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Washington, DC 20268-0001

Annual Compliance Report, 2009 Docket No. ACR2009

COMMENTS OF THE GREETING CARD ASSOCIATION

The Greeting Card Association (GCA) files these comments pursuant to the Commission's Notice of Public Forum and Opportunity to Comment (January 20, 2010). The Notice invited comments on the Postal Service's January 29, 2010, response to Commission Information Request No. 1 and on "alternate means for achieving financial stability under the PAEA."

Earlier in this Docket, the Public Representative moved for production of estimates of the rate adjustments necessary to cure the Postal Service's deficits. The Commission denied the motion, essentially because the data it asked for were found inessential for purposes of the proceeding. GCA filed an opposition to the motion, presenting, inter alia, our view that its apparently exclusive focus on rate changes was inappropriate.[1] GCA adheres to the views expressed in that pleading and respectfully requests the Commission to consider them in connection with these Comments.

I. The Postal Service's response to CIR No. 1

Referring to standard public sources of information on its financial planning, including the Integrated Financial Plan and the 10-K report lodged with the Commission within the last few months, the Postal Service emphasizes the environment in which it is now operating at least as heavily as the steps it has taken.

[1] Reply of the Greeting Card Association to Motion of the Public Representative for Production of Estimates of Rate Adjustments (December 23, 2009) ("GCA Reply").

Its response might be said to urge that in the present compliance review proceeding, external limitations are at least as important as its own activities. Its position, briefly, is that its rate policies in FY 2009 "were as consistent with the objectives of 39 U.S.C. § 3622(b)(5) as circumstances allowed them to be."[2]

"Financial stability" – and, for that matter, "adequate revenues" as the term is used in § 3622(b)(5) – have both cost and income aspects. The specific external limitations the Service faces, in general, are causing significant increases (or preventing significant reductions) in its costs. The unrealistic statutory schedule for prefunding retiree health care is perhaps the clearest example, but political hindrance to closing unneeded facilities is another.[3] These are not cost problems that can be solved by raising rates, even if in the short run higher rates were to reduce the gap between income and outlays. They require a consensus among postal stakeholders sufficient to solve the problems, whether by legislation or otherwise.

On the income side, "adequate revenues" are a function of both rate levels and volume. Volume has suffered from the recession and, more gradually, from Internet diversion of transactional mail. Volumes lost to the recession will probably be recovered in substantial part; Internet losses probably will not. Neither problem is likely to be cured by higher rates in FY 2010, for reasons the Service has described.[4] We should note, in this connection, that there is no indication that the Postal Service's FY 2010 finances are currently worsening. Through the latest preliminary monthly data, the Service is running slightly better than plan in operating costs (-0.1 percent through November) and distinctly ahead of plan in

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[2] Response of the United States Postal Service to Commission Information Request No. 1, p. [3] ("Postal Service Response").

[3] Some stakeholders – though definitely *not* GCA – would add the required maintenance of six-day delivery.

[4] Ibid.

revenue (+3.4 percent through November). Forecasting errors for mail volumes as 2010 unfolds could be overly pessimistic as easily as overly optimistic.

II. Achieving financial stability under PAEA

A. <u>Framing the issue</u>. The Commission has made clear its view that "financial stability" is not a completely open-ended concept. CIR No. 1 asks for

> . . . the Postal Service's current plans to achieve financial stability in FY 2010 and beyond under the Postal Accountability and Enhancement Act (PAEA) *to enable it to meet its principal responsibilities, including to bind the Nation together and to provide prompt, reliable, and efficient services to patrons in all areas.* See 39 U.S.C. § 101(a).[[5]]

GCA agrees with this formulation. Financial stability is necessary not merely so that the Postal Service may continue, in some form or another, as a going concern, but so that it may go on providing the public services which have been its *raison d'être* at least since the Postal Reorganization Act of 1970.

More specifically, the Commission's framing of the issue harmonizes with the standard that would have to be applied in the (hypothetical) event of a rate adjustment initiative by the Service. In the current state of the general economy[6], such an initiative seemingly would have to be based on § 3622(d)(1)(E). An exigency increase may be approved under that provision only if it is

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

[5] CIR No. 1, p. 2 (italics added).

[6] The most recent 12-months' change in the CPI-U, as reported by the Commission, is – 0.356 percent. This clearly rules out a normal price-cap increase.

Before turning to substantive questions, we should make clear that these Comments focus on the *global* question of financial stability and what can or cannot properly be done under § 3653 to promote it. That is the reason for our concentration on § 3622(b)(5). As some of the comments filed on February 1 indicate, other rate level or rate design issues, of a more localized nature, may arise in this proceeding; some of them may well involve apparently inadequate revenues from a particular product or subgroup of products. GCA expects to contribute to one or more of these debates in reply comments on February 16. Our present focus on the question of overall financial stability does not imply a view that the Commission should not correct any noncompliance it may find after developing a sufficient factual basis for doing so.

B. <u>Interpreting the "financial stability" objective</u>. As CIR No. 1 makes clear, the concept of "financial stability" centers on 39 U.S.C. § 3622(b)(5), which makes it one of the objectives of the new system of regulation "[t]o assure adequate revenues, including retained earnings, to maintain financial stability." As the Postal Service points out, this directive applies not directly to rates, but to the mechanisms by which rates are to be set.[7] This means, in GCA's view, that if at a given point in time the Postal Service's financial stability is at risk, (i) the remedial mechanisms include all those available under the new system of regulation, and (ii) the facts governing the use of such mechanisms include all those of which that system could be expected to take account, *whether or not subject to action by the regulator.* Thus the revenue adequacy called for by subsection (b)(5) is a contributor – along with other, non-rate-related factors – to the ultimate goal of stability. "Financial stability," in other words, is not identical with "adequate revenues"; and so rate levels are not the only parameter to be considered when the Commission acts to shore up financial stability.[8]

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[7] Postal Service Response, pp. [2-3]. The Service says that this fact makes it "difficult to evaluate compliance by the Postal Service in any particular year." This is both true and relevant, but the issue raised by the structural role of § 3622(b)(5) is in fact somewhat broader.

[8] At the most elementary level, "revenues" implicates volumes as well as rate levels; actions taken by the postal agencies to encourage more use of the mails contribute to revenue adequacy

The Postal Service has identified a number of external factors causing its present difficulties, and we have nothing to add to that list.[9] The point we would make regarding them is that they are not compliance issues within the meaning of 39 U.S.C. § 3653.

The most relevant provision is § 3653(b)(1):

> (1) whether any rates or fees in effect during such year (for products individually or collectively) were not in compliance with applicable provisions of this chapter (or regulations promulgated thereunder)[.]

That total revenues may fail to equal total costs because of exogenous costs imposed by other legislation[10] does not necessarily mean that current rates are responsible for a noncompliance with § 3622(b)(5). The appropriate course is to address the reasons for the revenue inadequacy, identifying any that do seem to be caused by rate levels (or rate structure), and restricting compliance review actions to the latter.

C. <u>The time factor</u>. The Postal Service's point that assessing compliance with § 3622(b)(5) "in any particular year" is difficult is relevant here as well. Section 3653 calls for an annual process focused retrospectively on compliance dur-

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even if rates are unchanged. Conversely, rate levels that drive away volume are likely to interfere with, rather than promote, revenue adequacy. GCA, for reasons developed in our Reply to the Public Representative, continues to believe that an exclusive focus on rate levels is a mistaken and probably counterproductive approach to the current financial stability problem.

[9] See particularly the Service's Form 10-K, pp. 6 et seq. Indeed, GCA would prefer to *subtract* from the list of problems the requirement that six-day delivery be maintained, since we believe that in the long run reduction of delivery service would do the Postal Service more harm than good. In any event, as the Service points out (Postal Service Form 10-K, p. 7), any actual savings from a delivery reduction probably would not occur until FY 2011.

[10] Thus, to use the example the Postal Service has particularly stressed, the retiree health benefit prefunding schedule is established by 5 U.S.C. § 8909a. We do not mean to imply that the Commission could *never* use § 3653 to remedy a systemwide revenue deficiency demonstrably due to universally inadequate rates: the phrase "for products individually or collectively" suggests that it may well have that power. The present point is rather that it would be inappropriate to use such authority to remedy financial problems which have not resulted from excessively low rates.

ing the year just completed. It does not follow from this structure that restoration of financial stability is likely, or even possible, within a year's time.[11] Since that restoration – including achievement of the "adequate revenues" which are a necessary element of it – is likely to be a multi-year process, it is difficult to see how it could be assessed as a compliance issue in the context of a single past year. At most, perhaps, the past year's rates could be examined in light of what seem to be the most plausible plans or expectations for upcoming volumes, costs, and rate adjustments – perhaps over several future years.[12]

That financial stability is not a "test year" concept is evident from the history of ratemaking techniques under the 1970 PRA. In Docket R76-1 the Postal Service proposed, and the Commission approved, a revenue-requirement element for prior years' loss recovery. The proposal entailed recovery of some $1.45 billion – most of it represented by operating debt – over a period of seven years, in order to bring the Service into compliance with the breakeven standard of former § 3621. The Commission read the PRA as permitting this technique, given its structural distinctions from the customary "*Galveston* rule" against past loss recovery in utility ratemaking.[13] The mechanism was later judicially approved.[14]

[11] The Commission rightly recognized this when it asked for the Service's plans to achieve stability "in FY 2010 and beyond." CIR No. 1, p. 2.

[12] In this connection, some observations may be in order concerning the criticism, expressed particularly by the Public Representative (Public Representative Comments on Annual Compliance Report 2009, pp. 5 et seq.), that the Service has run operating deficits for several years. This criticism may implicitly assume that financial stability *is* a "single-year" concept and that, accordingly, it is especially reprehensible to record deficits for successive years. Such a view might be persuasive in a setting like that of the 1970 Act, where rates were legally required to recover costs "as nearly as practicable" (former 39 U.S.C. § 3621), and, in practice, rate cycles tended to progress predictably from surplus to approximate breakeven to deficit (precipitating a further § 3622 filing). With the looser "financial stability" standard of PAEA, together with a system of ratemaking no longer based on the idea of full cost recovery (assessed using a test year), it is much less cogent.

[13] PRC Op. R76-1, pp. 25-51. Later the recovery period was extended from seven to nine years. That the Commission later came to believe that the prior years' loss recovery device was not working as expected (see the Joint Concurring Opinion of Chairman Haley, Vice-Chairman Folsom, and Commissioners Crutcher, Le Blanc, and Tyson *in* PRC Op. R90-1) does not invalidate the analysis leading to its initial approval.

The breakeven rule of the 1970 Act was certainly no less strict than § 3622(b)(5), and might well be viewed as stricter[15], and yet the Commission and the Court of Appeals had little difficulty in seeing that achieving compliance with it over a relatively extended period was appropriate. Thus, achieving breakeven for the Postal Service through two consecutive across-the-board increases of 3.1 percent or more, in 2010 and 2011[16] presupposes that the causes of the imbalance are such that they can or must be redressed by an immediate fly-up in rates – rather than, for example, causal factors that in the past, under the 1970 PRA, were curable by regular revenue increments over an extended period.

It seems to follow from this that fulfillment of the mandate of § 3622(b)(5) requires the ratemaking system of which it is an objective to use the most effective path to financial stability, even if that path requires several years. In a recessionary economy, with many Postal Service products heavily dependent on general economic activity, and with a long-term trend toward Internet substitution which can only be accelerated by rapid rate increases, it seems clear that (what appears to be) the quickest fix may be the *least* effective.

The benefit from exploring the issue the Commission has raised in CIR No. 1, accordingly, is the opportunity to evaluate the Postal Service's plans for restoring financial stability, as they developed during FY 2009. This evaluation, therefore, needs to cover not only rate levels but also costs and cost reduction programs, the effectiveness vel non of rate designs (including, particularly, incen-

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[14] *National Association of Greeting Card Publishers* v. *U.S. Postal Service,* 607 F.2d 392 (D.C. Cir., 1979), *cert. denied,* 444 U.S. 1025 (1980).

[15] For example, former § 3621 required that "[p]ostal rates and fees shall provide sufficient revenues so that total estimated income and appropriations will equal as nearly as practicable total estimated costs of the Postal Service." Section 3622(b)(5) instead uses the more flexible criterion of financial stability.

[16] As suggested by the Public Representative. See Public Representative Comments, pp. 26 et seq...

tive rates[17]), efforts to retain existing and encourage new mail volume, and initiatives looking to needed structural changes in PAEA.

D. Ratemaking standards of PAEA. What follows in this section is hypothetical in character, but the breadth of the Commission's invitation for comments suggests that it is not out of place.

If, hypothetically, the Commission were to decide, after the sort of analysis suggested above, that an adjustment in rates was indeed necessary to put the Postal Service in compliance with the requirements of ch. 36, further problems would have to be addressed. Because in a § 3622(d)(1)(E) case the normal CPI-based revenue per class limitation does not apply, the Commission would face ratemaking problems among classes and subclasses somewhat like those found in rate cases under the PRA – but with only 90 days to render a decision.[18]

Initially, we re-emphasize a point made in responding to the Public Representative: while the Postal Service's deficits may, as a policy matter, be the overriding issue today, it does not follow that the adequate-revenue standard of § 3622(b)(5) trumps the other objectives expressed in that section.[19] The requirement of § 3622(b) that each objective be applied in conjunction with the others still governs.

For example, any rate adjustment ordered in reliance on a finding that the existing rates actually violated § 3622(b)(5) would also have to obey subsection (b)(2), calling for "predictability and stability in rates." The Commission would have to consider the current environment of continuing economic disruption, as well as the expectations created by the Postal Service's announcement of last

[17] This area has two significant aspects: (i) are the existing incentives no longer successfully eliciting either the expected worksharing activity or additional volume? and (ii) are they larger than needed to achieve those objectives (and thus a needless drain on revenues)?

[18] 39 CFR § 3001.66.

[19] See GCA Reply, p. 7.

October 15 that rates would not change in 2010. Mailers and other postal stakeholders have already made binding financial decisions for 2010 based on the Postmaster General's unequivocal statement that market-dominant rates would not change from their 2009 levels. At best, the necessity to arrive at a reasonable accommodation between predictability and stability, on one hand, and revenue enhancement, on the other, could limit severely the amount of deficit relief available.

This problem is further complicated by the size of the expected 2010 deficit. Remedying even a substantial part of that shortfall by means of an exigency rate adjustment could entail an unusually large increase. If, for example, it were determined that just half the $7.8 billion deficit should be recovered through new rates, the increase would be about 5.7 percent.[20] Apart from its predictably depressing effect on mail volume, in a still-weak economy, the size of the potential increase raises questions about the relative response of particular mail categories. Would recently-calculated price elasticity estimates, never subjected to independent analysis and Commission review, be reliable in the context of such a change? Would the size of the increase, in combination with exogenous factors like the continuing decline in the cost of broadband service, accelerate volume-loss trends that are already recognized?

III. Conclusions

To summarize: GCA would urge the Commission, first, to recognize that restoring the Postal Service's financial stability will be a multi-year process that cannot be compressed into a single year's compliance review, even if the Service has run operating deficits for the past few years. It involves recognition, and solution, of problems imposed on the Postal Service from outside, causing structural deficits – problems resulting not from its rate levels but from legislative and

[20] FY 2009 revenue from mail and services was $67.9 billion; $7.8 billion x 0.5 = $3.9 billion, or 5.74 percent – substantially larger than any CPI-based increase under PAEA.

other external constraints on its ability to manage its finances and its network efficiently. The adequate-revenue standard of § 3622(b)(5) does not predominate over the other ratemaking objectives of PAEA, and, in particular, does not call for exclusive concentration on revenue from rates as a solution for the Service's volume losses and inescapably expanding delivery network costs. Examination of FY 2009 rates in this proceeding should, instead, focus on areas where it can be clearly shown that deficiencies in design or rate level are contributing to the Postal Service's financial troubles.

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Respectfully submitted,

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