneously defined medium- and long-term financial stability. A lawful system of regulation, however, must not only preserve the CPI-based price cap required by 39 U.S.C. § 3622(d)(1)(A), but it must achieve all of the objectives in concert. The regulatory systems proposed by the Commission, Postal Service, unions, and the Public Representative cannot do that. A CPI-based price cap can. The correct course of action is clear: withdraw the proposed supplemental rate authorities, reaffirm the price cap, and focus on those aspects of the proposed rule—such as revisions to workshare discounts—that will actually lead to a more efficient and successful Postal Service.

Respectfully submitted,

Eric S. Berman
VENABLE LLP
600 Massachusetts Avenue, N.W.
Washington DC 20001
(202) 344-4661
esberman@venable.com

Counsel for Alliance of Nonprofit Mailers and MPA–The Association of Magazine Media

Matthew D. Field
Ian D. Volner
VENABLE LLP
600 Massachusetts Avenue, N.W.
Washington DC 20001
(202) 344-8281
mfield@venable.com
idvolner@venable.com

Counsel for Association for Postal Commerce

Hamilton Davison
President & Executive Director
American Catalog Mailers Association, Inc.
PO Box 41211
Providence, RI 02940-1211
(800) 509-9514
hdavison@catalogmailers.org

Donna Tschiffely
Executive Director
Direct Marketing Association of Washington
11709 Bowman Green Drive
Reston, VA 20190
703-689-DMAW (3629)
donna@DMAW.org

Shannon McCracken
Chief Executive Officer
The Nonprofit Alliance
1319 F St NW, Suite 402
Washington, DC 20004
smccracken@tnpa.org

Maynard H. Benjamin
President and CEO
Envelope Manufacturers Association
700 S. Washington Street, Suite 260
Alexandria, VA 22314-1565
703-739-2200
mhbenjamin@envelope.org

Donna Hanbery
Executive Director
Saturation Mailers Coalition
33 South 6th Street, Suite 4160
Minneapolis, MN 55402
612-340-9350
hanbery@hnclaw.com

Jody Berenblatt
Executive Director
Continuity Shippers Association
180 Thompson St
New York, NY 10012-4910
(212) 677-3284
JodyBerenblatt@gmail.com

March 4, 2020