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UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Petition for Rulemaking　　　　Docket No. RM2022-5

PETITION FOR RULEMAKING OF THE ASSOCIATION FOR POSTAL COMMERCE AND ALLIANCE OF NONPROFIT MAILERS
(April 11, 2022)

When the Commission proposed its ratemaking rules in Order No. 5337, it "proposed to review the modified ratemaking system in its entirety after 5 years to assess the effects of the changes and the evolving economic trends affecting the mailing industry."[1] It further "added that if an unforeseen change occurred before the 5-year review period, the Commission would respond as necessary prior to the 5-year review."[2] Now that President Biden has signed the Postal Service Reform Act of 2022 into law, the Commission should make good on this promise and revisit its rules authorizing above-inflation price increases prior to the scheduled five-year review. Doing so not only keeps the Commission's promise, but is warranted by Congress' mandate to review the rate system ten years after PAEA's enactment "and as appropriate thereafter." It is appropriate now. The legislation undermines the basis for the Commission's findings in Order No. 4257 regarding the Postal Service's financial health—and thus the foundation for the rules authorizing additional rate authority promulgated by Order No. 5763—by radically reducing the Postal Service's accumulated deficit, eliminating significant institutional costs going forward, and thereby dramatically improving the Postal Service's medium- and long-term financial health. These legislative changes, combined with economic

[1] Order No. 5763 at 20 (citing Order No. 5337 at 243).
[2] Order No. 5763 at 20 (citing Order No. 5337 at 243).

conditions that are significantly different than those that obtained between 2006 and 2017, require a fresh look at the Commission's pricing regulations. Accordingly, the Association for Postal Commerce ("PostCom") and the Alliance of Nonprofit Mailers ("ANM") (collectively, "Petitioners") ask the Commission to open a rulemaking docket to assess how its rate authority regulations should be revised to reflect these changes.

I. THE PROBLEM HAS CHANGED; SO MUST THE SOLUTION

A. The Foundation of the Commission's Pricing Rules is Order No. 4257's Finding that Prefunding Requirements Prevented the Postal Service from Covering its Total Costs

Order No. 5763 was issued under the authority of 39 U.S.C. § 3622(d)(3), which authorizes the Commission to modify its ratemaking system or "adopt [an] alternative" ratemaking system to better meet the objectives of 39 U.S.C. § 3622(b) upon a finding that the existing ratemaking system "is not achieving the objectives in [39 U.S.C. § 3622(b)], taking into account the factors in [39 U.S.C. § 3622(c)]." The Commission reached the foundational conclusion that the existing system of ratemaking was not achieving the objectives in Order No. 4257. In that order, the Commission sorted the Objectives into three categories and examined whether the existing ratemaking system allowed the Postal Service to achieve them.

The Commission first found that the existing system had been "largely successful in achieving the goals related to the structure of the ratemaking system,"[3] which encompass Objectives 1, 2, 4, 6, and 8.[4] With respect to these Objectives, it noted only that the system had not increased pricing efficiency.[5]

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[3] Order No. 4257 at 145.
[4] Order No. 4257 at 142.
[5] Order No. 4257 at 146. The Commission's finding regarding pricing efficiency turned on the Postal Service's failure to set workshare discounts as close as practicable to their avoided costs. *Id.* at 145. The Commission addressed this deficiency through new rules governing workshare discounts in Order No. 5763. That action was appropriate, and we do not ask the Commission to revisit its workshare rules in this proceeding.

With respect to the second grouping, Financial Health, encompassing Objectives 1, 5, 7, 8, and 9,[6] the Commission found the existing system had allowed the Postal Service to achieve short-term financial stability, but not medium- and long-term financial stability.[7] The Commission explained that "[m]edium-term financial stability requires total revenue to cover total cost, both attributable and institutional."[8] The Postal Service had not met this objective because, in several years after PAEA was enacted, the Postal Service did not generate sufficient revenue to recover its total costs. As a result, Postal Service books showed an accumulated deficit, indicating it had not achieved long-term financial stability. The Commission explained that "[t]he accumulated deficit of $59.1 billion includes $54.8 billion in expenses related to prefunding the RHBF."[9] In other words, 92.7% of the accumulated deficit over 10 years resulted from requirements to prefund retirement obligations.[10]

Finally, the Commission found that the Postal Service had not achieved Objective 3 because service standards had declined during the PAEA era.[11] It then concluded that, "based on its review of the objectives of the PAEA, considering the factors . . . the system as a whole has not achieved the objectives of the PAEA."[12]

Since the Commission found the existing system had generally achieved the structural objectives, and its findings regarding service reflected only Objective 3, it is clear that this finding regarding the performance of the existing system turned primarily on the Financial

[6] Order No. 4257 at 247.
[7] Order No. 4257 at 247.
[8] Order No. 4257 at 248.
[9] Order 4257 at 171.
[10] Petitioners note that the Commission's statement in Order No. 4257 appears to conflate prefunding for the RHBF, FERS, and CSRS. In Order No. 5763, the Commission explained that of the $59.1 billion accumulated deficit, $47.2 billion was due to prefunding the RHBF; $4.8 billion due to CSRS; and $2.9 billion due to FERS. Order No. 5763 at 104. Together, these retirement benefit prefunding obligations constituted $54.9 billion of the $59.1 billion accumulated deficit.
[11] Order No. 4257 at 273.
[12] Order No. 4257 at 275.

Health of the Postal Service. That finding, in turn, was premised on the inability of the Postal Service to recover its total costs,[13] which was primarily the result of Congress artificially increasing the Postal Service's institutional costs by imposing prefunding requirements on the Postal Service for retirement benefits—in particular, obligations at the time of $47.2 billion for the RHBF.[14]

While the solutions the Commission ultimately crafted to address the Financial Health issues—the density and retirement adders that allow the Postal Service to increase rates above the rate of inflation—are ostensibly tied to particular cost drivers, their ultimate purpose is to help bridge the gap between Postal Service costs and revenues. If no such gap existed, the Commission could not have supported a finding that the existing system was not meeting the Objectives, and it would have lacked the authority to devise an alternative ratemaking system pursuant to § 3622(d)(3). However the Commission ultimately justified its solutions in Order No. 5763, their foundation lies in the Commission's findings in Order No. 4257.

B. The Findings of Order No. 4257 Regarding the Postal Service's Financial Health Are Obsolete

Whatever the merits of the Commission's findings in Order No. 4257 regarding the Postal Service's financial health, they are now obsolete. In Order No. 5763, the Commission acknowledged that "Congress certainly has the authority to act to address the retirement obligations of the Postal Service," which it described as the "primary driver of the Postal

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[13] The Commission also found that the system had not maximized incentives to achieve cost reductions, based on its conclusion that even though the Postal Service had made some cost reductions and efficiency gains, those had not been achieved at a greater rate than before PAEA and had not been "sufficient to contribute to the financial stability of the Postal Service." Order No. 4257 at 248. In other words, the cost reductions had not been sufficient to close the gap between total costs and total revenues. Thus, the "Financial Health" problem identified by the Commission remains one of a gap between total costs and total revenues.

[14] *See* Order No. 5763 at 104. As noted in footnote 10, *supra*, the Commission in Order No. 4257 conflated all the prefunding requirements when stating that "[t]he accumulated deficit of $59.1 billion includes $54.8 billion in expenses related to prefunding the RHBF." Order No. 4257 at 171. The correct figure for RHBF prefunding at the time of Order No. 4257 is $47.2 billion; that figure has since grown.

Service's ongoing losses."[15] Indeed, the Commission premised its authority to take action (*i.e.*, implement above-CPI retirement-based rate authority) on "the absence of Congressional action." But Congress has now acted. The Postal Service Reform Act has eliminated prefunding requirements for the RHBF and codified the *de facto* principle that the Postal Service need not make up prior missed payments. These actions radically reduce the accumulated deficit of the Postal Service and raise the question of whether additional rate authority is necessary for the Postal Service to achieve medium- or long-term stability, especially as the Act produces additional savings through Medicare integration and broader changes in the economy provide the Postal Service with additional revenue sources.

Section 102 of the Postal Service Reform Act eliminates the requirement in existing 5 U.S.C. §8909a that the Postal Service make prefunding payments into the Retiree Health Benefit Fund. It also states in § 102(c)(1) that "[a]ny payment required from the Postal Service under section 8909a of title 5, United States Code, as in effect on the day before the date of enactment of this Act that remains unpaid as of such date of enactment is canceled." This provision means that the $47.2 billion liability for the RHBF identified in Order Nos. 4257 and 5763 has been eliminated. If this provision had been enacted at the time of Order No. 4257, it would have reduced the Postal Service's accumulated deficit from $59.1 billion to $11.9 billion, a reduction of nearly 80%.

Perhaps more importantly, without the RHBF prefunding requirement in place, the Postal Service would have been within striking distance of breaking even between 2006 and 2015, despite the limitations of the CPI-U price cap, growing delivery points, and volume loss induced by the Great Recession and secular trends. As the Office of Inspector General explained in 2016,

[15] Order No. 5763 at 116.

the Postal Service would have broken even during this period "with 3.1 cents [per mail piece] in cost savings, or additional revenue or a combination of both. Of the 3.1 cents in Postal Service losses, 2.8 cents is due to Retiree Health Benefits."[16] That is, without the RHBF prefunding requirements, the Postal Service would only have had to reduce per-piece costs or increase per-piece revenue by 0.3 cents to achieve break even, and any improvement above that level would have resulted in sustained profitability. The OIG concluded that "[e]liminating retiree health benefits payments would have reduced the Postal Service's total losses by 90%."[17]

We cannot know, of course, what conclusion the Commission would have reached in Order No. 4257 if the Postal Service's total accumulated losses had been 90% lower than they were, or if it had been so close to break even on a year-by year basis, likely showing an operating profit in multiple years.[18] But even if the Commission had still found the pre-review system wanting, it could not have justified providing the Postal Service with rate authorities of 5.0562% above inflation[19] when the Postal Service would have been so close to break-even, or even profitable, under the CPI restriction.

Logically, the Commission also cannot justify continuing to provide that additional rate authority now that the Postal Service Reform Act has eliminated the RHBF prefunding requirement. The Postal Service reported total current liabilities of $87.329 billion in its FY2021 10-k against total assets of only $46.05 billion, reflecting a net deficit of $41.279 billion.[20] But

[16] OIG Report No. RARC-WP-16-009, *Peeling the Onion: The Real Cost of Mail* at 1 (April 18, 2016).
[17] *Id*.
[18] The National Association of Letter Carriers states that the RHBF prefunding requirement "accounted for 100 percent of losses from 2013 to 2018" and "USPS would have recorded surpluses of nearly $4.0 billion" during this period absent the requirement. *See* https://www.nalc.org/government-affairs/body/Postal-Service-Reform-Act-Fact-Sheet-1-1.pdf.
[19] *See* Order No. 861, Docket No. ACR2020, Determination of Available Market Dominant Rate Authority at 4, 6 (April 6, 2021).
[20] FY 2021 Annual Report of the United States Postal Service, Form 10-k, at 57, available at https://about.usps.com/what/financials/10k-reports/fy2021.pdf.

$56.975 billion of those liabilities are Retiree Health Benefits, which the Postal Service Reform Act eliminates.[21] The result is that Postal Service assets now exceed liabilities by $16.051 billion. The Postal Service further reported total past due unpaid obligations $71.6 billion.[22] Eliminating the $57 billion in unpaid Retiree Health Benefit obligations leaves only $14.6 billion, or the FERS and CSRS payments the Postal Service has not made.[23] The Postal Service could pay this full amount tomorrow and still have $9.3 billion in cash, a better cash position than it was in at the end of every fiscal year from FY2013 through FY2016.[24] The Commission must take notice of this radical transformation of the Postal Service's finances. The Postal Service is not in the same financial position it was in when the Commission issued Order No. 4257, and the findings about the Postal Service's financial health in that order can no longer support the above-CPI rate authority the Commission has granted it.

C. The Postal Service Reform Act Will Support Future Improvement of Postal Service Finances Rendering Above-CPI Rate Increases Unnecessary

The Postal Service Reform Act not only reduces the deficit associated with past prefunding payments, it eliminates RHBF prefunding payments going forward. As indicated in the Postal Service's March 14, 2022 filing to the Commission, the Act reduces the RHBF amortization obligation by $910 million in the upcoming year.[25] The Postal Service has

[21] *Id*.
[22] 1FY2021 0-k at 55.
[23] *See* FY 2021 10-k at 45, reporting $6.2 billion in unpaid FERS payments and $8.4 billion in unpaid CSRS payments.
[24] *See* FY 2017 Annual Report of the United States Postal Service, Form 10-k at 14, available at https://about.usps.com/who-we-are/financials/10k-reports/fy2017.pdf. The Postal Service held $23.9 billion of unrestricted cash and cash equivalents at the end of FY2021. *See* FY2021 10-k at 45.
[25] *See* March 14, 2022 Letter to Hon. Erica A. Barker, Secretary, Postal Regulatory Commission from Nabeel R. Cheema, Chief Counsel, Pricing & Product Support, USPS at 1 (indicating "[t]he Act would reduce the Postal Service's statutorily mandated amortization payments from approximately $4.17 billion to approximately $3.26 billion").

estimated that the elimination of this requirement will save it roughly $27 billion over 10 years,[26] a reduction in costs of $2.7 billion per year.

The Act also requires future Postal Service retirees to enroll in Medicare. This provision could save the Postal Service $22.6 billion over 10 years,[27] or $2.26 billion per year. Together, these provisions create nearly $5 billion per year in cost savings going forward without any action at all on the part of the Postal Service to reduce costs or improve efficiency. Those savings alone would offset the net loss the Postal Service reported in FY2021,[28] a year in which it mostly did not benefit from the additional rate authority provided by Order No. 5763. If the initiatives outlined in the Postal Service's Delivering for America Plan, including the reductions in service standards that have recently been implemented, achieve their intended cost savings, the Postal Service will be in even better position.

Recent experience also demonstrates that the Postal Service has been able to grow its cash holdings under the CPI restriction. The Postal Service reports cash holdings of $23.858 billion at the end of FY 2021, up from $14.358 billion at the end of FY 2020 and $8.795 billion at the end of FY 2019.[29] It has debt of only $11 billion, meaning it was able to pay off $3 billion in debt in FY 2021 while still increasing its cash holdings by $9.5 billion.[30] The Postal Service attributes this ability to grow its cash to defaults on its RHFB and pension payments.[31] Now that the RHFB payments can be effectively defaulted on forever, one can expect this trend to

[26] *See* House Committee on Oversight and Reform, Postal Service Reform Act of 2021 Fact Sheet, https://oversight.house.gov/sites/democrats.oversight.house.gov/files/Postal%20Service%20Reform%20Act%202-Pager%20-%20FINAL.pdf.

[27] *Id*.

[28] *See* FY 2021 10-k at 56 (reporting net loss of $4.930 billion). This figure does not account for the $10 billion contribution the Postal Service received from Congress to offset expenses associated with the COVID-19 pandemic.

[29] Docket No. ACR2021, Fiscal Year 2021 Performance Report and Fiscal Year 2022 Performance Plan at 24.

[30] *Id*.

[31] *See, e.g.,* Docket No. ACR2021, Reply Comments of the United States Postal Service at 8 (March 15, 2022).

continue, especially with the additional savings Medicare integration will create. And while the Postal Service's current cash position was buoyed by the $10 billion contribution provided by Congress in the CARES Act, that money was to offset higher-than-usual pandemic expenses, which should decrease as the pandemic winds down.

The Postal Service Reform Act has presented the Postal Service with the opportunity to build on the recent improvements in its financial position without unduly burdening mailers with excessive rate increases. But as long as the Postal Service has access to additional rate authority and maintains market power over its market dominant services, one can expect the Postal Service to use all the rate authority it has been provided. It falls to the Commission, as regulator, to reduce the available authority to reflect these changed conditions.

II. THE ABOVE-CPI RATE AUTHORITIES ARE INCONGRUENT WITH AND CANNOT ADAPT TO THE CHANGES CATALYZED BY THE POSTAL SERVICE REFORM ACT

Petitioners recognize the effort the Commission put forth in Order No. 5637 to tie the additional rate authorities it was creating to specific problems facing the Postal Service. While we may disagree with whether these authorities actually address the identified problems, we acknowledge that the density rate authority is intended to address the problem of covering the cost of serving increasing delivery points while market dominant volume is decreasing. The retirement authority is designed to help the Postal Service cover the amortization payments for retiree benefits calculated the Office of Personnel Management and reduce its unfunded liabilities. Petitioners further acknowledge that the Postal Service Reform Act of 2022 does not eliminate these problems. Delivery points will continue to grow, and market dominant volume could continue to decline, thus continuing growth in per-unit costs. The Postal Service is still required to make amortization payments for some retirement liabilities. But the fact that these problems still exist is not a sufficient justification to maintain these rate authorities now that the

Postal Service is in a far superior financial position than it was before passage of the Act. In fact, the changes created by the Act illustrate that these authorities are ill-equipped to adjust to the Postal Service's changing financial circumstances.

The first principal to recognize is that the costs these rate authorities are intended to address are institutional costs.[32] As PostCom pointed out in its ACR2021 comments, Postal Service cost coverages are healthy, and postal products as a whole—despite the existence of some noncompensatory products—are covering well above 100% of their attributable costs.[33] The Postal Service's net losses occur because the gap between the Postal Service's attributable costs and its total costs is larger than the revenue above attributable costs generated by postal products and services as a whole. That is, this revenue only covers part of the Postal Service's institutional costs.

In developing the density and retirement authorities, the Commission separated out some institutional costs from others and developed mechanisms to recover them. But if the Postal Service is generating enough revenue to recover its total costs, including all of its institutional costs, there is no need to separately recover specific costs. A cost is a cost and revenue is revenue; the Postal Service will be healthy financially so long as revenues exceed costs, regardless of the source of either.

As discussed above, the fundamental problem identified in Order No. 4257 was not increasing per-unit costs, but the inability of the Postal Service to recover its total costs, including both attributable and institutional costs. This distinction is important. Rising per-unit

[32] *See. e.g.*, Order No. 5763 at 105 (recognizing that amortization payments for retirement obligations are institutional costs).
[33] *See* Docket No. ACR2021, Comments of the Association for Postal Commerce at 8-10 (Jan. 31, 2022); *id.* at 9 (noting total Market Dominant cost coverage of 153.28%, Competitive cost coverage of 162.7%, and cost coverage for All Mail and Services of 156.9%).

costs are not a problem in and of themselves, and they are not a "driver" of any of the Postal Service's financial problems. Per-unit costs are simply mail volume divided by total costs. When they are rising, that is an indication that the Postal Service is experiencing declining volume, rising costs, or some combination of the two. The factors that drive volume loss and increasing costs are the "drivers" of the Postal Service's finances. A problem arises only if volume declines to the point where the total revenue the Postal Service receives from sales of its products and services is less than its total costs. The "problem" of rising per-unit costs can be addressed by increasing units (volume), decreasing costs, or increasing revenue. But importantly, cost decreases do not need to occur on a per-unit basis, nor must revenue increases be associated with per-unit rate increases (*i.e.*, increasing volume at the same rate or increasing rates enough to offset revenue loss from lower volumes). So long as total costs decrease or total revenues increase, the Postal Service's finances will improve.

The Postal Service Reform Act addresses one cause of rising per-unit costs by decreasing the total costs faced by the Postal Service. It reduces the RHBF amortization obligation, saving $27 billion over 10 years, and it requires future Postal Service retirees to enroll in Medicare, saving the Postal Service $22.6 billion over 10 years. This $5 billion reduction in annual costs will directly stem the rise in per-unit costs one would expect from current volume trends, and it will far outpace any cost increases caused by the addition of delivery points.

The Postal Service will also continue to benefit from revenue increases from competitive products. While these increases will have no impact on the per-unit costs of Market Dominant mail, that is of no importance to the Postal Service's financial health. The revenues from competitive products count just as much toward offsetting total costs as revenues from market dominant products. So long as competitive product revenues increase faster than the costs of

providing those products, these revenues will reduce any shortfall between total revenues and total costs and improve the financial health of the Postal Service. Indeed, we saw this dynamic play out during the pandemic, as the Postal Service was able to maintain its short-term financial stability despite a radical loss of market-dominant volume. Competitive revenue increased sufficiently to offset market-dominant revenue losses caused by declining volume.

The Postal Service has also received revenue from Congress--$10 billion—that offset its pandemic-related expenses. This revenue, just like competitive product revenue, improved the Postal Service's financial health by eliminating the gap between total revenues and total costs in FY 2021. Partially as a result, the Postal Service was able to increase its cash holdings by $9.5 billion and pay off debt of $3 billion, achieving the retained earnings that are indicative of financial health (even though the Postal Service did not reflect the influence of this cash infusion when reporting a net loss in FY 2021).

The additional rate authorities provided to the Postal Service in Order No. 5763 are ill-equipped to recognize these developments because they are not focused on matching total costs to total revenues. Instead, the retirement authority separates out one kind of institutional cost from all others and imposes a charge solely on market dominant products to recover it. The density authority focuses on the change in per-unit costs for market dominant products only, ignoring changes in the overall financial situation of the Postal Service and providing additional rate authority even when, as in FY2021, the Postal Service receives more revenue from all sources than the expenses it incurs. The additional density related rate authority for declining market dominant mail volumes that have been accelerated due to loosened service standards and the expectation of above inflation price increases perpetuates the mail volume declines and creates a downward spiral rather than acting as a solution.

In any case, the density and retirement authorities were developed in an environment in which Postal Service institutional costs were higher and were projected to continue to be higher than they will be now that the Postal Service Reform Act has passed. The Commission should revisit the need for these authorities in light of this legislation, recent capital contributions from Congress, and continued increases in contribution from competitive products. There is no need for these additional rate authorities when the Postal Service can now recover its total costs with the revenue generated by CPI-based increases (which, it should be noted, will generate significantly more revenue than they did between 2006 and 2020) and competitive products.

Nor does the Postal Service need to raise additional revenue for capital expenditures when it is sitting on $23 billion of cash and has access to billions in additional borrowing authority. Rather, it should put its liquidity to use, investing in efficiency improvements, improving service, attempting to grow volume, and creating even brighter prospects for its financial future. The Commission's regulations should encourage these investments by limiting the Postal Service's ability to continue to grow cash without making these efforts. But so long as the density authority automatically rewards the Postal Service with additional rate authority whenever volume declines, these incentives will be perverted. With the rationale of closing the gap between revenues and total costs no longer supporting the density authority, it must be eliminated.

III. <u>CONCLUSION</u>

With the passage of the Postal Service Reform Act, the Postal Service is now well-positioned to continue to improve its financial position without saddling mailers with rate increases exceeding historically high levels of inflation. The Act eliminates the bulk of the Postal Service's accumulated deficit, frees it from past obligations, and significantly reduces institutional costs going forward. Moreover, it remedies the conditions on which the

Commission relied when finding the CPI-limited rate system did not achieve the objectives of PAEA. The Commission has a duty to revisit its regulations authorizing above-CPI rate increases in light of these changes and should immediately open a rulemaking docket to do so.

Respectfully submitted,

/s/ Matthew D. Field

Matthew D. Field
Ian D. Volner

VENABLE LLP
600 Massachusetts Ave., NW
Washington, DC 20001
(202) 344-8281
mfield@venable.com
idvolner@venable.com
Counsel for Association for Postal Commerce

Eric S. Berman
VENABLE LLP
600 Massachusetts Ave., NW
Washington, DC 20001
(202) 344-4661
esberman@venable.com
Counsel for Alliance of Nonprofit Mailers