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Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Rate Adjustment Due to Extraordinary or Exceptional Circumstances

Docket No. R2010-4

PUBLIC REPRESENTATIVE COMMENTS IN RESPONSE TO THE EXIGENT REQUEST OF THE UNITED STATES POSTAL SERVICE

(August 17, 2010)

Respectfully submitted,

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I. INTRODUCTION AND SUMMARY

A. Introduction

On July 6, 2010, the United States Postal Service (Postal Service) filed a request with the Postal Regulatory Commission (Commission) for authorization to increase rates for market dominant products, which exceed the otherwise applicable limitations allowed by 39 U.S.C. § 3622(d)(1)(A) and 39 CFR § 3010.11.[1] The Postal Service filed this Request pursuant to 39 U.S.C. § 3622(d)(1)(E) and 39 CFR § 3010.60 *et seq.,* the provisions of the United States Code and the Commission's Rules of Practice and Procedure applicable to rate adjustments in "exigent" circumstances. The Public Representative respectfully submits the following comments addressing the issues raised by the Postal Service's Request as permitted by Order No. 485.[2]

[1] Exigent Request of the United States Postal Service, July 6, 2010 (Request).

[2] Notice and Order Concerning Rate Adjustment for Extraordinary or Exceptional Circumstances, July 8, 2010 (Order No. 485).

B. Summary

The Public Representative's comments address the sufficiency of the justification for an exigent rate increase (Section III), the adequacy of the justification for increases in the amounts requested by the Postal Service (Section IV), and whether the specific rate adjustments are reasonable and equitable (Section V). *See* 39 CFR § 3010.65(f).

Section III, Exigency Analysis. The Public Representative believes that the Postal Service has not adequately justified its exigent Request, but leaves open the possibility that in the future the Postal Service may be able to provide adequate justification based upon the effects of the current economic downturn. A four part framework is developed for analytical purposes in reaching this conclusion. The roles of the Postal Service and the Commission are discussed in terms of the responsibility for deciding the sufficiency of either extraordinary or exceptional circumstances, with the conclusion that each organization has a role in making this determination. The Public Representative also is skeptical of the causes of mail volume decline, and urges that if the Commission approves this exigent request, it does so only to the extent that volume declines relate to the exigency.

Section IV, Revenue Analysis. The Public Representative believes it is a major deficiency of the Request not to have been based upon a revenue requirement directed at achieving a particular goal (other than addressing the pending liquidity problem). Regardless, the revenue that is derived from the Request will result in short-term liquidity relief, but is insufficient by itself to ensure the long-term financial recovery of the Postal Service. Without intervention by Congress, this insufficiency may force the Postal Service to seek additional funding by filing a second exigent rate request before the end of FY 2011.

Section V, Rate Analysis. The Public Representative concludes that for the most part the Postal Service has proposed rates that are reasonable and equitable. There is no indication that the proposed rates will have an adverse impact on the general public.

Workshare discounts and cost coverages are reviewed in light of the Commission's most recent Annual Compliance Determination. Generally, the Public Representative believes that the Postal Service has taken the Commission's comments into consideration. Regardless, the Public Representative opposes rates for any product that do not cover attributable costs at a time when the Postal Service is experiencing financial difficulties. Finally, the Public Representative reviewed several classification changes proposed by the Postal Service. On principle, the Public Representative does not oppose classification changes that are directly related to resolution of an exigency, but believes unrelated classification changes such as the Reply Ride Free and the Saturation and High Density programs are inappropriate for consideration within this docket and should be reviewed separately.

II. THE RECORD AND STATUTORY CONSIDERATIONS

A. Record Overview

On July 6, 2010, the Postal Service filed Exigent Request of the United States Postal Service (Request). The Postal Service filed three statements and nine library references in support of its Request. The following statements were filed:

- Statement of Joseph Corbett on Behalf of the United States Postal Service, July 6, 2010 (Corbett Statement);
- Statement of James M. Kiefer on Behalf of the United States Postal Service, July 6, 2010 (Kiefer Statement); and
- Statement of Stephen J. Masse on Behalf of the United States Postal Service, July 6, 2010 (Masse Statement).

The following library references also were filed on July 6, 2010:

- USPS-R2010-4/1 - First-Class Mail Worksheets;
- USPS-R2010-4/2 - Standard Mail Worksheets;
- USPS-R2010-4/3 - Periodicals Worksheets;
- USPS-R2010-4/4 - Package Services Worksheets;
- USPS-R2010-4/5 - Special Services Worksheets;
- USPS-R2010-4/6 - Product Cost & Contribution Estimation Model (Public Version), USPS-R2010-4/NP1 - Product Cost & Contribution Estimation Model (Non-Public Version) (Under Seal);
- USPS-R2010-4/7 - Cost Factor Development (Public Version), USPS-R2010-4/NP2 - Cost Factor Development (Non-Public Version) (Under Seal);
- USPS-R2010-4/8 - Revenue and Volume Forecast Materials (Public Version), USPS-R2010-4/NP3 - Revenue and Volume Forecast Materials (Non-Public Version) (Under Seal); and
- USPS-R2010-4/9 - Operations Plans for Flats (Public Version).

The above materials were updated as necessary throughout the course of the proceeding.

The Presiding Officer posed four Presiding Officer Information Requests to the Postal Service dated: July 14, 2010; July 20, 2010; August 3, 2010; and August 5, 2010. The Postal Service provided responses to these requests in the form of written responses and additional library references.

Finally, public hearings convened in the Commission's hearing room on August 10–12, 2010. Messrs. Corbett, Kiefer, Masse, and Neri on behalf of the Postal Service answered questions posed by the Commissioners of the Postal Regulatory Commission.

Although not part of the record of this proceeding, the Commission also sponsored three technical conferences. The topics of the technical conferences were as follows:

- Cost, volume, and revenue forecasts presented by Mr. Masse, July 19, 2010;
- Pricing, including workshare discounts, July 23, 2010; and
- Periodicals, other flats products and the "flats strategy," July 27, 2010.

B. Statutory Considerations

1. United States Code Provisions

Title 39, section 3622, enables the development of modern rate regulation applicable to all Postal Service market dominant products. This section authorizes the Commission to establish "a modern system for regulating rates and classes for market-dominant products." 39 U.S.C. § 3622(a). It specifies "objectives" (39 U.S.C. § 3622(b)) and "factors" (39 U.S.C. § 3622(c)) that must be considered as part of the regulatory system. Finally, it specifies "requirements" that must be incorporated into the regulatory system. 39 U.S.C. § 3622(d).[3]

Two requirements are directly applicable to the Postal Service's exigent Request. The first requirement establishes an annual limitation on rate adjustments equal to the Consumer Price Index for All Urban Consumers (CPI-U).

> (1) In general. - The system for regulating rates and classes for market-dominant products shall - (A) include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index for All Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates;

39 U.S.C. § 3622(d)(1)(A). This requirement establishes limitations for rate-setting under typical business conditions.

The second requirement establishes an exception to the above limitation. Its purpose is to allow rate adjustments in excess of CPI-U under limited, atypical circumstances.

> (E) notwithstanding any limitation set under subparagraphs (A) and (C), and provided there is not sufficient unused rate authority under paragraph (2)(C), establish procedures whereby rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances, provided that the Commission determines, after notice and opportunity for a public hearing and comment, and within 90 days after any request by the Postal Service, that such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

39 U.S.C. § 3622(d)(1)(E).

[3] Additional provisions are included concerning "workshare discounts" (39 U.S.C. § 3622(e)) and transitioning from the previous regulatory system to the new system (39 U.S.C. § 3622(f)).

2. Code of Federal Regulations Provisions

The Commission developed implementation rules encompassing 39 U.S.C. § 3622(d)(1)(E). These rules appear in the Commission's Rules of Practice and Procedure appearing at 39 CFR § part 3010, subpart A, General Provisions, and subpart E, Rules for Rate Adjustments in Exigent Circumstances (Type 3 Rate Adjustments). Specific rules applicable to exigent requests address: Applicability (3010.60); Contents of exigent requests (3010.61); Supplemental information (3010.62); Treatment of unused rate adjustment authority (3010.63); Expeditious treatment of exigent requests (3010.64); Special procedures applicable to exigent requests (3010.65); and Deadline for Commission decision (3010.66).

The Public Representative files its comments pursuant to Order No. 485 and 39 CFR § 3010.65(f).

> (f) Following the conclusion of the public hearings and submission of any supplementary materials interested persons will be given the opportunity to submit written comments on:
>
> (1) The sufficiency of the justification for an exigent rate increase;
>
> (2) The adequacy of the justification for increases in the amounts requested by the Postal Service; and
>
> (3) Whether the specific rate adjustments requested are reasonable and equitable.

The Public Representative is permitted to file reply comments pursuant to Order No. 485 and 39 CFR § 3010.65(g).

> (g) An opportunity to submit written reply comments will be given to the Postal Service and other interested persons.

III. EXIGENCY ANALYSIS

A. Introduction

The Code of Federal Regulations, 39 CFR § 3010.65(f)(1), permits comments that address "[t]he sufficiency of the justification for an exigent rate increase." The comments that follow address whether the Postal Service presents either extraordinary or exceptional circumstances that adequately justify its exigent request.

Three specific topics are covered. The first topic concerns the role of the Postal Service and the Commission when deciding what are or are not extraordinary or exceptional circumstances. The Public Representative believes that this is a joint responsibility that requires an initial decision by the Postal Service and a confirmation by the Commission.

The second topic presents a framework for the Commission to use to determine whether the Postal Service has presented either extraordinary or exceptional circumstances that are adequate to justify an exigent request. Utilizing this framework, the Public Representative believes that the Postal Service has failed to justify its exigent request, but leaves open the possibility for the Postal Service to adequately justify a future request based upon the extraordinary or exceptional circumstances cited in this docket.

The third topic questions the source of current mail volume declines. The Postal Service's Request relies heavily on the severe economic downturn. The Postal Service in other forums relies heavily on both the severe economic downturn and on electronic diversion. Other causes also are possible. The Public Representative believes that the Commission should attempt to analyze the effects of each cause, and only approve an exigent request to the extent that the underlying cause is due to either the extraordinary or exceptional circumstance, and not to the extent that the underlying cause is due to "normal" business cycles.

B. Either Extraordinary or Exceptional Circumstances

The requirement that establishes an exception to the CPI-U rate cap limitation, 39 U.S.C. § 3622(d)(1)(E), contains many provisions, all of which are applicable to the instant proceeding. The Public Representative would like to focus on only one phase at this time, “either extraordinary or exceptional circumstances.”

The importance of “either extraordinary or exceptional circumstances” is in establishing the bar that must be surpassed to trigger and justify an exigent rate request. Two immediate issues arise when considering this phase: (1) what circumstances qualify as extraordinary or exceptional; and (2) who makes the determination that a circumstance is in fact extraordinary or exceptional?

The Public Representative believes that the first issue, what circumstances qualify as extraordinary or exceptional, is a fact-based question that necessarily involves judgment. The judgment should be made while comparing the purpose and intent of the CPI-U rate cap provisions of the PAEA with the exigent provisions of the PAEA. The proffered circumstance should in fact be out of the ordinary or atypical in nature when compared against events occurring in the normal course of business.

The circumstance should be evaluated to ensure that the proffered circumstance in fact has an effect on the Postal Service, and that the effect is in some way significant in magnitude and/or duration such that the Postal Service would normally not be expected to absorb the consequences of the circumstance. Otherwise, the circumstance would not be extraordinary or exceptional within the meaning of the statute.

Finally, the Public Representative believes it is critical to look at the Postal Service’s overall Request for indications that differentiate a business-as-usual rate request from an appropriately filed exigent request. For example, there should be substantial indications that the Request filed by the Postal Service addresses the effects of the exigency, and is not merely an attempt to circumvent the CPI-U rate cap provisions. Further discussion of this point appears in Section III.C of these comments.

The Public Representative believes that the second issue, who makes the determination that a circumstance is in fact extraordinary or exceptional, is a responsibility shared both by the Postal Service and the Commission.

The Public Representative strongly disagrees with the Postal Service's inference that the Postal Service Governors are solely responsible for this determination, and that this is not something the Commission needs to determine.[4] This interpretation would effectively write the "either extraordinary or exceptional circumstances" provision out of the statute. It denies the rate cap protection that mailers deserve and expect, by allowing the Postal Service to set the bar at any level when determining extraordinary or exceptional circumstances. There would be few if any effective checks or balances against potential abuse of the Postal Service's discretion. This interpretation would provide the Postal Service with an unfettered ability to set rates at any level.

The Postal Service's argument also implies that the Commission's only duty is to determine whether an exigent rate adjustment is "reasonable and equitable and necessary" while putting aside the "either extraordinary or exceptional circumstances" issue. *Id.* Contrary to what the Postal Service implies, the Public Representative believes that the application of a "reasonable and equitable and necessary" standard cannot be divorced from consideration of the "either extraordinary or exceptional circumstances." In the context of an exigent request, there must be a connection between the circumstance and the funding request in order to meet the "reasonable and equitable and necessary" standard.

The Public Representative believes that the proper application of "either extraordinary or exceptional circumstances" requires the Postal Service to make an initial determination of either extraordinary or exceptional circumstances. This is

[4] Response of the United States Postal Service to Motion of the Affordable Mail Alliance to Dismiss Request, August 2, 2010, at 10-11 (Postal Service Response to AMA Motion).

necessary to trigger the Postal Service's preparation and filing of an exigent request. The Commission then must concur with that determination. The concurrence is the check against abuse of Postal Service discretion. This check against abuse provides mailers with a level of protection against the abuse of monopoly power, which substitutes for the protection otherwise provided by the CPI-U rate cap limitations.[5]

C. Framework for Evaluating Conformance with 39 U.S.C. § 3622(d)(1)(E)

The Public Representative offers a framework for the Commission's consideration in its determination of whether the Postal Service has provided justification for a price increase in excess of what would be allowable under a CPI-U based rate cap system in conformance with 39 U.S.C. § 3622(d)(1)(E). After applying this framework, the Public Representative concludes that while under certain circumstances a severe economic downturn causing a significant reduction in mail volume, as cited by the Postal Service, could form the basis of an exigent price increase, in this instance the Postal Service fails to demonstrate that its exigent request is anything more than a business-as-usual request to increase rates.

Although it has yet to do so, the Public Representative believes it may be possible for the Postal Service to formulate a proposal which fully justifies an exigent price increase in the future. At this time, the Public Representative urges the Commission to deny the Postal Service's Request, while providing the Postal Service an opportunity to determine if it can file a new request that clearly meets the requirements of 39 U.S.C. § 3622(d)(1)(E), using the framework proposed by the Public Representative as a guide. Delaying an exigent increase for the few months necessary

[5] If the Public Representative's interpretation is incorrect at this point in time, the Public Representative urges the Commission to incorporate the Commission's review of an initial Postal Service finding of exigent circumstances into the Commission's Rules of Practice and Procedure. Section 3622 provides authority for the Commission to develop a modern system for regulating rates and classes, and to establish rules and procedures for evaluating exigent requests. Since the Commission has rulemaking authority, it has the authority to consider evaluation of and concurrence with the proffered exigent circumstance.

for the Postal Service to develop a justifiable proposal will not materially alter the Postal Service's financial situation, and may focus the Postal Service's attention on taking steps to address the effects of the exigency on its operations. This approach is opposed to the business-as-usual approach presented by the Postal Service of funding operations until the next period of crisis, which is likely to occur by the end of FY 2011 whether or not this exigent request is approved. It also has the benefit of providing time for the Commission and/or Congress, as applicable, to resolve issues surrounding a change from 6- to 5-day delivery, the Postal Service Retiree Health Benefit Fund (PSRHBF) payment, and the CSRS modification legislation. Favorable resolution of any or all of these issues may improve the Postal Service's financial condition.

1. Ratemaking Checks and Balances

A brief review of the checks and balances included within the PAEA and within previous legislation that protects mailers from potential abuse of the Postal Service's grant of monopoly authority over many of its products may add context to the discussion of the framework being proposed by the Public Representative.

The Postal Reorganization Act of 1970 led to a system for determining postal rates which included an adversarial system whereby rate proposals were litigated before the Postal Rate Commission within the context of an omnibus rate case.[6] This system provided mailers with a due process right to challenge the legality of any or all of the proposed rates prior to implementation of those rates. The Postal Rate Commission weighed the positions presented during the litigation process (in light of the costs of service, factors established by Congress, and precedent) and developed a recommendation for consideration by the Postal Service's Governors.

The Postal Accountability and Enhancement Act of 2006 (PAEA) replaced the previous system with a rate cap based system tied to inflation measured by CPI-U.

[6] Coincidentally, overall postage rates tended to track the rate of inflation under this system for more than 30 years.

Under this system, mailers are afforded protection against monopolistic abuses in the area of ratemaking by being assured that postage rates (on a class level) do not increase by more than the rate of inflation, except when “extraordinary or exceptional circumstances” are demonstrated.[7] The PAEA replaces the “due process” provided mailers through the prior litigation process with an assurance of limiting price increases to the rate of inflation. Mailers may comment on the Postal Service’s rate proposals, but may no longer utilize discovery or present their own testimony. Mailers may file a complaint after-the-fact with the Commission challenging the legality of rates. However, the complaint approach for challenging rates remains virtually untested.

The CPI-U rate cap approach introduced under the PAEA is intended to be the normal method for adjusting prices. Price adjustments under this approach, for example, should encompass the effects of inflation and economic cycles, fluctuations in mail volume, including the long term electronic diversion that is underway, fluctuations in fuel prices, the effects of labor negotiations, and cash flow issues. All are part of the normal business process, and should be accounted for under the price-cap regime. These situations fall under the Postal Service’s responsibility to operate “under best practices of honest, efficient, and economical management,” but fall outside of an exigent circumstance.

However, Congress also understood that unforeseen events beyond those described above could occur and threaten the Postal Service’s ability, “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.” Thus, it provided the Postal Service authority to request rate adjustments “on an expedited basis due to either extraordinary or exceptional circumstance.” For the Postal Service to adjust rates, it would have to persuade the Commission (after public notice, hearing and comments) of the existence of

[7] Other aspects of the PAEA, such as the Annual Compliance Report/Annual Compliance Determination process, complement this protection.

“extraordinary or exceptional circumstances,” and that the adjustments are “necessary” to sustain the Postal Service. The term “exigent” rate request was coined to describe this type of Postal Service request. *See* 39 CFR § 3010.60.

Congress has provided little direct guidance on what extraordinary or exceptional circumstances are necessary to trigger an exigent rate request. A search through several popular dictionaries leads the Public Representative to conclude that the words themselves, “extraordinary” and “exceptional,” can be used interchangeably, and that separate meanings were not intended.[8] The search into the meaning of the individual words helps in interpreting the magnitude of the circumstances that are required, but does not help in providing examples of the types of circumstances to be considered.

Insight into the intended meaning of “extraordinary or exceptional circumstances” can be gained by reading the phrase in the context of other provisions of the PAEA (balanced against the normal rate cap provisions), and with an eye towards the rights and protections afforded mailers (with less rights provided in exigent circumstances). As discussed above, the PAEA definitively specifies the CPI-U price cap requirement as the approach to be taken to adjust rates to account for typical business related circumstances. A general conclusion that can be drawn is that to trigger an exigent request, atypical, rarely occurring, or out-of-the-ordinary circumstances must be present.

Further insight into the intended meaning of extraordinary or exceptional circumstances may be gained by comparing the protections afforded mailers under these circumstances with the protections afforded mailers under rate adjustments proposed to account for typical business related circumstances. Under extraordinary or exceptional circumstances, the protections afforded mailers against abuse of the Postal Service’s monopoly authority are drastically reduced. There is no rate-cap protection. This reduction in mailer protection may be justifiable since the viability of the Postal

[8] Exceptional is frequently used in the definition of extraordinary.

Service to continue to provide service might be at stake, and provides further indication that exigency requests should be limited to situations out of the norm.

After examining the exigent provision of the statute in context with the CPI-U rate cap provisions and considering the reduced protections afforded mailers, it is clear to the Public Representative that exigent rate requests are not to be used in business-as-usual situations. The challenge then is to discern business-as-usual from extraordinary or exceptional circumstances.

The Public Representative believes that examples of extraordinary circumstances that might qualify under the meaning of the statute are many: recovery from a natural disaster affecting a significant portion of the Postal Service's distribution system, recovery from a terrorist event, a 1970s style oil embargo, or new congressional mandates that must be funded, to name a few. The severity and duration of each circumstance also must be considered, with an expectation that the Postal Service absorb the effect of less severe or shorter duration events.

2. Proposed Framework

The above very brief background is provided to emphasize that an exigent request should be reserved to address rare, not business-as-usual, situations. This conclusion is based on a comparison of the other rate-setting provisions incorporated in the statute, and the resulting reduction in protections afforded mailers. Given the above, the Public Representative believes that review of an exigent request requires a higher level of scrutiny, and that "honest, efficient, and economical management" requires the Postal Service to provide substantial justification for any exigent request leading to rate increases in excess of the CPI-U price cap. The Public Representative proposes a framework for determining whether the Postal Service has made such a justification which includes the following elements:

(1) Identification of the extraordinary or exceptional circumstance and the effect the extraordinary or exceptional circumstance has upon the Postal Service;

(2) Identification of a recovery goal that either establishes a new norm of operations or places the Postal Service back in its original position;

(3) Identification of a plan to accomplish the recovery goal; and

(4) Identification of the cost (a revenue requirement) of accomplishing that goal either as a one-time expenditure or on a recurring basis.

To meet the intent of 39 U.S.C. § 3622(d)(1)(E), the Public Representative believes that each of the above elements must be adequately addressed.

(1) Identification of the extraordinary or exceptional circumstance

The first element proposed for providing a justification of an exigent request is the identification of the extraordinary or exceptional circumstance, and the effect the extraordinary or exceptional circumstance has upon the Postal Service.

The predominant triggering event cited by the Postal Service as justification for the instant request is the current economic crisis underway in the United States (and arguably around the world). "As stated earlier, the Postal Service is in the throes of the worst contraction in mail volume in modern American postal history caused, in large part by the worst economic crisis since the Great Depression." Corbett Statement at 11. "Not only is the overall volume loss extraordinary and record-breaking, when isolating recessionary periods, the current recession is unlike any other in terms of comparable volume loss" *Id.* at 11. "It is an historical fact that the depth and severity of the financial crisis that precipitated the current recession were unforeseen." *Id.* at 15. These statements combine both a description of an event and the effect of an event upon the Postal Service.

The Postal Service goes on to better describe the effect of the event upon the Postal Service. The Postal Service states that what distinguishes present conditions from previous circumstances is the "dramatic, rapid and unprecedented decline in mail volume." Request at 1. It contends that "[t]he unprecedented drop in mail volume constitutes the 'extraordinary or exceptional circumstances' that trigger the need for an exigent increase." Request at 6. Finally, "[t]he recent volume decline has exceeded the volume declines of all mail recessions in the previous 35 years put together." *Id.* at 11.

Once a circumstance is identified, it is a judgment call based upon the facts presented in each case whether a proffered circumstance meets the extraordinary or exceptional circumstances intent of 39 U.S.C. § 3622(d)(1)(E). The proffered extraordinary or exceptional circumstance should be contrasted against what would be considered "normal" business occurrences that typically would be accounted for pursuant to the CPI-U rate cap provisions. The duration and severity of the circumstance and the effect upon the Postal Service also must be considered. The final responsibility for making this judgment rests with the Commission.

The Public Representative believes that the Postal Service has described circumstances, the unprecedented recession and the resulting decline in mail volume, which far exceed a normal business cycle or what can be accounted for merely by electronic diversion. The depth and severity of the recession is well documented. Furthermore, the pessimism regarding mail volumes returning to pre-recession levels anytime soon, if ever, is noted.[9] Finally, the Postal Service describes the effects of the recession on mail volumes, and thus revenue.

Thus, the Public Representative believes that the Postal Service so far has satisfied the first element of the proposed framework. The Postal Service adequately identifies an exigent circumstance and describes the effect that it believes the circumstance has had upon the Postal Service.

However, the Public Representative believes that this alone is not sufficient to conclude that the exigent circumstance is consistent with the intent of 39 U.S.C. § 3622(d)(1)(E). The Postal Service also must demonstrate that its overall Request is somehow related to resolving the effects of the proffered exigent circumstance. This is based upon the Public Representative's firm belief that the intent of 39 U.S.C. § 3622(d)(1)(E) is only to raise revenue to address an identified exigent circumstance, and not to raise revenue for general Postal Service operations.

The reaction of the Postal Service to the exigent circumstance provides valuable insight into this issue. Thus, it becomes necessary to determine whether the Postal Service, through its Request, is addressing the exigent circumstance, or the Postal Service is using the exigent circumstance in place of the CPI-U rate cap regime. The evaluation that follows, which includes consideration of whether the Postal Service has

[9] The Postal Service would have improved the clarity of its position if it had isolated known volume effects, such as electronic diversion, from the economic effects of the recession.

identified a recovery goal, a plan of action, and a revenue requirement, will help answer this question.

(2) Identification of a recovery goal

The second element proposed for providing a justification is the identification of a recovery goal that either establishes a new norm of operations or places the Postal Service back in its original position.

The Postal Service does not articulate a clear goal, but does provide an indication of what it is attempting to achieve. It states that it is attempting to improve its financial condition: "This exigent Request is not the only step the Postal Service has taken to improve its financial position."[10] Request at 2. Mr. Masse references the Postal Service's pending liquidity crisis.

> But what I believe the real extraordinary event is, and I would ask you to keep that in mind going further, the extraordinary event is the insolvency in 13 months. It's the inability of an institution like the U.S. Postal Service to pay its bills when due 13 months from now. That's really the extraordinary event as I see it.

Tr. 2/206. Thus, he infers a goal of easing the Postal Service's liquidity problems.

Whatever the goal, it somehow should be associated with recovery from the exigency. This would bolster an argument that an exigency actually exists and that it is worthy of urgent attention. An unrelated goal or the absence of a recovery goal would bring into question the necessity of requesting a rate increase outside the normal CPI-U rate cap procedures.

The Public Representative does not dispute the effects of the economic downturn or serious cash flow problems the Postal Service faces. However, a simplistic goal of

[10] The Postal Service also indicates a goal of reducing accumulated debt. "It would also severely impede the Postal Service's progress toward the goal of reducing the substantial amount of debt accumulated over the last several years, an amount expected to approach $13.2 billion by the end of the current fiscal year, FY 2010." Request at 2. The Public Representative believes that the reduction of debt is a laudable goal, but hardly the basis for an exigent rate request.

wanting to "improve its financial position" by way of averting a pending liquidity crisis is wholly inadequate given the apparent seriousness of the situation. The Postal Service has proffered a business-as-usual approach that fails to reflect the cited exigency.

Achieving the Postal Service's goal does nothing other than perpetuate the current financial situation, and delay the inevitable liquidity crisis. This conclusion appears consistent with the Postal Service's sentiment. "The proposed increases will not be sufficient by themselves to avert the liquidity crisis at the end of FY 2011, nor will they return the Postal Service to financial health." Masse Statement at 13. This is a clear indication that the Postal Service has not established a goal that addresses the effects of the exigency.[11] It also indicates the very real probability that the Postal Service will be in the same financial position by the end of the next fiscal year, and will have no choice, based upon the logic used in this Request, but to file a second exigency request.

The Postal Service could have articulated a goal that would satisfy the second element of the Public Representative's framework. As one of potentially many examples, the Postal Service might have started by recognizing what mail volumes are likely to be at some point in the future. This could lead to a goal of adjusting its complement of facilities and workforce to a level appropriate to handle this future mail volume. The Public Representative is suggesting a serious restructuring of facilities and manpower that could be accomplished by a date certain, as opposed to a business-as-usual approach where the Postal Service may or may not ever achieve any goal.[12] The

[11] Although the Postal Service may have intended an opposite effect, its argument that the exigent request is but one of many steps being taken to resolve financial problems tends to obscure the issue. This approach deemphasizes the significance of its exigent request. Focusing on its exigent request and what it hopes to accomplish through this particular request might have made a stronger case for approving the Request.

[12] No doubt there is a litany of reasons the Postal Service could offer for why it is impossible to achieve this goal. However, it is still a goal that can be planned and implementation costs determined. Implementation can be achieved even to the extent of funding overhead accounts to pay salaries and benefits to excess employees until they leave the system through attrition, for example. At least the costs would be known and could be isolated from the cost characteristics of actual mail products.

date certain goal directly addresses the effects of the proffered exigency of a severe economic downturn causing significant reductions in mail volumes. Obviously, the Postal Service also could set a goal that requires less drastic action, assuming the goal addresses the exigency.

The point of the above hypothetical is to compare and contrast a goal that addresses the exigency, versus the Postal Service's goal, which does not. The Public Representative's conclusion is that the Postal Service has not presented a goal worthy of approving an exigent rate request. Rather, all indications are that the Postal Service is taking a business-as-usual approach to addressing its current, although nonetheless severe, financial difficulties.

(3) Identification of a plan

The third element proposed for providing a justification is the identification of a plan to accomplish the recovery goal.

Of the many business reasons which require the Postal Service to have a solid plan to accomplish its goal, three reasons stand out in this circumstance. First, a plan is necessary to provide a roadmap to recovering from the exigency. The very process of developing a plan may inform the Postal Service of its options and of potential problems it faces to achieve its goals. Second, a plan is necessary for convincing others that the Postal Service has a potentially successful approach to addressing the exigency, and that approving an exigent request is worthwhile. In this case, the Postal Service should be required to convince the Commission of the efficacy of its plan. Finally, a plan is necessary to act as the basis for estimating the cost of achieving the recovery goal.

The plan that is presented should address the steps needed to reach the goal of recovering from the exigency. The Postal Service argues that the exigent request is only one element of a multifaceted plan to recovery. However, many elements of its plan are steps that need to be taken regardless, *i.e.,* they do not represent actions specifically directed towards the exigency. The Postal Service does not present a plan in the context of its Request that addresses how it specifically hopes to resolve the effect of the exigency. Thus, it is unable to inform the Commission as to how the additional revenue obtained through the exigent request relates to the items specified within a plan. The closest it comes to informing anyone of its plan for the revenue obtained due to the exigent request is that the revenue will be used to generally, and most importantly, temporarily, improve its financial condition. Mr. Corbett testifies that revenue raised through the exigent request will be used "to pay general operating expenses." Tr. 1/95, *see also,* witness Masse's testimony at Tr. 2/217-8. The Public Representative concludes that paying operating expenses is an indication that the Postal Service seeks a general business-as-usual revenue request, and is not seeking funds to resolve the effects of a specific exigency.

(4) Identification of costs

The fourth and final element proposed for providing a justification is the identification of the cost (a revenue requirement) of accomplishing the goal, either as a one-time expenditure or on a recurring basis.

Cost identification is a critical element. Foremost, the existence of a revenue requirement is a clear indication that the Postal Service has a goal in mind and a plan to accomplish that goal. Importantly, it clearly distinguishes a business-as-usual general rate adjustment from a rate adjustment necessary to deal with a particular exigent circumstance. Finally, it serves as the basis for determining how all rates will be adjusted.

In the instant request, the Postal Service has not developed a revenue requirement, *per se.* It formulates a rate adjustment that it apparently considers appropriate under the circumstances, and that happens to generate increased revenue. Mr. Corbett testifies that a goal of raising rates 4 to 6 percent was established, as opposed to establishing a specific revenue target. Tr. 1/94-5, *see also,* witness Masse's testimony at Tr. 2/209. The Public Representative believes that this approach is indicative of a business-as-usual rate adjustment, which is inconsistent with the intent of 39 U.S.C. § 3622(d)(1)(E).

3. The Postal Service Has Not Justified its Exigent Request

The Public Representative believes that the Postal Service has sufficiently demonstrated that the severe economic downturn is a major contributing cause of the significant reduction in mail volume now being experienced. Furthermore, the decline in mail volume has contributed to the deteriorating Postal Service financial condition to the point of insolvency *(first element)*. However, the Postal Service has not justified its exigent request because: (A) it has not formulated a recovery goal related to the exigent request *(second element)*; (B) it has not formulated a plan related to achieving a specific goal or a plan for the expenditure of revenues obtained through the exigent request *(third element)*; (C) nor has it developed a revenue requirement *(fourth element).* The Public Representative believes that approving an exigent request to address extraordinary or exceptional circumstances requires this higher level of justification. Failing to provide this justification, as exhibited by the Postal Service's Request, is inconsistent with the concept of "honest, efficient, and economical management" and does not support an exigent request.

The Public Representative has provided suggestions through the discussion above indicating that it may be possible for the Postal Service to provide adequate justification in a future request. Without undertaking the effort to adequately justify a request, the Public Representative believes that the Postal Service will not resolve its current financial problems, and without other intervention (by Congress) will have no choice but to file another exigent request in the near future.

D. Electronic Diversion

The Public Representative believes that it is important to quantitatively understand the causes of recent volume declines, and approve exigent requests only to the extent that the causes relate to extraordinary or exceptional circumstances.

The Postal Service seems to rely upon the recent economic recession for accelerating the decline in mail volume, which has the effect of reducing revenue. This is used as justification for the exigent request.

> Neither the Postal Service nor those responsible for the PAEA foresaw the dramatic and rapid decline in mail volume between FY 2006 and FY 2009, during which period volume plunged a total of nearly 17 percent. …Even just a few years ago, the depth and severity of the current recession—and its impact on mail volume—were unforeseeable.

Request at 6.

While relying on the recent economic downturn, the Postal Service also appears to distance itself from relying on electronic diversion as an underlying cause for the recent precipitous volume decline.

> While the long-term impact of electronic diversion has been widely acknowledged over the last 10 years, neither electronic diversion nor any other single factor caused the sudden, precipitous drop in mail volume.

Id. at 6.

However, in the March 31, 2010 Postal Service Form 10-Q filing, the Postal Service cites both the economy and electronic diversion as “major” (at least for First-Class Mail) causes of volume decline.[13]

> The recent losses are primarily attributable to unprecedented declines in mail volumes that began in 2008. The declines in mail volumes are primarily a result of the recent widespread economic recession and the long-term trend of hard copy correspondence and transactions migrating

[13] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended March 31, 2010 (Form 10-Q).

> to electronic media. This migration trend accelerated during the recession and is expected to continue.

Form 10-Q at 8, 28.

> While price has some effect on First-Class Mail volume, in this environment the economy and electronic diversion are both major causes of the volume decline. The recent economic recession appears to have accelerated the rate of migration to electronic alternatives to First-Class Mail. We anticipate that any positive impacts of an economic recovery on single-piece First-Class Mail will be more than offset by the continuing technology-driven decline in single-piece First-Class Mail.

Id. at 20.

The Postal Service further attributes its revenue decline to both the economy and electronic diversion.

> [T]he recession that began in December 2007, coupled with the continued electronic diversion of mail caused a significant decrease in operating revenue in recent years.

Id. at 19.

> The decline in revenues and volumes for both the quarter and six months ended March 31, 2010, can largely be attributed to the recent recession, its impact on electronic diversion rates and continuing electronic diversion.

Id. at 20.

The Postal Service clearly indicates that it believes the economy is stabilizing.

> The economic slowdown appears to be ending with uneven but encouraging signs of economic recovery. Year-over-year GDP growth stabilized after a first quarter surge of 5.6% growth. Real GDP growth was 3.2% in Quarter II, with a projection for the remainder of the year to be in the mid-two percent range. By historical standards, this is a weak recovery from a widespread recession.

Id. at 30.

> Our economic forecasts anticipate that revenues will stabilize in the second half of the year.

Id.

> The Postal Service has even noted some improvement in Standard Mail volume.
>
> Only our Standard mail category within Mailing Services has a volume increase to the quarter ended March 31, 2010.

Id. at 19.

However, even with the noted improvement in the economy, the Postal Service appears to believe that electronic diversion will continue to have a major negative impact upon at least First-Class Mail volume. Furthermore, even with an end to the economic downturn, the Postal Service does not foresee improvement in its financial condition.

> We expect advertising mail to stabilize and slightly increase as the economy improves; however increased migration of advertising to the internet or other media will adversely impact volumes.

Id. at 21.

> The volume of First-Class Mail, our highest margin product, which includes bills, bill payments, statements, confirmations, orders and rebates, has been in decline for nearly a decade.

Id. at 20.

> While the economic recession may have ended, the adverse effects on our results continue.

Id. at 19.

The Public Representative suggests that it is important to have an understanding of the underlying causes for recent volume declines when analyzing the Postal Service's exigent request. The Postal Service paints a fuzzy picture as to what extent the economy, electronic diversion, or "any other single factor" bears responsibility.[14] Furthermore, even with an improving economy, the Postal Service continues to believe

[14] The Postal Service's apparent approach is consistent with the Public Representative's view that the Postal Service seeks to temporarily resolve a serious cash flow problem through the filing of its request, and is not addressing a specific extraordinary or exceptional circumstance.

that at least First-Class Mail volumes will continue to decline.[15] This continuing long term trend tends to cast doubt on the underlying causes of the recent volume decline and the proffered justification for the exigent request.

The Public Representative believes that some estimate must be made, which attributes volume decline to specific factors or causes. Volume decline, and by association revenue decline, attributable to normal business factors should be isolated from volume/revenue decline attributable to the exigent circumstance factors. This exercise allows an exigent request to be based on extraordinary or exceptional circumstances, and not on normal business cycle circumstances. The Public Representative's opinion is that any additional revenue developed through an exigent request must relate to addressing the exigent circumstance factors, and not the normal business factors. The Public Representative does not know if the above analysis can be made based upon the Postal Service's presentation in this case, but suggests that the request should be denied to the extent that rate adjustments address issues unrelated to the proffered exigent circumstance.

[15] Some information can be gleamed from reviewing various regression factors used to forecast future volume. However, this is such a significant issue that the Postal Service's presentation should clearly address this issue.

IV. REVENUE ANALYSIS

A. Introduction

The Code of Federal Regulation, 39 CFR § 3010.65(f)(2), permits comments that address "[t]he adequacy of the justification for increases in the amount requested by the Postal Service."

The Public Representative interprets 39 CFR § 3010.65(f)(2) as suggesting comments which analyze the adequacy of exigent requests from the perspective of generating sufficient revenue to accomplish a certain goal, *e.g.,* analyzing the sufficiency of a revenue requirement. It is not possible to analyze the Request from this perspective because the Postal Service has not formulated a revenue requirement, nor has it earmarked potential additional revenue for any particular purpose other than general operating expenses.[16] As previously discussed in Section III.C, the Public Representative believes this is a fatal deficiency of the Postal Service's Request.

Regardless, the Public Representative comments on the Postal Service's view of its financial position, and the many factors that may affect this position in the near future. The Public Representative concludes that the Postal Service's financial condition is indicative of systemic problems that go well beyond what might be resolved by this exigent rate request.

The Request also is analyzed from the perspective of the effect of the additional revenue in terms of addressing the Postal Service's general financial condition. The Public Representative believes that the additional revenue generated as a result of the proposed rate adjustment only will provide short-term relief to the Postal Service. The magnitude of the request is wholly insufficient to ensure the Postal Service's long-term

[16] Nor has the Postal Service presented its request with anything comparable to a Postal Reorganization Act of 1970 vintage break-even requirement. The exigent request "is not, by itself—from the Postal Service's perspective—designed to achieve 'break-even' in any particular future time period". Corbett Statement at 17.

survivability. Finally, without outside intervention (by Congress or a dramatic economic improvement), this insufficiency may force the Postal Service to seek additional funding by filing a second exigent rate request in FY 2011.

B. Postal Service's Current Position is Indicative of Systemic Problems

The Postal Service describes the serious financial challenges that it faces, and summarizes historical events that have contributed to its current financial position. It explains that historically mail volume has grown year-to-year, but in FY 2007 volume growth stalled and then plunged in FY 2008 and FY 2009. Request at 1. Total volume declined nearly 17 percent between FY 2006 and FY 2009, with revenue falling $7 billion in FY 2009 alone. *Id.* at 1-2. The Postal Service contends it is experiencing the worst contraction in mail volume in modern postal history, "caused in large part by the worst economic crisis since the Great Depression." Corbett Statement at 11. With the decline in revenue, the Postal Service faces a liquidity crisis. The Postal Service cites to the economic crisis, and its effect on mail volume and revenue, in combination with a lack of flexibility, electronic diversion, and a statutory obligation to pre-fund retiree health care benefits as contributing to the Postal Service's current fiscal predicament. Corbett Statement at 5.

The Postal Service has recognized the status of its financial condition for some time. In April 22, 2010, the Postmaster General testified before the Subcommittee on Federal Services, and International Security, United States Senate.

> For the past two years, I have testified about the dire financial circumstances facing the United States Postal Service. Once again, I am here to report that our financial situation is precarious, mail volumes continue to decline, and the cost of delivering mail to each address continues to increase. …While all postal stakeholders are aware of these circumstances, I am concerned that there is insufficient appreciation for the long-term financial peril that the Postal Service faces. Expert, independent analysis clearly shows an open-ended decline in mail volume and the revenues associated with it. …Today, the Postal Service stands on the brink of financial insolvency. Without significant and immediate

changes, this pattern of constant financial distress will continue unabated for years to come.[17]

To improve its financial situation over the past decade, the Postal Service states that it has undertaken initiatives to reduce costs, including investments in automation, reductions in the career workforce, workhour savings, and productivity improvements, among others. Request at 2. The Postal Service asserts that these efforts have resulted in an average savings of over $1 billion per year. Request at 2.

The Postal Service also has several initiatives underway to improve its financial situation in addition to this exigent request. The following are most promising for expedient relief: (1) a reduction from 6 to 5-day delivery ($3 billion);[18] (2) adjustments in Postal Service Retiree Health Benefits Fund prefunding ($4-5.5 billion); and (3) adjustments in previous Civil Service Retirement System overpayment ($50-75 billion). The outcomes of any of the additional initiatives are uncertain, as they require Congressional action prior to implementation.

The Postal Service discusses the limitations of the CPI-U rate cap regime, given the current need to generate revenue. The Postal Service states that without an exigent rate increase, it is limited to market dominant product price increases of 0.578 percent[19]

[17] Statement of Postmaster General/CEO John E. Potter Before the Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security United States Senate, April 22, 2010; http://www.usps.com/communications/newsroom/testimony/2010/pr10_pmg0422.htm.

[18] The sentiment of Congress appears to be to continue 6-day delivery throughout FY 2011.

[19] The Public Representative notes the Postal Service underestimated the price cap in this docket. The Postal Service explains that based on available data the price cap is 0.578 percent. The actual price cap is 0.757 percent, with a -0.179 “interim unused rate adjustment authority.” If the Postal Service had filed a Type 1 rate adjustment, they would not have been required to use the -0.179 percent interim unused rate adjustment authority. Therefore, the maximum rate adjustment available for each class equals their positive banked amounts from Docket Nos. R2008-1 and R2009-2 plus the cap of 0.757 percent. The Postal Service could choose to let the -0.179 percent interim unused rate adjustment authority expire in 5 years under 39 U.S.C. § 3622(d)(2)(C)(ii).

per the CPI-U based price cap.[20] The Postal Service explains that an increase of this magnitude would do little to reduce its FY 2011 revenue shortfall estimated at $7 billion, or reduce the debt estimated at $13.2 billion by the end of FY 2010. Request at 2-3. The Postal Service argues that “[e]ven under ordinary circumstances”, when a CPI-U based price increase is so low, that it would be challenging “for the Postal Service to achieve financial results sufficient to maintain universal service”. Request at 5-6. A CPI-U based rate increase also “would prevent the Postal Service from making discernible progress towards closing the multi-billion dollar shortfall between projected expenses and projected revenues for FY 2011, currently estimated at approximately $7 billion.” Request at 3. Furthermore, “[e]ven under ordinary circumstances, when the CPI-U price cap calculated with the normally applicable cap calculation methodologies is so low, it would be a challenge for the Postal Service to achieve financial results sufficient to maintain universal service with only a routine Type 1 price adjustment.”[21] *Id.* at 5-6. When asked if the current rate cap system was “dead,” neither Mr. Corbett nor Mr. Masse could fully endorse the CPI-U price cap system under current economic conditions. *See* Tr. 1/62-5 and Tr. 3/190-2.

The Public Representative’s concern is that the exigent request is being used to address apparent systemic problems, such as operating under a CPI-U price cap regime, the ability to right-size personnel and facilities to current workload, and Retiree Health Benefits Fund pre-funding obligations, to name a few. The exigent request is not being used to address an exigency related to the severe economic downturn. If this

[20] The CPI-U Rate Cap technically is not applicable to exigent rate adjustments, other than ensuring that all unused rate authority has been expended and appropriately accounted for. However, the fact that an exigent rate increase occurs has implications for future rate adjustments. First, there is a question of when and under what circumstances the price cap is reset. The Public Representative believes that it is appropriate to set the May 2010 CPI-U as the base (denominator) for the next general rate adjustment.

[21] The Public Representative notes that inflation rates are projected to remain low for the next few rate cycles.

concern is valid, approving the Postal Service's request may provide temporary relief, but does not address the systemic problems.

C. The Revenue Generated by the January 2, 2011, Proposed Rate Request will be Insufficient to Meet the Postal Service's Needs

1. Without Other Action a Substantial Increase is Necessary

The Postal Service presents a multifaceted approach to address its current financial problems. It recognizes that attempting to resolve these financial problems by solely raising rates is insufficient. Mr. Kiefer notes that:

> Some parties have observed that it would require the Postal Service to raise prices by an average of 20 percent if it were to attempt to close this entire gap by the end of FY 2011 using price increases alone.[22]

He goes on to mention that a price increase of this magnitude would be devastating to some, could damage a fragile mailing industry, and does not address other structural burdens. Kiefer Statement at 5-6. Witness Masse confirms Mr. Kiefer's statement testifying that a price increase on the order of twenty-five percent over one or two years would be necessary, without other action, to completely address the exigency. Tr. 2/118.

The Public Representative does not dispute that a rate increase in the range of twenty to twenty-five percent would place the Postal Service on sound financial ground, assuming no other actions were taken to address the current financial conditions. However, a rate increase of this magnitude would drive mail out of the system and exacerbate the Postal Service's financial problems. More troubling is that a rate increase alone (of any magnitude) does nothing to address any of the aforementioned structural problems that the Postal Service faces. Furthermore, such a large rate

[22] Referring to Docket No. ACR2009, Public Representative Comments on Annual Compliance Report 2009, February 3, 2010 (Public Representative ACR2009 Comments).

increase would not be in keeping with the intent of the PAEA to encourage the Postal Service to improve its efficiency.

2. Short Term Relief Provided by Approving an Exigent Request Will Not Resolve the Postal Service's Financial Crisis

In this docket, the Postal Service proposes an aggregate exigent rate increase of 5.6 percent. Corbett Statement at 19. This amounts to a revenue increase of approximately $2 billion in FY 2010, and $3 billion in years thereafter. Table IV-1 shows a condensed statement of Postal Service Revenues and Expenses. The Postal Service had a net loss of $3,794 million in FY 2009.[23] It forecasts a net loss of $6,448 million in FY 2010 and a net loss of $6,984 million in FY 2011 before rates. If the Postal Service is allowed to raise rates an aggregate 5.6 percent on January 2, 2011, the Postal Service forecasts an FY 2011 AR net loss of $4,713 million. The statement includes the payment of the $5.5 billion Postal Service retiree health benefit payment (PSRHBF) due in FY 2010 and FY 2011 in both before and after rates calculations.

Table IV-1
Postal Service's Actual FY 2009 and Forecasted FY 2010 and FY 2011 Revenue and Expenses
($ Millions)

	FY 2009 Actual	**FY 2010 Forecast**	**FY 2011 BR Forecast**	**FY 2011 AR Forecast (January 2, 2011)**
Total Revenue	68,166	67,175	67,821	69,811
Total Postal Service Operating Expenses	71,911	73,623	74,805	74,524
Net Income (Loss)	(3,794)	(6,448)	(6,984)	(4,713)

Masse Statement, Attachment 3. See also, Responses of the United States Postal Service to Questions 1-16 of Presiding Officer's Information Request No. 1, Question 16.

[23] The Postal Service had a net loss of $3,794 million in FY 2009. The loss would have been $7.9 billion, however, Congress' deferment of $4.0 billion of the $5.4 billion PSRHBF pre-funding payment reduced the FY 2009 loss to $3.8 billion. Masse Statement at 5.

Table IV-2 shows a statement of the Postal Service's Cash Flow projections. The Postal Service is projected to have a cash balance of $1,274 million at the end of FY 2010, and projects a cash shortfall of $4,369 million at the end of FY 2011 before rates. If the Postal Service is allowed to raise rates an aggregate 5.6 percent on January 2, 2011, the Postal Service forecasts an FY 2011 AR cash shortfall of $2,098 million.

Table IV-2
Postal Service's Actual FY 2009 and Forecasted FY 2010 and FY 2011 Cash Flow
($ Millions)

	FY 2009 Actual	**FY 2010 Forecast**	**FY 2011 BR Forecast**	**FY 2011 AR Forecast (January 2, 2011)**
Net cash provided by operating activities	1,573	(4,267)	(5,838)	(3,567)
Net cash used in investing activities	(1,806)	(1,439)	(1,493)	(1,493)
Net cash (used in) provided by financing activities	2,890	2,890	1,688	1,688
Net Increase (Decrease) in Cash	2,657	(2,815)	(5,643)	(3,372)
Cash balance at beginning of year	1,432	4,089	1,274	1,274
Cash Balance (Shortfall) at end of year	4,089	1,274	(4,369)	(2,098)

Masse Statement, Attachment 4.

The Revenue and Expenses, and Cash Flow projections shown above assume that the Postal Service will exhaust its borrowing authority in FY 2011. At the end of FY 2009, the Postal Service's debt will be $10,194 million.[24] Under the Postal Reorganization Act, as amended by Public Laws 101-227 and 109-435, the Postal Service is limited to an annual debt increase of $3 billion. The maximum Postal Service

[24] 2009 Annual Report United States Postal Service at 71.

debt ceiling is $15 billion. In FY 2010, the Postal Service increased its outstanding debt by the $3 billion annual limit, bringing its total debt to $13.194 billion. The Postal Service will exhaust the remaining $1.8 billion borrowing authority in FY 2011.

The Revenue and Expenses, and Cash Flow projections shown above also assume the general volume trends shown in Table IV-3. Mr. Corbett states that the total mail volumes from Quarter 1, FY 2007 to Quarter 2, FY 2010 declined 20.1 percent.[25] In FY 2009, the Postal Service experienced a 12.7 percent volume decline and in FY 2010 the Postal Service forecasts a volume decline of 4.4 percent. The FY 2011 volume forecast shows a slight volume increase of 2.1 percent. Global Insight indicates:

> The economy has lost momentum. Growth should downshift to around 2.5% in the second half of the year. GDP growth averages 3.1% in 2010, but slows to 2.7% in 2011.[26]

With GDP improving in FY 2010, a slight volume increase may occur, but the Postal Services 2.1 percent projection appears optimistic. Lower percentage volume increases, or volume declines, will further deteriorate the Postal Service's forecasted financial condition.

[25] Corbett Statement at 12.

[26] IHS Global Insight, U.S. Executive Summary, July 2010 at 1. Note: The data reflects a calendar year not a postal year, which may result in a slight difference.

Table IV-3
Total Mail Volume Annual Growth Ranges FY 2005-2009, Forecasts for FY 2010 and FY 2011

Fiscal Year	Total Mail Volume (Millions of Pieces)	Percent Change From Prior Year (%)
2005	211,743	2.7
2006	213,138	0.7
2007	212,234	- 0.4
2008	202,703	- 4.5
2009	177,058	- 12.7
2010 Forecast	169,281	- 4.4
2011 After Rates Forecast	172,994	2.1

Masse Statement at 5-6, and Attachment 11. Response of the United States Postal Service to Questions 1-16 of Presiding Officer's Information Request No. 1, July 23, 2010, Question 5 and 16.

The Public Representative believes that the results of pending labor negotiations will have a significant impact on financial projections. The Postal Service assumed that salaries and benefits based on current labor agreements are incorporated into the Revenue, Expenses, and Cash Flow projections shown in Tables IV-1 and IV-2. The current labor agreements for the National Association of Letter Carriers (NALC) and the National Postal Mailhandlers Union (NPMHU) expire in November 2011. Contract agreements for employees represented by the American Postal Workers Union (APWU) and the National Rural Letter Carriers Association (NRLCA) expire November 2010. The Postal Service based its wage and benefit forecasts on Global Insights projections of changes in the Employment Cost Index Wages and Salaries – Private Industry (ECI) after the agreements expire in November 2010. Masse Statement at 7-8. The Postal Service's ECI forecast is 1.7 percent in FY 2010 and 1.9 percent in FY 2011. *Id.* at 7. Whether or not APWU and/or NRLCA accept a 1.7 or 1.9 percent rate increase will have a significant impact on Postal Service costs. *Id.* For example, in FY 2009, the postal compensation and benefits were $53,154 million and total operating expenses were $71,830 million. Compensation and benefits equaled approximately 74 percent (rounded) of the total operating expenses. As stated by the Postal Service:

> Current labor agreements with the two largest unions expire in November 2010 and November 2011. The ability to negotiate fair contracts that reflect the state of the economy and current and future mail revenues is essential to maintaining our financial stability. Failure to do so, or an adverse decision by an arbitrator should we not be able to agree to terms with the unions, could have significant adverse consequences on our ability to meet our obligations.[27]

Furthermore, the savings associated with reducing delivery to 5-days a week is not included in the Revenue and Expenses or Cash Flow projections shown above. It is unlikely that Congress will approve the 5-day mail delivery until after the issuance of the Commission's Advisory Opinion and even then there is no guarantee the change will occur in FY 2011, if ever.[28] The Postal Service did not incorporate potential savings in its FY 2011 forecast in this docket so lack of approval has no bearing upon the impact of forecasted data.

The Postal Service fully recognizes that the instant exigency request will only provide temporary relief and that it will be in financial trouble by the end of FY 2011. As Mr. Masse states in his comments, the Postal Service will be "…unable to pay all its obligations before the end of FY 2011, regardless of whether the exigent price increases are approved. Masse Statement at 11. He goes on to state that "... the price increases alone are not sufficient to avert the liquidity crisis looming at the end of FY 2011." *Id.* at 12.

The Public Representative believes that implementation of the proposed rate increases on January 2, 2011, may provide some short-term relief, but will be insufficient to resolve the Postal Service's financial crisis. With a projected loss of

[27] 2009 Annual Report United States Postal Service at 36.

[28] Congress appears unlikely to remove the requirement to provide 6-day delivery during FY 2011.

$4,713 billion and negative cash of $2,098 billion FY 2011 AR, the Postal Service essentially will be in the same financial condition as it will be in at the conclusion of FY 2010. This ensures that without other changes the Postal Service will need to request another significant (above CPI-U) rate increase before the end of FY 2011.

3. PSRHBF Payment Relief in FY 2010 Will Help, but not Alleviate the Postal Service's Financial Crisis

Congressional relief from the FY 2010 PSRHBF payment will help, but is not enough, even combined with a rate increase to resolve the Postal Service's financial crisis.

Postal Service witness Corbett, in Docket No. N2010-1, stated in regard to being released from the $5.5 billion PSRHBF payments: "It won't in and of itself be enough, but it would help reduce the financial stress that we're undergoing right now in the near term. I have to say that I'm not confident that that legislation will be passed this year."[29] Witness Corbett further states:

> It's my understanding that regardless of the relief that we might be afforded it's going to score in the Federal budget deficit, which is, and certainly this year in a midterm election year is something that most people don't want to happen. And so just looking at it objectively as a voter and seeing the American, the sentiment, [ ], it's going to be extremely difficult to get it passed this year.[30]

If Congress allows the Postal Service to make a $1.4 billion PSRHBF payment in FY 2010, as it did in FY 2009, the Postal Service's FY 2010 net loss would be reduced to $2,348 million. *See* Table IV-4. With partial PSRHBF payment relief in FY 2010 and the proposed rate increases in January 2011, the Postal Service will continue to have a yearend net loss of $4,713 million.

[29] Docket No. N2010-1, Tr. 3/651, July 16, 2010.

[30] Docket No. N2010-1, Tr. 3/653, July 16, 2010.

Table IV-4
Public Representative's Actual FY 2009 and Forecasted FY 2010 and FY 2011 Statement of Revenue and Expenses
($ Millions)

	FY 2009 Actual	FY 2010 Forecast	FY 2011 BR Forecast	FY 2011 AR Forecast (January 2, 2011)
Total Revenue	68,166	67,175	67,821	69,811
Total Postal Service Operating Expenses	71,911	73,623	74,805	74,524
PSRHBF Relief	—	4,100	—	—
Net Income (Loss)	(3,794)	(2,348)	(6,984)	(4,713)

Revenue and USPS Ops from Table IV-1. Responses of the United States Postal Service to Questions 1-16 of Presiding Officer's Information Request No. 1, July 23, 2010, Question 16.

Table IV-5 shows the Public Representative's revised cash flow forecast in the event Congress reduces the PSRHBF payment to $1.4 billion in FY 2010. Assuming an FY 2010 net loss of $2,348 million, there will be a cash surplus at the end of FY 2010 of $5,375. The cash surplus will give the Postal Service funds to pay its financial obligations for another year. Implementation of the proposed rate increase in FY 2011 coupled with the FY 2010 PSRHBF payment relief allows the Postal Service to end FY 2011 AR with a cash surplus of $2,003 million.

Table IV-5
Public Representative's Actual FY 2009 and Forecasted FY 2010 and FY 2011 Statement of Cash Flows
($ Millions)

	FY 2009 Actual	FY 2010 Forecast	FY 2011 BR Forecast	FY 2011 AR Forecast (January 2, 2011)
Net cash provided by operating activities	1,573	(165)	(5,838)	(3,567)
Net cash used in investing activities	(1,806)	(1,439)	(1,493)	(1,493)
Net cash (used in) provided by financing activities	2,890	2,890	1,688	1,688
Net Increase (Decrease) in Cash	2,657	1,286	(5,643)	(3,372)
Cash balance at beginning of year	1,432	4,089	5,375	5,375
Cash Balance (Shortfall) at end of year	4,089	5,375	(268)	2,003

Table IV-2 and IV-3; Responses of the United States Postal Service to Questions 1-16 of Presiding Officer's Information Request No. 1, July 23, 2010, Question 16.

The Public Representative believes that FY 2010 PSRHBF payment relief combined with the proposed rate increase will provide additional relief to the Postal Service. However, the Postal Service will still have a net loss $4,713 million after rates during FY 2011 and will end the fiscal year with only $2,003 million in cash.[31] Although this is an improvement when compared to no PSRHBF relief, it does not place the Postal Service on stable financial ground. In reality, the Postal Service will be financially in the same condition at the end of FY 2011, as it is at the end of FY 2010. The Public Representative believes that without other intervention, the Postal Service will continue to need above CPI-U rate increases to improve its financial condition.

[31] This assumes a January 2, 2011 implementation date.

V. RATE ANALYSIS

A. Introduction

The Code of Federal Regulations, 39 CFR § 3010.65(f)(3), permits comments that address "[w]hether the specific rate adjustments requested are reasonable and equitable". The comments that follow are intended to aid the Commission in its statutory task of determining whether a proposed exigent rate adjustment is "reasonable and equitable" such that the adjustment enables "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." *See* 39 U.S.C. § 3622(d)(1)(E). The comments are provided assuming that the Postal Service has adequately justified its exigent request based on either extraordinary or exceptional circumstances, and that the magnitude of the proposed adjustment is both adequate and "necessary." The Public Representative concludes that for the most part the Postal Service has proposed rates that are reasonable and equitable. Rates that remain problematic are identified throughout these comments.

As part of evaluating whether the proposed rates are both reasonable and equitable,[32] the Public Representative analyzes whether the proposed rates include the workshare discount and cost coverage considerations put forth by the Commission in its 2009 Annual Compliance Determination (2009 ACD). The Public Representative concludes that for the most part the Postal Service has considered the workshare discount and cost coverage issues put forth by the Commission, but urges the Commission to require the Postal Service to provide a plan, including a timeline, for resolving all remaining issues.

[32] The Postal Service has not indicated a specific revenue target, therefore, when discussing the equity of price increases, only an evaluation of proposed increases relative to other proposed increases can be made.

The comments also consider several classification changes proposed by the Postal Service. The Public Representative believes that the Reply Ride Free program and the Saturation and High Density program may be reasonable, however, both programs are inappropriate for consideration within this docket, and should be comprehensively reviewed in a separate docket. For the several other minor classification changes, the Public Representative concludes that the changes are reasonable.

B. Rate Increases

The Postal Service proposes market dominant prices that are forecast to provide the Postal Service an additional $1.98 billion in FY 2010. Almost 18 percent of this additional revenue is expected to come from the eleven domestic market dominant products that failed to cover their attributable costs in FY 2009.[33] Over one-half of this revenue will be generated from the profitable First-Class Mail, and 32 percent of the total will come from Standard Mail. *See* Table V-1.

In the 2009 ACD, the Commission found fourteen domestic market dominant products and services that did not generate sufficient revenues to recover attributable costs.[34] With few exceptions, the Postal Service has taken the approach of increasing products with low or insufficient cost coverages higher than average to increase profitability. The Public Representative believes this is a reasonable and equitable approach to recover revenue from products with insufficient cost coverages, and is necessary at a time when the Postal Service is losing billions of dollars a year.

[33] The eleven domestic products that failed to cover attributable costs in FY 2010 are: Standard Flats, Standard Not-Flat Machinables and Parcels, Periodicals Within County, Periodicals Outside County, Single-Piece Parcel Post, Bound Printed Matter Parcels, Media Mail/Library Mail, Registered Mail, Stamped Cards, Address List Services, and Confirm. *See* 2009 ACD at 28.

[34] See 2009 ACD at 28.

Table V-1
Projected Additional Revenue
Generated From Exigent Rate Adjustment by Class

	Before Rates Revenue ($ millions)	**After Rates Revenue ($ millions)**	**Difference ($ millions)**	**Additional Revenue Distribution (%)**
	(1)	(2)	(3)=(2)-(1)	(4)= (3)/Sum(3)
First-Class Mail	32,108	33,223	1,115	56.31
Standard Mail	18,907	19,538	631	31.87
Periodicals	1,848	1,948	100	5.05
Package Services	1,488	1,539	50	2.55
Domestic Market Dominant Services	2,851	2,924	73	3.67
International Mail and Services	2,579	2,590	11	0.56
Total	67,676	69,656	1,980	100

Masse Statement, Attachments 10 and 11.

The Postal Service's FY 2011 After Rates projections show that there remain five domestic products that fail to recover attributable costs.[35] The Postal Service has proposed above average increases for four out of five of these products Only Standard Mail Flats receives a below average increase.[36] *See* Table V-2.

The cost coverage for the flats product generally associated with catalog mailers remains problematic. The Postal Service identifies the "delicate financial position" of catalog mailers as the basis for the below average pricing approach. Request at 29. While difficulties in the catalog industry are recognized (among other industries), the Postal Service has not provided any quantitative data to support this claim. Below average increases generally are not reasonable or equitable to rate payers as a whole

[35] *See* Masse Statement, Attachment at 11.

[36] Standard Mail Flats is receiving an above average increase within the Standard Mail class, however, when compared to overall postal products it is receiving a below average increase.

when insufficient cost coverages are present, and should not be accepted for any product failing to cover its attributable costs without adequate justification.

Table V-2
Specific Cost Coverages and Percentage Increases

	FY 2011 AR Cost Coverage (%)	R2010-4 Proposed Percentage Increase (%)
Standard Mail Flats	90.6	5.1
Standard Non-Flat Machinables (NFMs) and Parcels	94.9	23.3
Periodicals In County	97.6	8.0
Periodicals Outside County	84.2	8.0
Media and Library Mail	94.1	7.0

In response to POIR No. 1, Question 4a, the Postal Service filed International data under seal. The 2009 ACD lists the following international market dominant products that failed to cover costs:

- Inbound Single-Piece First-Class Mail International;
- Inbound Surface Parcel Post (at UPU Rates); and
- International Ancillary Services.

The Postal Service's response provides the necessary projections to evaluate the products and services that failed to cover attributable costs in FY 2009. The forecasts provided by the Postal Service show that two of these products are not anticipated to generate sufficient revenues to recover attributable costs in FY 2011.

In general, the Public Representative believes that the Postal Service is proceeding in the right direction to ensure that products with insufficient cost coverages become self-sufficient, and that the price increases proposed by the Postal Service are reasonable and equitable among the market dominant mail classes. However, the Public Representative urges the Commission to require the Postal Service to develop and present a plan, including deadlines, for all products to cover attributable costs.

1. First-Class Mail

The Postal Service proposes a 2-cent (4.5 percent) increase for single-piece letters. Other than minor trepidation about any price increase, there is little evidence that this increase will harm residential single-piece mailers and presumably will be absorbed by the general public without much objection.[37] The rate increases that will be experienced by single-piece users are proportional to the rate increases that will be experienced by business mailers. Thus, the rate increases proposed by the Postal Service for First-Class Mail appear reasonable and equitable.

As shown in Table V-3, the Postal Service estimates the single-piece stamp increase alone will increase revenues by approximately $334 million in FY 2011. The remaining portion of First-Class Mail will provide almost 40 percent of the overall revenue generated by the proposal, or $781 million in additional revenue.

[37] The Public Representative reviewed the Commission's Public Commenter File on August 5, 2010. Only 295 comments were on file at that time. The comments generally opposed the increase, with a significant number of oppositions coming from religious organizations. To gauge the level of public concern with an exigent adjustment the Public Representative notes that 12,431 comments have been submitted concerning the six- to five-day delivery case by this same date. The unscientific conclusion is that the general public is far more concerned with a reduction in delivery than an increase in the price of a First-Class Mail single-piece letter stamp.

Table V-3
Projected Additional Revenue
Generated From Exigent Rate Adjustment
for First-Class Mail

	Before Rates Revenue ($ millions)	After Rates Revenue ($ millions)	Difference ($ millions)	Additional Revenue Distribution (%)
	(1)	(2)	(3)=(2)-(1)	(4)= (3)/Sum(3)
First-Class Mail				
Single-Piece Letters	11,910	12,244	334	16.86
Single-Piece Cards	380	939	13	0.66
Total Single-Piece Letters and Cards	12,290	12,637	347	17.53
Presort Letters	14,819	15,359	540	27.48
Presort Cards	696	700	4	0.21
Total presort Letters and Cards	15,515	16,059	544	27.48
Flats	3,119	3,235	115	5.82
Parcels	1,017	1,125	108	5.47
Total for First-Class Mail	32,108	33,223	1,115	56.31
Total for all Classes	67,676	69,656	1,980	100

Masse Statement, Attachments 10 and 11.

The Postal Service proposes two moderate classification changes for First-Class Mail Parcels. First, the Postal Service proposes to differentiate between commercial and retail users by postage payment method. Second, the Postal Service proposes to combine prices for one ounce, two ounce, and three ounce parcel prices into a single rate category. These changes result in price increases ranging from 2.9 percent for commercial three ounce parcels to 40.2 percent for one ounce retail parcels. The Postal Service justifies its price increases by asserting that “lightweight parcels are often not able to be processed on machines since they tend to fly off the trays or other conveyers due to their low weight.” Kiefer Statement at 22 fn. 19. The Public

Representative believes the Parcels classification changes are reasonable. The changes effectively increase the contribution for First-Class Mail Parcels, since all of the parcels will be priced at the three-ounce rate. First-Class Parcels had a 101.8 percent cost coverage in the 2009 ACD, therefore the Public Representative believes these increases and structural changes are appropriate to ensure the profitability of the product. However, the Public Representative is concerned that the changes may result in unexpected volume loss from the relatively large price increases for some mailers.

2. Standard Mail

The Postal Service proposes an overall increase of 6.2 percent for the Standard Mail class. As a result, Standard Mail is expected to generate $631 million in additional revenues.

The Postal Service's proposal includes a classification change which changes the existing name of the "Not Flat-Machinables (NFMs)/Parcels" product to "Parcels", and makes accompanying definitional changes. Request at 37. The Postal Service proposes a 23 percent price increase for the newly defined Parcels product (when compared to the existing product), which accounts for $120 million of the overall Standard Mail revenue increase. Not Flat-Machinables (NFMs)/Parcels previously accounted for 3.6 percent of total Standard Mail revenue in FY 2009, and exhibited an extremely low cost coverage. Therefore, the Public Representative supports the larger percentage increase for this product.

The Postal Service proposes a 5.1 percent increase for Standard Mail Flats, though it only exhibited an 82 percent cost coverage in FY 2009. In this docket, it is the lowest increase for any domestic product that did not cover its attributable costs in FY 2009. The Standard Mail Flats cost coverage has been an issue since FY 2008 when the Postal Service began reporting product level data. From FY 2008 to FY 2009, the unit attributable cost rose from 38.87 cents to 44.75 cents, a 15 percent increase. From

FY 2009 to FY 2011 the Postal Service anticipates a 2.15 cent cost decrease to 42.6 cents, or a 5 percent decrease in two years.

In response to the Commission's request for a plan to improve the Flats cost coverage in the 2009 ACD,[38] the Postal Service in this docket filed a "Flat's Strategy" that qualitatively outlines potential cost savings that may help improve the profitability of the product. The Postal Service lays out dozens of cost savings plans that may impact Flats. These strategies are qualitatively ranked as having been a "Large Opportunity", "Medium Opportunity," or "Small Opportunity." The Postal Service provides four transportation strategies, nineteen mail processing strategies, seven post office and delivery operations strategies, and one pricing strategy. The Postal Service has provided vague timelines for each strategy.

The Commission requested quantitative numerical data from the Postal Service to further explain the Flat Strategy proposals in POIR No. 1, questions 1 (a)-(f). In response, the Postal Service states:

> All programs for which cost savings have been planned or budgeted are contained in Mr. Masse's statement and associated materials. Beyond these programs, cost savings are more speculative; they are based on the size of the opportunity, but detailed plans for addressing each issue have not all been developed yet. Additional savings from the strategies in USPS-R2010-4/9 are part of the Postal Service's productivity goals, and are recognized in the BPI provisions of Mr. Masse's estimates.

Response to POIR No. 1, Question 1.

Because the Public Representative remains unconvinced that any real progress is being made, the Public Representative urges the Commission to reject the 5.1 percent proposed increase, and mandate at least a 7.0 percent increase for Standard

[38] 2009 ACD at 86-87.

Mail Flats.[39] The Postal Service cannot take a "wait and see" approach, because there may not be another opportunity to increase prices at a later date due to the CPI-U rate cap limitations.[40]

The Postal Service's attempt at providing quantitative data is troubling because it specifically does not respond to the flats cost coverage problem. The Postal Service should be able to quantify when cost savings and scheduled increases will have a positive impact on the Standard Mail Flats cost coverage. The Public Representative urges the Commission to require the Postal Service to provide a timeline (as it requested in the 2009 ACD) of when the Postal Service expects Standard Mail Flats will cover its attributable costs.[41] A goal should be established to demonstrate that the cost savings associated with the Standard Mail Flats product will result in the product covering its costs within the next 1 to 3 years. The timeline also should address the potentially low price cap limitations expected in the future.[42]

3. Periodicals

The Periodicals class as a whole has not covered its attributable costs since the PAEA was signed into law. The Postal Service has taken the opportunity afforded by this exigent rate adjustment to request an above CPI-U price adjustment that increases Periodicals' rates 8.0 percent, the largest rate increase (by class) requested. The

[39] The smallest increase for a domestic product not covering its costs in FY 2009 is Bound Printed Matter Parcels, which has a proposed 7.0 percent increase in this docket. The Public Representative believes the price increases, to be fair and equitable for Standard Mail Flats should be at least equal to the proposed increase for Bound Printed Matter Parcels.

[40] The Postal Service can give above average increases for this product within the Standard Mail class. The Public Representative believes the Postal Service is missing a valuable opportunity in this proposed rate adjustment.

[41] The hardship in the catalog industry may warrant a cost coverage slightly above 100 percent. However, a below 100 percent cost coverage, as well as a below average price increase is unacceptable.

[42] Global Insight forecasts CPI-U increases of 1.5 percent in FY 2010, 1.4 percent in FY 2011, and 2.0 percent in FY 2012. HIS Global Insight, U.S. Economic Service, Executive Summary, July 2010 at 11.

Postal Service forecasts that the increase will increase the Periodical's cost coverage from 76.1 percent in FY 2009 to 85.4 percent in FY 2011.[43] The Postal Service also expects that the costs for this class will decrease from 33.7 cents per piece in FY 2009 to 32.5 cents per piece in FY 2011.

While a larger price increase could solve the cost coverage problems within the Periodicals class, it potentially may result in rate shock. Thus, the Public Representative believes that the Postal Service is taking an appropriate action by increasing rates by 8.0 percent.

4. Package Services

The Postal Service proposes a 6.8 percent increase for the Package Services class. The Package Services class failed to generate sufficient revenues to recover attributable costs in FY 2009. Postal Service projections show that without a price increase, Package Services would have a 102.6 percent cost coverage and would contribute $38 million to institutional costs in FY 2011.[44] The Public Representative agrees with the Postal Service that this class of mail needs to become more profitable and the proposed price increase will further assist in that goal. The proposed 6.8 percent increase is expected to increase the Package Service's cost coverage to 107.3 percent and make a contribution to institutional costs of $105 million in FY 2011. These increases appear reasonable.

One troubling pricing proposal within this class concerns the Single-Piece Parcel Post low weight pieces.[45] The Postal Service has chosen to set these prices above similar zone/weight Priority Mail pieces. Single-Piece Parcel Post is considered a lower service product because it is typically transported using ground transportation and it has

[43] Without the increase, the Postal Service expects that the cost coverage would have risen to 80.7 percent.

[44] *See* Masse Statement, Attachments 10 and 11.

[45] One pound pieces to zones 1 to 6, and 2 to 4 pound pieces to zones 1 to 4.

a service standard of 1-4 days for local packages. On the other hand, Priority Mail advertises a 1-3 delivery standard for anywhere in the United States. The Public Representative believes that the Postal Service should retain the appropriate price signals between these two products. However, the Public Representative sees no reason for the Commission to reject the proposed Single-Piece Parcel Post prices. Instead, when the Postal Service files for a future Competitive price increase, the Commission should urge the Postal Service to set retail Priority Mail prices equal to or greater than their corresponding Single-Piece Parcel Post prices.[46]

5. Special Services

The Postal Service proposes a 5.2 percent increase for Special Services. The only two increases over 6.0 percent in the class are for International Ancillary Services (11.7 percent) and Confirm (13.1 percent). Both of these categories failed to cover their costs in FY 2009, therefore, both increases are reasonable and bring revenues closer to covering their attributable costs.

C. Workshare Discounts

In the 2009 ACD, the Commission determined thirteen workshare discounts that exceeded avoidable costs were not properly justified. Overall, the Postal Service has attempted to resolve many of the issues related to workshare discounts that were noted in the 2009 ACD. However, some discounts that were not an issue in the 2009 ACD, are at issue in this docket because passthroughs now are greater than 100 percent.

It is important to note that the proposed workshare discounts, in this docket, are based on FY 2009 cost avoidance estimates. The Postal Service has proposed a January 2, 2011, implementation date for the new prices. At approximately the same time (late December 2010), the Postal Service will provide FY 2010 avoided cost

[46] Mr. Kiefer testifies that the Postal Service anticipates setting Priority Mail rates at least equal to the corresponding Single-Piece Parcel Post counterpart rates. Tr. 3/465-7.

estimates. Thus, the Public Representative is concerned with the timing of the Postal Service's Request. If the Postal Service maintains a January implementation date, discounts will be continuously established using stale avoided cost estimates. In the future, the Public Representative believes the Postal Service should return to Spring implementation dates, so that the most up-to-date avoided cost estimates are used. Alternatively, the Postal Service should provide updated cost avoidance figures at the time of a rate adjustment request.

1. First-Class Mail

The Postal Service has reduced two of the three excessive First-Class Mail passthroughs cited by the Commission in the 2009 ACD. However, AADC letters, which had a passthrough of 110 percent in the 2009 ACD, now has a proposed passthrough of 120 percent. In addition, two First-Class Mail workshare discounts with passthroughs below 100 percent in the 2009 ACD, 3-digit and 5-digit Flats, are now proposed to be above 100 percent. Table V-4 shows the change in passthroughs from the 2009 ACD to the proposed passthroughs in this docket.

The Postal Service justifies the excessive discounts under 3622(e)(2)(B), as necessary to mitigate rate shock. The Postal Service explains that adjusting the three noncompliant passthroughs to 100 percent would result in a "ripple effect" and cause other presort discounts to receive 8 and 9 percent increases.[47]

The Public Representative appreciates the Postal Service's concern that forcing compliance of some workshare discounts may come at the expense of others. However, over the long term, discounts should approximately equal avoided costs. The Public Representative believes the Postal Service should provide a plan to phase out the excessive discounts.

[47] Kiefer Statement at 25-26.

Table V-4
Select First-Class Mail Workshare Discounts

Type of Worksharing (Benchmark)	**FY 2009 Unit Cost Avoidance (cents)**	**FY 2009 Year-End Discount (cents)**	**FY 2009 Pass-through (%)**	**R2010-4 Proposed Discount (cents)**	**R2010-4 Pass-through (%)**	**Change in Pass-through[1]**
Letters Barcoding & Presort						
Automation Mixed AADC (Bulk Metered Mail (BMM) Benchmark)	4.6	5.8	126.1	5.5	119.6	(-)
Automation AADC (Automation Mixed AADC Letters)	2.0	2.2	110.0	2.4	120.0	**(+)**
Flats Barcoding & Presorting						
Automation ADC (Automation Mixed ADC)	4.5	12.2	270.6	9.9	219.6	(-)
Automation 3-digit (Automation ADC)	6.4	6.1	95.7	7.2	112.9	**(+)**
Automation 5-digit (Automation 3-digit)	16.9	16.2	16.2	18.7	110.9	**(+)**

[1] This column displays whether the passthrough increases (+), decreases (-), or remained the same (=) for the 2009 ACD to the proposed Docket No. R2010-4 passthroughs.

2. Periodicals

Every Periodical Outside County workshare discount that exceeded 100 percent in the 2009 ACD remains above 100 percent in the instant docket, and some actually increase. *See* Table V-5. As the Postal Service has done in every ACD and rate adjustment, it relies on 3622(e)(2)(C) to justify the excessive discounts. Even though this class qualified for an ECSI exemption, the Public Representative does not believe that the Postal Service should rely on the exemption year-after-year without a plan to bring the discounts in line with avoidable costs, and thus send the appropriate price signals.

In the instant docket, the number of discounts that exceed 100 percent passthrough increases from the five discounts noted in the 2009 ADC to the nine now appearing in the Request. The Public Representative believes the workshare discounts within Periodicals should be monitored to ensure that the discounts move closer to 100 percent.

Table V-5
Select Periodical (Outside County) Workshare Discounts

Type of Worksharing (Benchmark)	**FY 2009 Unit Cost Avoidance (cents)**	**FY 2009 Year-End Discount (cents)**	**FY 2009 Pass-through (%)**	**R2010-4 Proposed Discount (cents)**	**R2010-4 Pass-through (%)**	**Change in Pass-through[1]**
Presorting - Flats						
Mach. Nonauto. 5-digit (Mach. Nonauto. 3-digit/SCF)	10.1	9.7	96.0	10.5	104.0	**(+)**
Mach. Auto. 5-digit (Mach. Nonauto. 5-digit)	8.9	8.6	96.6	10.0	112.4	**(+)**
Nonmach. Nonauto. ADC (Mach. Auto. 5-digit)	12.1	11.5	95.0	12.5	103.3	**(+)**
Nonmach. Nonauto. 3-digit/SCF (Nonmach. Nonauto. ADC)	4.5	7.4	164.4	8.0	177.8	**(+)**
Nonmach. Nonauto. 5-digit/SCF (Nonmach. Nonauto. 3-digit/SCF)	3.7	6.0	162.2	6.5	175.7	**(+)**
Prebarcoding - Flats						
Mach. Auto. MADC (Mach. Nonauto. MADC)	3.3	3.2	97.0	3.4	103.0	**(+)**
Presorting Automation Letters						
ADC Auto. (Mixed ADC Auto.)	1.7	4.0	235.3	4.3	252.9	**(+)**
3-digit Auto. (ADC Auto.)	0.2	2.0	1000.0	2.2	1100.0	**(+)**
5-digit Auto. (3-digit Auto.)	2.0	6.0	300.0	6.5	325.0	**(+)**

[1] This column displays whether the passthrough increases (+), decreases (-), or remained the same (=) for the 2009 ACD to the proposed Docket No. R2010-4 passthroughs.

3. Standard Mail

In the 2009 ACD, the Commission found twelve Standard Mail workshare discounts that exceeded avoidable costs. The Commission concluded that five of the discounts were not properly justified, three excessive discounts had anomalous avoided cost estimates, and four were justified, under 39 U.S.C. § 3622(e)(2)(D), as impeding efficient operations. The comments that follow address each of the above discounts, and also discuss discounts related to Parcel pre-barcoding, Automation Flats, and Irregular Parcels. In general, the Public Representative believes all excessive discounts should be phased out, regardless of whether the excessive passthrough qualifies for an exemption under 3622(e)(2). In this docket, the Public Representative believes that the Postal Service has not properly justified discounts for Regular, Flats pre-barcoding, and Automation Mixed ADC. A summary of the current and proposed Standard Mail discounts are shown in Table V-6.

(1) Discounts not properly justified as of the 2009 ACD

The following five excessive discounts were found to not have adequate justification in the 2009 ACD:

- Non-automation 3-digit non-machinable letters;
- Non-automation 5-digit non-machinable letters;
- Automation ADC flats;
- Automation 3-digit flats; and
- 5-digit non-automation flats.

The Commission requested that the Postal Service adjust all of the discounts to equal their avoided costs at the time of the next general rate adjustment. 2009 ACD at 82.

In the instant docket, the Postal Service has set each of the above discounts equal to the respective avoided costs. The Public Representative believes this is responsive to the issues raised by the Commission in the 2009 ACD.

Table V-6
Select Standard Mail Workshare Discounts

Type of Worksharing (Benchmark)	**FY 2009 Unit Cost Avoidance (cents)**	**FY 2009 Year-End Discount (cents)**	**FY 2009 Pass-through (%)**	**R2010-4 Proposed Discount (cents)**	**R2010-4 Pass-through (%)**	**Change in Pass-through[1]**
Regular Letters - Presorting						
Nonauto. 3-digit (Nonauto. ADC Nonmach.)	2.6	4.4	169.2	2.6	100.0	(-)
Nonauto. 5-digit (Nonauto. 3-digit Nonmach.)	11.5	11.7	101.7	11.5	100.0	(-)
Regular Flats - Presorting						
Auto. ADC (Auto. Mixed ADC)	0.0	1.0	N/A	0.0	100.0[2]	(-)
Auto. 3-digit (Auto. ADC)	6.3	6.8	107.9	6.3	100.0	(-)
Nonauto. 5-digit (Nonauto. 3-digit)	8.5	9.7	114.1	8.5	100.0	(-)
Regular Flats - Prebarcoding						
Auto. Mixed ADC (Nonauto. Mixed ADC)	3.1	6.2	200.0	7.7	248.4	**(+)**
Presorting Parcels						
NDC Mach. (Mixed NDC Mach.)	21.8	40.0	183.5	34.8	159.6	(-)
5-digit Mach. (NDC Mach.)	41.3	43.9	106.3	36.4	88.1	(-)
5-digit Irregular (SCF Irregular)	18.2	5.9	32.4	27.0	148.4	**(+)**
Prebarcoding Parcels and NFMs						
Mixed NDC Mach. Barcoded Parcels (Mixed NDC Mach. Nonbarcoded Parcels)	3.8	7.0	184.2	7.0	184.2	(=)
Mixed ADC Irregular Barcoded Parcels (Mixed ADC Irregular Nonbarcoded Parcels)	3.8	7.0	184.2	7.0	184.2	(=)
Mixed ADC Barcoded NFMs (Mixed ADC Mach. Nonbarcoded NFMs)	3.8	7.0	184.2	7.0	184.2	(=)

[1] This column displays whether the passthrough increases (+), decreases (-), or remained the same (=) for the 2009 ACD to the proposed Docket No. R2010-4 passthroughs.
[2] Discount equals unit cost avoidance.

(2) Discounts with anomalous avoided costs estimates as of the 2009 ACD

The following three discounts had anomalous avoided costs estimates in the 2009 ACD:

- Automation Mixed AADC Letters;
- High Density-Saturation letters differential; and
- Carrier Route-High Density parcels differential.

In this docket, the Postal Service states:

> As of the date of filing of this price adjustment, the Postal Service has not been able to resolve the issues that led to negative avoided costs for Carrier Route-High Density parcels differential, the High Density-Saturation letter differential, or the pre-barcoding avoided cost for automation letters.

Request at 33.

The anomalous avoided cost estimates, which produce negative passthroughs, remain in the instant docket. Because the avoided cost estimates are anomalous, the Public Representative is unable to draw any conclusion as to whether the discounts are reasonable or equitable. The Public Representative asks the Commission to require the Postal Service to develop reliable avoided cost estimates such that the discounts can be properly analyzed.

(3) Discounts properly justified as of the 2009 ACD

In the 2009 ACD, the Commission found the following four Standard Mail workshare discounts properly justified under 39 U.S.C. § 3622(e)(2)(D), impedes efficient operations:

- Regular Flats- Pre-barcoding Automation Mixed ADC;
- Presorting Parcels- NDC Machinable;
- Presorting Parcels- 5-digit Machinable; and

- Pre-barcoding Parcel Discount
  - Pre-barcoding Parcels - Mixed NDC Machinable
  - Pre-barcoding Parcels - Mixed ADC Irregular
  - Pre-barcoding NFMs - Mixed ADC.

Except for 5-digit Machinable Parcels, each of the passthroughs associated with the above discounts remain above 100 percent. The Postal Service proposes reducing passthroughs for NDC Machinable Parcels and Presort 5-digit Parcels. The Public Representative believes the Postal Service should continue to decrease discounts that exceed avoidable costs, even if the discount qualifies for an exception under 39 U.S.C. § 3622(e)(2). The Public Representative believes these rates are both equitable and reasonable because the Postal Service is moving the discounts closer to their avoided costs.

The Postal Service has proposed no change for the remaining Parcel pre-barcoding discounts.[48] The Postal Service notes that the passthrough for these workshare discounts are calculated using a possibly unreliable Bound Printed Matter proxy.[49] While the Public Representative believes these discounts should be reduced over time, there is no reason to object to discounts remaining the same since reliable cost estimates are not available, and it qualifies for an exemption under 39 U.S.C. § 3622(e)(2). However, the Public Representative believes the Postal Service should either file a plan to reduce the excessive discount, or work towards a reliable avoidable cost estimate.

(4) Automation Flats discounts

The Postal Service proposes to increase the passthrough for Automation Flats. The proposed discount increases the passthrough from 200 percent in the 2009 ACD to

[48] Mixed NDC Machinable Barcoded Parcels, Mixed ADC Irregular Barcoded Parcels, and Mixed ADC Barcoded NFMs.

[49] Kiefer Statement, Appendix B.

248 percent, or 6.2 cents to 7.7 cents, in this docket. As discussed previously, the Public Representative does not believe that an exemption under 39 U.S.C. § 3622(e) gives the Postal Service the authority to continue setting discounts greater than avoided costs without a plan to bring discounts back in line with avoided costs. In this instance, the Postal Service has not provided sufficient justification to increase the Automation Flats passthrough from 200 to 248 percent. The Postal Service should be required, at a minimum, to explain why the current excessive passthrough (200 percent in the 2009 ACD) does not create a sufficient incentive for mailers to presort parcels, and report how the Postal Service expects to reduce the difference between the discount and avoided cost over time.

(5) 5-digit Irregular Parcels discount

The 5-digit Irregular Parcel discount did not exceed avoided costs in the 2009 ACD, but now has a proposed passthrough of 148.4 percent. In response to POIR No. 1, Question 8, the Postal Service confirmed the passthrough for 5-digit Irregular Parcels exceeds avoided costs. The Postal Service explains that the increased discount, 5.9 to 27 cents, "encourages all potentially machinable parcels to be sorted at the NDCs" and "the larger passthrough is needed to ensure efficient mail processing, consistent with 3622(e)(2)(D)." Response to POIR No. 1, Question 8. The Postal Service later states that it "has observed that some mailers have been entering potentially machinable parcels as irregular parcels at destination Sectional Center Facilities (DSCFs)." *Id.* The Postal Service believes that processing parcels at the NDC is most efficient. So, it believes increasing the 5-digit Irregular Parcel discount will encourage more efficient operations. The Public Representative believes this is in line with the Postal Service's position that parcels are more efficiently handled at the NDC. However, the Public Representative urges the Commission to encourage the Postal Service to reduce the discount to equal avoided costs.

4. Package Services

In the 2009 ACD, the Commission found seven Package Services workshare discounts that exceeded avoidable costs. Three were properly justified[50] and four were not.[51] The four discounts that the Commission found not sufficiently justified have been remedied in the instant docket. Now each previously unjustified passthrough is equal to 100 percent of avoided costs. *See* Table V-7. The Postal Service has continued to bring the other three discounts that had exemptions in the 2009 ACD closer to a 100 percent passthrough. The Public Representative believes that the discounts are reasonable and equitable.

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[50] Media Mail Basic Presort, Media Mail 5-digit Presort, and Library mail 5-digit Presort. 2009 ACD at 98.

[51] Bound Printed Matter Flats DNDC Dropship, Bound Printed Matter Flats DDU Dropship, Bound Printed Matter Parcels DNDC Dropship, and Bound Printed Matter Parcels DDU Dropship. 2009 ACD at 100 to 101.

Table V-7
Select Package Services Workshare Discounts

Type of Worksharing (Benchmark)	**FY 2009 Unit Cost Avoidance (cents)**	**FY 2009 Year-End Discount (cents)**	**FY 2009 Pass-through (%)**	**R2010-4 Proposed Discount (cents)**	**R2010-4 Pass-through (%)**	**Change in Pass-through**[1]
Media Mail - Presorting						
Basic (Single-Piece)	37.0	39.0	105.4	37.0	100.0	(-)
5-digit (Basic)	24.0	37.0	154.2	35.0	145.8	(-)
Library Mail - Presorting						
5-digit (Basic)	24.0	35.0	145.8	33.0	137.5	(-)
Bound Printed Matter Flats - Dropship						
Basic, Carrier Route DNDC Flats (Basic Origin Flats)	21.7	22.0	101.4	21.7	100.0	(-)
Basic, Carrier Route DDU Flats (Basic Origin Flats)	76.1	79.5	104.5	76.1	100.0	(-)
Bound Printed Matter Parcels - Dropship						
Basic, Carrier Route DNDC Parcels/IPPs (Basic Origin Parcels/IPPs)	21.7	21.8	100.5	21.7	100.0	(-)
Basic, Carrier Route DDU Parcels/IPPs (Basic Origin Parcels/IPPs)	76.1	79.5	104.5	76.1	100.0	(-)

[1] This column displays whether the passthrough increases (+), decreases (-), or remained the same (=) for the 2009 ACD to the proposed Docket No. R2010-4 passthroughs.

D. Mail Classification Changes

The Postal Service suggests several mail classification changes in the instant docket. Less significant classification changes are not of concern. However, the Public Representative does not believe that major classifications proposals such as the "Reply

Rides Free Program" and the "Saturation and High Density Incentive Program" are in line with the intent of an exigent filing. The Public Representative believes these programs should not be considered in this docket. An exigent rate adjustment is not the place to evaluate substantial mail classification changes, unless the changes are fundamental to the exigency request. Neither the Reply Rides Free Program nor the Saturation and High Density Incentive Program are fundamental to the exigent request.[52] Regardless, the Postal Service did not initially provide data concerning the profitability of these initiatives. Any major proposals to change the current rate structure should have adequate financial support filed with the proposal to ensure profitability.

1. Reply Rides Free

The Reply Rides Free pricing initiative allows First-Class Mail Presort and Automation Letters over 1 ounce and below 1.2 ounces to qualify for the 1 ounce price. Kiefer Statement, Attachment A, at 1. The Postal Service believes that many current mailers are "filling to the ounce", meaning that many mailers keep the weight per piece below one ounce. *Id.* The hope is that the initiative will increase the amount of promotional inserts placed in these mailpieces. *Id.* The Postal Service believes that these advertising inserts will generate additional mail, and therefore additional revenue.

Mailers who wish to participate in the Reply Rides Free program must commit to increase their First-Class Mail Presort and Automation Letter volume by 2.5 percent in the program year. *Id.* at 2. Mailers must also consent to enclosing a reply card or envelope in the mailpiece, using Full-Service IMb, and random verifications to ensure compliance with enclosure requirements. *Id.* at 1.

[52] The Postal Service has indicated that the volume, revenue, and cost forecasts provided in this docket do not take into account mail classification changes; therefore, separating the mail classification changes from the instant docket do not impact the overall financial results projected by the Postal Service.

The Postal Service has not provided any quantitative analysis demonstrating additional profitable volume will be created from the incentive.[53] The Public Representative has no basis for supporting or objecting to this proposal due to the lack of information presented. As previously stated, the proposal requires a more comprehensive review in a separate docket.

2. Saturation and High Density Incentive Program

The Saturation High Density Incentive Program extends the current Saturation Mail Volume Incentive Program to High Density mailers. To qualify for the program, mailers must commit to mail at least what they mailed in CY 2010 plus a 5.5 percent threshold. Once the mailer surpasses the threshold, excess pieces will be eligible for a percentage rebate off of their average revenue per piece.

The Public Representative has no specific objection to this proposal, but believes that the proposal requires a more comprehensive review in a separate docket. The Public Representative also believes the proposed Mail Classification Schedule language should be improved to reflect the program requirements discussed in Kiefer Statement, Appendix A.

[53] As an example of the inadequacy of support for this program, the Postal Service estimates the additional cost per piece for this program is $0.054. POIR No. 2 Question 8, POIR.2.Q.1.8.10.xlsx, tab: Reply Ride Free, cell: C22. POIR No. 3, Question 4a asked the Postal Service to explain the rationale and provide a source for each assumption. In response, the Postal Service failed to provide a rational or source for the cost figure.

VI. CONCLUSION

The Public Representative concludes that the Postal Service has not adequately justified its exigent Request, and until such time that adequate justification can be provided, the Request should be denied. However, if approved, potential revenues obtained as a result of this exigent Request are insufficient and only temporarily improve the Postal Service's precarious financial condition. Other Congressional action, or a vastly improving national economy, is necessary to provide concrete long-term relief. Without other intervention, the probability is high that the Postal Service will need to file a second exigent request in FY 2011. The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

Respectfully submitted,

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