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POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

RATE ADJUSTMENT DUE TO EXTRAORDINARY OR EXCEPTIONAL CIRCUMSTANCES

Docket No. R2010-4

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE

UNITED STATES POSTAL SERVICE

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Introduction

On July 8, 2010, the Commission issued Order No. 485, which established dates for receiving comments in this docket regarding the Postal Service's request for an exigent price increase. Order No. 485 set August 17th as the date for initial comments, and September 2nd as the date for reply comments. In the interim, on July 26, 2010, the Affordable Mail Alliance (AMA) filed a motion to dismiss the Postal Service's request (hereinafter "AMA Motion"). The Commission, in Order No. 507 (August 4, 2010), citing the need for further investigation of the allegations made in the AMA's Motion, took the Motion under advisement and stated that it would rule on the Motion at an appropriate time.

Over two dozen parties have filed initial comments in the instant docket. Many of these comments reiterate and/or expand on issues that were raised in the AMA's Motion. The Postal Service addressed those issues in its August 2nd Response to the AMA Motion (hereinafter "Response"), and the Postal Service hereby incorporates by reference the arguments contained in that pleading. In addition to these broader issues, other initial comments express support or opposition for discrete price and/or classification changes in the Postal Service's proposal.

With such a large number of parties submitting initial comments, the Postal Service will herein discuss the key issues collectively raised by various parties. Citations to particular parties' comments are included where the Postal Service has provided a specific reply. However, if the Postal Service has failed to cite to a particular party's comment in any section below, it should not indicate that the Postal Service supports those views. The Postal Service submits that its position on all of the salient issues facing the Commission in this docket has been fully presented in the Postal Service's initial Request, its Response to the AMA Motion, its testimony, its responses to Commission inquiries, and in these reply comments.

Summary of Argument

Extraordinary or Exceptional Circumstances

The Postal Service has demonstrated that a 12.7 volume decline in a single year, and a 20.1 percent decline over three years, constitutes unprecedented circumstances that are "extraordinary or exceptional" within the plain meaning of those terms. As witness Corbett discusses, these year-to-year volume declines dwarf anything experienced by the Postal Service, or its predecessor (the Post Office Department), since the Great Depression.

There is nothing in the language of the "extraordinary or exceptional circumstances" standard that indicates that volume declines cannot constitute the requisite "circumstances." Even after an examination of the *causes* of these volume declines, the "extraordinary or exceptional" standard is still satisfied. While AMA and its allies are correct that recessions are part of the business cycle, that argument fails to take account of the fact that some recessions can be abnormally or unusually severe, and thus be considered "extraordinary or exceptional." The opposing parties fail to explain why *this recession* has not had an effect on the Postal Service that is unusually severe, as manifested by the historic loss of volumes that has occurred, and the affect it has had on customer behavior, which has led to less postage for the volume that has remained in the mail. Furthermore, while the gradual diversion of mail to electronic communications is not "abnormal," the situation changes substantially when that trend begins to accelerate significantly in a very short number of years, caused in large part by the recession itself.

Having no answer to the Postal Service's point that year-to-year volume declines not experienced since the Great Depression are within the ordinary meaning of "extraordinary or exceptional," the AMA argues that the Commission should not look to the plain meaning of those terms in applying the statute. Rather, it argues that the legislative history and context of the statute requires a different interpretation, presumably one in which the standard can only extend to events such as terrorist attacks or natural disasters. However, there is nothing in the legislative history or statutory context that demonstrates that "extraordinary or exceptional" cannot be given their ordinary meaning (or that the current circumstances do not qualify as "extraordinary or exceptional"). The AMA has not demonstrated that *this case* constitutes an inappropriately expansive interpretation of the statutory terms, such that it would eliminate the efficiency incentives of the cap. In addition, the legislative history affirmatively demonstrates that Congress intended the standard to be *broader* than simply terrorist attacks, natural disasters, or other events that could fall within the apparent scope of the Senate exigency standard of "unexpected and extraordinary." The Commission therefore cannot permissibly interpret the standard as if it only encompasses such circumstances.

While Time Warner does not contest the Postal Service's position that "unforeseeability" is not a required element of meeting the “extraordinary or exceptional” standard under the plain meaning of those terms, it seeks to quibble with the Postal Service’s characterization of AMA’s position on this topic, its own prior comments, and Commission precedent. However, Time Warner’s declaration that “extraordinary or exceptional circumstances” are rarely “foreseeable or foreseen” is not only wrong, but is of no utility in interpreting the meaning of the statute. With regard to natural disasters, or (unfortunately in this age) terrorist attacks, or recessions, or a myriad of other potential “circumstances” that might occur, one can always claim that they were “foreseeable.” As such, the important question is not whether a particular circumstance was reasonably “foreseeable,” but whether the circumstances giving rise to the question are sufficiently abnormal or unusual to qualify under the plain meaning of those terms.

Time Warner’s reading of precedent is also flawed. The Postal Service was clearly correct when it stated in its Response that the Commission had recognized that Order No. 26 could not be relied upon as a statement of the legal requirements of 3622(d)(1)(E). This is clearly evident from the fact that the rule in question went from dictating a required justification for the filing of an exigent request, to simply a rule that required the Postal Service to discuss foreseeability “if applicable” in order to “shed light on matters of considerable concern to mailers.” Furthermore, while Time Warner may find it inconvenient now, it was the Commission that cited its comments as indicating that Order No. 26 was incorrect.

GCA's argument that the Postal Service can only propose a 3.55 percent or 3.84 percent increase under the "extraordinary or exceptional" standard is fatally flawed. First, it treats the 5.6 percent increase proposed by the Postal Service as if it was the maximum increase that possibly could have been proposed. However, the requested increase is a significant reduction from the amount that would be proposed if the Postal Service sought to offset the full impact of the exigent circumstances. Thus, even assuming that a portion of the recession is "non-exigent" and cannot justify an above-cap increase, that would provide no basis for reducing the very moderate increase that the Postal Service has proposed.

In addition, in considering the severity of the recent recession, GCA takes no account of the magnitude of its effect on the Postal Service. Considering section 3622(d)(1)(E) is designed to ensure that the Postal Service is able to maintain adequate postal services subsequent to unusual or abnormal events that adversely affect Postal Service finances, it stands to reason that application of this provision requires a consideration of the extent to which the Postal Service has itself experienced abnormal or unusual circumstances. Nor is it appropriate to skew rates according to some arbitrary calibration of causal factoids, without considering the actual financial impact of a particular set of circumstances on the Postal Service.

Necessary

As the law is written, the Commission, before granting the Postal Service the authorization it seeks, must determine that the proposed price adjustments are "necessary to enable the Postal Service … 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). Therefore, any claim that an exigent revenue infusion beyond that strictly necessary to keep the Postal Service from defaulting on its cash obligations is "unnecessary" would be directly inconsistent with the expansive scope of the needs of the Postal Service which the statute explicitly requires must be considered. Yet the AMA Comments make exactly such a claim, asserting that proposed increases are not "necessary" because they would not extend postal operation "by a single day." Mr. Corbett, however, explained that with the Postal Service expected to lose approximately $7 billion in FY 2011, even assuming temporary relief from the impending liquidity crisis by virtue of not-yet enacted legislative relief regarding Retiree Health Benefits (RHB) funding, the prospects of multi-billion dollar losses for the year remain unchanged. Of course, such legislative relief is beyond the control of the Postal Service or the Commission, and assumptions regarding the legislative process are fraught with peril. Under the plain language of the law, the Postal Service's moderate proposed increases meet and surpass the statutory "necessary" standard.

Moreover, the AMA is likewise in error to claim that postal officials changed their views regarding the forecast horizon over which the "necessary" determination should be focused. The Postal Service's exigent request, while importantly part of a broader long-term plan, is based on the financial circumstances facing the Postal Service in FY 2011. Witnesses Corbett and Masse responded to questions regarding years beyond that to show that subsequent events are extremely unlikely to render "necessary" price increases "unnecessary" in the years following, given the totality of the circumstances that the Postal Service is facing over that period, and also to demonstrate that the moderate increases sought are but one part of management's balanced, comprehensive, and carefully considered approach to deal with those circumstances.

Unlike AMA, Time Warner argues that the "necessary" standard must be applied to each class individually and separately. This claim is impractical. Time Warner is trying to cram a round peg in a square hole, confusing the distinction between evaluation of "reasonable and equitable" with the distinct review of "necessary." Moreover, to the extent that Time Warner suggests that above-average increases for a class of mail that has constantly failed to cover its costs over many years are not "necessary," it should not be surprised that its claim rings hollow. Lastly, the fundamental flaw in the Public Representatives challenge to authorization for exigent increases is that it is premised on the alleged failure of the Postal Service to present a case consistent with a framework which as yet exists only in the imagination of the Public Representative.

Honest, Efficient, and Economical Management

As the Postal Service pointed out in its Response to AMA's Motion to Dismiss, "honest, economical, and efficient management" of the Postal Service can only fairly be judged in light of the legal and pragmatic reality in which the Postal Service operates. It would be inappropriate to hold Postal Service management responsible for not behaving as radically as a private-sector business when the Postal Service simply does not have the same range of options available to it. These constraints include not only the options that private firms might be free to exercise, such as bankruptcy or cessation of employee retirement contributions, but also affirmative obligations placed on the Postal Service, such as universal service and six-day delivery.

Moreover, "honest, efficient, and economical management" must inhere a substantial measure of deference to Postal Service management's reasonable business judgment. Even if a given measure might arguably reduce costs, it is consistent with "honest, efficient, and economical management" for the Postal Service to weigh those cost reductions against mitigating factors and requirements, such as maintaining high quality of service, distribution of core supervisory staff, administrative burdens, and the expense and loss of political capital involved in arbitration.

Under any reasonable standard, the Postal Service has exercised "honest, efficient, and economical management" in its response to the recent volume declines. While, for reasons explained in the Postal Service's Response, the Postal Service experienced Total Factor Productivity (TFP) declines during the first period of the Great Recession, the Postal Service's responsive efforts have resulted not only in recoupment of all TFP lost, but also in new gains to record TFP levels. Even while maintaining very high levels of service, the Postal Service has reduced its workforce by unprecedented levels, particularly in the areas most responsive to volume; for instance, workhours for mail processing and customer service has dropped by a percentage greater than the decline in volume. While it has proven more difficult to streamline aspects of the Postal Service network that are more fixed in nature (such as City and Rural Delivery), the Postal Service is working, through initiatives such as the 5-day case, to aggressively address these costs as well. The Postal Service has also streamlined a wide range of operations and facilities, far more than is suggested by the AMA's lone statistic about Processing and Distribution Centers, and the Postal Service is planning an even greater level of network optimization, though its ability to do so is oftentimes hemmed in by legal and political considerations for which private businesses need not account.

The Postal Service has also attained significant gains in reducing labor costs, which are not acknowledged by the AMA and Flat-Shaped Mail Users. These include restructuring of delivery routes, reductions in work hours and employees, and facility consolidations. Thus, the Postal Service has already pursued the AMA's proposal to "reopen labor agreements," to the extent that it is able to receive the necessary consensus from its contract partners. Although the Postal Service is committed to further cost reductions in its upcoming labor negotiations, any outcome remains in the future and might not show an effect on

Postal Service finances for some time after it is reached: it would be premature to factor the possible outcome of labor negotiations into the immediate, exigent request.

Pricing and Classification

The Postal Service's pricing in this docket reflects a balance among several competing factors. For First-Class Mail, the major balance is between the standard that worksharing discount be no more than avoided costs, and the impact on mailers (and Postal Service finances) of reduced discounts. For Standard Mail, the major balance is between covering costs for Standard Mail Flats and Parcels, and the impact on mailers of higher prices. The results are different for Flats, which are in an industry that is particularly vulnerable in the short term, compared to Parcels, which are in a competitive environment in which postal prices are relatively low. For Periodicals, the major balance is between the opportunity to move closer to covering costs, and the impact on the fragile Periodicals industry.

Appropriately balancing the cost-related standards with the marketplace considerations is important in all classes of mail, but it is of paramount importance for First-Class Mail and Standard Mail. These two classes together make up nearly 90 percent of the Postal Service's Market Dominant revenues. Pricing signals that lead to substantial volume declines could impact the very survival of the Postal Service.

The proposed classification changes, including two initiatives intended to retain and increase mail volumes, are appropriate for this exigent filing, because they do not create, remove, or transfer a postal product, and are closely related to price changes needed for the Postal Service's response to extraordinary and exceptional circumstances. The 90-day exigent proceeding actually provides more due process than these classification changes would receive if they were filed separately as classification or price changes.

Forecasting

The National Postal Policy Council (NPPC) opposes the exigent price adjustments by, among other things, criticizing the Postal Service's forecasting methodology for Bulk First-Class Mail as it relates to the electronic diversion of mail, and presenting survey results intended to show that the Postal Service has understated the mailers' volume response to the proposed price increase for that product. The survey results do not provide reliable support for NPPC's assertions, and the other criticisms of the forecasting methodology are likewise not valid. NPPC has failed to support any tangible claims that the Postal Service's forecasting model is not adequate for the purpose presented within the range of proposed increases.

Discussion

I. The Postal Service Has Clearly Demonstrated that Extraordinary or Exceptional Circumstances Have Occurred

Throughout this proceeding, the Postal Service has discussed the fact that a 12.7 volume decline in a single year, and a 20.1 percent decline over three years, constitutes unprecedented circumstances that are "extraordinary or exceptional" within the plain meaning of those terms. See, e.g., Postal Service

Response at 11-15; Request at 1-2; Tr. 1/49-51. "Extraordinary" is defined as "beyond what is usual, ordinary, regular, or established," while "exceptional" is defined as "forming an exception or rare instance" or "unusual." See WEBSTER'S ENCYCLOPEDIC UNABRIDGED DICTIONARY 674, 686 (1996). Indeed, as witness Corbett discusses, these year-to-year volume declines dwarf anything experienced by the Postal Service, or its predecessor (the Post Office Department), since the Great Depression. Corbett Statement at 4, 11-13.

Several parties agree that "extraordinary or exceptional circumstances" have occurred, though in certain instances they concentrate on the causes of the volume declines, rather than simply the volume declines themselves. See PR Comments at 18; Stamps.com Comments at 1-2; Valpak Comments at 12-14; GCA Detailed Analysis at 6; NPMHU Comments at 2. The NPMHU notes that "a sudden drop in mail volume of more than twenty percent" meets the statutory standard. NPMHU Comments at 2.

The AMA and its constituent parties, meanwhile, fail to make any serious attempt to demonstrate that volume declines of such a precipitous and historic nature fail to rise to the ordinary meaning of "extraordinary or exceptional." Rather, they assert that, for various reasons, the Commission should disregard the plain meaning of those terms. However, their arguments fail to give any license to the Commission to do so, or to disregard the fact that the current circumstances clearly qualify under the plain meaning of "extraordinary or exceptional." Meanwhile, while GCA agrees that "exceptional" circumstances have occurred, it incorrectly argues that these exigent circumstances only permit a smaller increase than that proposed by the Postal Service.

A. A 20 percent decline in volume in three years, including a 12.7 percent decline in volume in a single year, is "extraordinary or exceptional"

i. Opposing parties fail to demonstrate that the current circumstances are not "extraordinary or exceptional" within the plain meaning of those terms

There is nothing in the language of the "extraordinary or exceptional circumstances" standard that indicates that volume declines cannot constitute the requisite "circumstances." GCA asserts that volume declines themselves cannot constitute exigent circumstances because unusual or out-of-the-ordinary volume declines could be precipitated by some manner of mismanagement by the Postal Service. GCA Comments at 7. It is hard, however, to imagine a scenario where volume declines that rise to an "extraordinary or exceptional" level would occur solely because of some inappropriate action by management; furthermore, if it did, the exigent case could be dismissed, since by definition a rate increase would not be "necessary" under the "honest, efficient, and economical management" standard. Furthermore, this is not the case here: GCA does not allege that the volume declines are the result of mismanagement, as opposed to other events; not even the AMA makes that argument. Once this point is conceded, trying to determine precisely how much volume declined for each particular reason is not as important as understanding that, as discussed by the Postal Service in its Response, such precipitous volume declines have an exceptionally pernicious effect on the Postal Service's finances due to its cost structure, and the unique political and statutory requirements and restrictions under which it operates. These declines are also particularly challenging in the context of a CPI cap that does not take volume shifts into account.[1]

Even after an examination of the *causes* of these volume declines, the "extraordinary or exceptional" standard is still satisfied. Witness Corbett

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[1] The AMA continues to assert that the current cap is not "challenging" because it does not include a productivity offset. AMA Comments at 18 n.6. Note, however, that the Postal Service's first argument in its Response (which AMA does not contest) was that the cap is "challenging" because a very large percentage of the Postal Service's cost inputs rise above CPI, and are beyond direct management control. See Response at 48. This includes the costs relating to statutory benefits, network growth, and wages. Because of this, the Postal Service has to substantially increase productivity for those costs within its control in order to compensate for the fact that many of its costs increase by greater than CPI, which can, taken as a whole, totally consume the increased revenue available from rises in the CPI. This operates as a *de facto* negative adjustment factor, and makes the cap extremely challenging. In addition, the notion that a productivity offset is necessary in this context presumes that Postal Service productivity gains have traditionally exceeded the productivity gains in the economy as a whole, and which are therefore embedded in the inflation index. See, e.g., In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, 5 F.C.C.R. 6786, 6796 (October 4, 1990) ("In prior Notices in this proceeding, the Commission explained that the mechanism used to cap LEC rates must include both a measure of inflation and a measure of the amount by which LEC productivity exceeded that of the economy as whole. The inflation measure embodies economy-wide productivity gains and price changes, *while the "productivity offset" subtracts the amount by which LECs can be expected to outperform economy-wide productivity gains*.") (internal footnotes omitted); In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, 4 F.C.C.R. 2873, 2989 (April 17, 1989) ("As we stated in the Further Notice, an analysis of productivity must begin with a determination of whether the productivity of the telecommunications industry has exceeded that of the economy as a whole. *Only if telecommunications productivity experiences greater gains than does the general economy is it necessary to include a productivity offset in our price cap index*.") (emphases added). Considering the labor-intensive nature of the Postal Service's costs, while the Postal Service's productivity gains have proven comparable to those of the private sector (prior to the significant decline in workload in the last several years, though as noted elsewhere Postal Service productivity rates have bounced back), they have certainly not justified the imposition of a productivity offset. This point was made by Dr. William Baumol in a statement to Congress. Dr. Baumol noted that, even presuming the selection of an inflation index well suited to the Postal Service's labor-intensive cost structure (as opposed to CPI, the selection of which he believed "poses an enormous peril for the Postal Service"), a productivity offset "very close to zero may be unavoidable, because "the handicraft nature of much of the activity of the service can prevent any substantial and cumulative productivity gains." See Statement of William J. Baumol to the Committee on Government Reform and Oversight, House of Representatives (April 16, 1997), *reprinted in* H.R. 22, The Postal Reform Act of 1997, Hearing Before the Subcommittee on the Postal Service of the Committee on Government Reform and Oversight, House of Representatives, 105th Cong. at 268 (1997).

Furthermore – and most importantly for purposes of this proceeding -- regardless of whether the CPI cap is challenging in normal circumstances, it becomes extremely onerous in the context of precipitous volume declines, due to the Postal Service's cost structure. The Postal Service made this point in its Response (see pages 51-55), a point that AMA does not contest.

discusses that the causes of the precipitous declines are primarily due to the recent recession. See Tr. 1/24, 29-30. In its Comments, the AMA simply reiterates the tropes from its Motion that recessions are *per se* incapable of constituting "extraordinary or exceptional circumstances" because they are "recurring events." The AMA also argues that, even if recessions could constitute exigent circumstances, the recent recession "was not severe enough to prevent well-run large American businesses…from returning to profitability by cutting costs within a quarter or two after the recession bottomed out in the spring of 2009." See AMA Comments at 8; see also NAA Comments at 3, 5 (arguing that "[a] loss of business due to an economic recession may be painful and difficult, but it is not 'extraordinary or exceptional.'").

The AMA cannot rely on the notion that recessions are a "fact of life"; while that is true, it fails to take account of the fact that some recessions can be abnormally or unusually severe, and thus be considered "extraordinary or exceptional."[2] In this regard, AMA fails to explain why *this recession* has not had an effect on the Postal Service that is unusually severe, as manifested by the historic loss of volumes that has occurred, a loss of volume that overwhelms that experienced by the Postal Service cumulatively in all previous recessions since Reorganization. See Corbett Statement at 4, 11-13. Furthermore, the recession has not only precipitated a dramatic drop in volume, it has also affected customer behavior so that the volume that has remained has oftentimes been paying less

[2] To the extent the AMA is relying on the "foreseeability" of recessions, it provides the AMA with no help. As the Postal Service has previously noted, and discusses further below, unforeseeability is not a required element of demonstrating "extraordinary or exceptional" circumstances. Furthermore, even if it was, the severity of the recent recession and its effect on the Postal Service was clearly unforeseeable. See Corbett Statement at 15-16; Tr. 2/188.

postage than before. For instance, the weight per piece for Periodicals has dropped steeply (especially the more profitable advertising weight), customers have in many instances switched their advertising mail from First-Class Mail to Standard Mail, catalogs have reduced their weight by printing less pages and using thinner paper, and Express Mail volumes have migrated to Priority Mail as customers buy down. All of this changed behavior has affected Postal Service revenue.

These volume and revenue declines are not simply the result of "predictable and natural cyclical changes in the economy and mail usage," as has been suggested (Senator Collins Letter at 1). Indeed, as the GCA has noted, "If the severity of the 2008-2009 recession is not considered an 'exceptional' circumstance under PAEA as reflected in part by the depth of postal volume declines, then it is hard to imagine for the future what circumstance it would take for the Commission to accept an exigent rate case under PAEA." See GCA Detailed Analysis at 6. Nor is it logical to regard tragic national events such as 9/11 and the anthrax attacks as being the only qualifying types of "extraordinary or exceptional circumstances," but not the current circumstances, when, in the context of postal operations -- which are, after all, the focus of the PAEA – the current circumstances have had a much more profound impact on the Postal Service.

In addition, the AMA's attempt to deny the severity of the recent recession by simply pointing to a chart of private sector profitability is fundamentally irrelevant since the AMA does not discuss exactly *how* the businesses represented on the chart returned to profitability so quickly, and *whether* those measures were available to the Postal Service. As the Postal Service discussed extensively in its Response, and also discusses further below, an in-depth understanding of these questions is vital before conclusions can be drawn, because the Postal Service lacks many of the tools that the private sector has employed in response to the economic downturn. Furthermore, the AMA's argument goes more to the "necessity" of an exigent increase under the second prong of the exigency analysis, rather than whether "extraordinary or exceptional circumstances" have occurred.

As witness Corbett discusses, a portion of the recent declines are due to materials being diverted from the mail to electronic means of communications. See Tr. 1/29-30. Several parties assert that any volume losses due to electronic diversion cannot constitute "extraordinary or exceptional circumstances." See, e.g., GCA Comments at 10-11. However, the Postal Service is not claiming for purposes of this proceeding that the well-understood and gradual diversion of mail to electronic means of communication constitutes circumstances that are unusual or out-of-the-ordinary, and thus "extraordinary or exceptional" within the plain meaning of those terms. Witness Corbett made this very point in a discussion with Commissioner Hammond during his testimony:

> VICE CHAIRMAN HAMMOND: Now, the Internet has been around for awhile and the volume of single piece First-Class has been in a general decline pretty much for several years, that's right, isn't it, overall?
>
> THE WITNESS: That's correct.

VICE CHAIRMAN HAMMOND: Okay. So gradual decline in first class volume is not an extraordinarily or exceptional circumstance as I read your testimony. The extraordinary and exceptional thing was the major volume decline at the end of 2008, and it's gone through 2009. That's correct, isn't it?

THE WITNESS: That's correct.

VICE CHAIRMAN HAMMOND: Right. Okay. So it's because of this historic decline the Postal Service revenue has been falling faster than management could reduce cost, even though you cut costs by about $6 billion plus last year, something like that as I recall. So you're asking for this exigent increase because you need to get the money to pay the bills. Is that right?

THE WITNESS: That's correct.

VICE CHAIRMAN HAMMOND: Okay. So if the economic downturn hadn't happened, and the only volume declines that you were experiencing were what we were talking about earlier, these anticipated one, the Postal Service would keep on exercising its good management and operating within the CPI cap envisioned by Congress when it passed the reform legislation, and you wouldn't be here today.

THE WITNESS: That would be the ideal situation, yes.

See Tr. 1/49-51.

As this discussion indicates, the important fact is that while the gradual diversion of mail to electronic communications is not “abnormal,” the situation changes substantially when that trend begins to accelerate significantly in a very short number of years, caused in large part by the recession itself. See Masse Response to POIR No. 4, Question 10; Tr. 1/29-30.

ii. AMA’s argument that the Postal Service has shifted its posture regarding the circumstances that are “extraordinary and exceptional” is completely baseless

In a dramatic rendering of the course of this proceeding, the AMA argues that, while the Postal Service’s initial position in this case may have been that the recent volume declines constitute “extraordinary or exceptional circumstances”, it drastically “changed course” during witness Masse’s hearing and now claims that the long-term loss projection set forth in the March 2 Action Plan is the actual exigent circumstances. See AMA Comments at 6. This argument is baseless. At no point did witness Masse identify the long-term loss projection as constituting the “extraordinary or exceptional circumstances” for purposes of this proceeding.

On the transcript pages the AMA cites in support of this proposition (Tr. 2/178-181, 234, and 245-46), witness Masse was simply making the point, in response to questions from the Commission, that the Postal Service does not expect mail volumes to bounce back following the recession, and that the Postal Service has set forth a plan to try to manage the financial challenges that will occur as a result. These points are substantively indistinguishable from the testimony of witness Corbett the previous day (see, e.g., Tr. 1/37-38), so the idea that the Postal Service suddenly decided to change course following witness Corbett’s testimony is absurd. The fact that this exigent case is simply one part of a broader effort to address the challenges to the Postal Service’s financial integrity has been known since at least the publication of the March 2 Action Plan. This does not change the fact that this case has been directly precipitated by the financial distress caused by the “extraordinary or exceptional” volume declines that have recently occurred, largely as a result of the recession, or the fact that, as discussed below, this increase is eminently “necessary” to address the Postal Service's precarious financial position, which again is a direct result of the recent volume declines.

Furthermore, witness Masse consistently identified the recent volume declines as constituting the "extraordinary or exceptional circumstances." See Tr. 2/205-06, 234.[3] In this regard, he also deferred to witness Corbett on this matter (id. at 206), as Mr. Corbett was the witness put forward by the Postal Service to discuss whether "extraordinary or exceptional circumstances" have occurred. Witness Corbett, in turn, consistently identified these circumstances as being the unprecedented declines in mail volumes, and explained why such precipitous declines have had a devastating effect on the Postal Service's financial situation. See Tr. 1/29-30 (noting that "the drop in overall volumes" is the "exigent driver"); 49-51 ("What I think is extraordinary or exceptional is the fact that our mail volume plummeted at a level and a rate which is unprecedented since the Great Depression."); 118.

B. AMA Provides No Basis for the Commission to Ignore the Fact that These Precipitous and Historic Volume Declines Fall within the Plain Meaning of "Extraordinary or Exceptional"

"Statutory construction must begin with the language employed by Congress and the assumption that the ordinary meaning of that language accurately expresses the legislative purpose." See Engine Mfrs. Ass'n v. S. Coast Air Quality Mgmt. Dist., 541 U.S. 246, 252 (2004) (citation omitted).

[3] Witness Masse did state that he considered the Postal Service's short-term liquidity issue to constitute "extraordinary or exceptional circumstances." See Tr. 2/191, 206. Witness Masse's answer in full, however, clearly identifies the volume declines as constituting the exigent circumstance justifying this Request. Id. at 205-06, 234. To be sure, a short term cash flow situation is a compelling symptom of the effect that the "extraordinary or exceptional" decline in volume giving rise to this Request has had on the Postal Service's finances.

However, the AMA, having no answer to the Postal Service's point that year-to-year volume declines not experienced since the Great Depression are within the ordinary meaning of "extraordinary or exceptional," argues that the Commission should not look to the plain meaning of those terms in applying the statute. Rather, the AMA argues that the legislative history and context of the statute requires a different interpretation, presumably one in which the standard can only extend to events such as terrorist attacks or natural disasters. However, there is nothing in the legislative history or statutory context that demonstrates that "extraordinary or exceptional" cannot be given their ordinary meaning (or that the current circumstances do not qualify as "extraordinary or exceptional"). As such, the AMA's arguments provide the Commission with no license to depart from the plain meaning of those terms. In fact, the legislative history affirmatively demonstrates that Congress intended the standard to be *broader* than simply terrorist attacks, natural disasters, or other events that could fall within the apparent scope of the Senate exigency standard of "unexpected and extraordinary." The Commission therefore cannot permissibly interpret the standard as if it only encompasses such circumstances.

i. AMA provides no basis for the Commission to ignore the commonly understood definitions of "extraordinary or exceptional"

Despite well-settled precedent that statutory terms, undefined by the statute itself, should be given their ordinary meaning, the AMA claims that the commonly understood definitions of "extraordinary" or "exceptional" are "simply too protean" to play a role in determining the meaning of the exigency standard.

AMA Comments at 10. This argument fails on several levels. Other parties have had no difficulty in discussing this standard by reference to the plain meaning of those terms. See, e.g., NPMHU Comments at 2; GCA Comments at 4.[4] Indeed, the terms are not unknown to the law, and courts that have been called upon to interpret their meaning have similarly relied on their plain and ordinary meaning. See, e.g., U.S. v Wages, 271 Fed. Appx. 726, 727 (10th Cir. 2008); S.E.C. v. Gemstar-T.V Guide Intern., Inc, 401 F.3d 1031, 1045, 1049 (9th Cir. 2005); Advance Pharmaceutical, Inc. v. U.S., 391 F.3d 377, 392, 397 (2nd Cir. 2004).

Furthermore, the case cited by the AMA as the sole support for its assertion (Verizon Communications Inc. v. FCC, 535 U.S. 467, 501 (2002)) is inapposite. In that case, petitioners challenged the Federal Communication Commission's (FCC) interpretation of a provision of the Telecommunications Act of 1996, which mandated that incumbent telecommunications providers allow new entrants the ability to interconnect to their network elements; the provision required the FCC to promulgate a methodology to determine "the cost…of providing the…network element." Verizon, 535 U.S. at 497-98. The FCC did so by interpreting "cost" as "forward-looking economic cost," and defined that term as based on the hypothetical, forward-looking costs of a perfectly efficient firm supplying the most efficient network element available, rather than actual costs of the element being provided by the incumbent. Id. at 496-98.

[4] The Public Representative argues that Congress did not mean "extraordinary" and "exceptional" to have separate meanings. PR Comments at 14. As GCA discusses, however, this is contrary to the language of the statute and established principles of statutory interpretation. GCA Comments at 4-5. The precise differences between the terms need not be resolved now, because it is irrelevant to the resolution of this proceeding. Interestingly, however, the Public Representative's articulation of the standard seems to encompass the separate, but complementary, meanings for "extraordinary" and "exceptional" proffered by GCA.

The petitioners alleged that this interpretation was inconsistent with the "plain meaning" of the term "cost," arguing "that 'the cost of providing the network element' can only mean, in plain language and in this particular technical context, the past cost to an incumbent of furnishing the specific network element actually, physically, to be provided." Id. at 498. The Court rejected this argument, noting that the term "cost" had a variety of different possible meanings, both in common and technical usage. Id. at 498-501. It therefore concluded that the statute did not plainly compel petitioner's reading of the statute, as opposed to that of the FCC.

Thus, petitioners in that case were alleging that the plain meaning of the term "cost" had a highly specific, technical meaning. The Court, however, noted that the noun "cost," without any qualifiers, is "a chameleon" and "a virtually meaningless term," because there are numerous different types of costs, and thus numerous different meanings for the term, standing alone. Id. at 500 (internal citations omitted). Here, however, the adjectives "extraordinary" and "exceptional" each have a common, well-understood meaning. While reasonable minds can sometimes argue as to whether a particular circumstance is "extraordinary or exceptional," that does not mean that those parties can reasonably deny the fact that those terms plainly have a particular meaning. As such, Verizon does not stand for the fact that the Commission is free to ignore the plain meaning of those terms. In fact, it is the AMA who, just like the petitioners in Verizon, is seeking to read the statutory terms in an unduly restrictive manner.

ii. Recognition that the current circumstances are exigent would not blunt the incentives of the cap

After incorrectly asserting that it is meaningless to refer to the ordinary definitions of “extraordinary” and “exceptional,” the AMA argues that the exigency standard must be read narrowly to avoid blunting the efficiency incentives of the price cap. AMA Comments at 10-11. Of course, the Postal Service agrees that application of the standard must reflect the fact that an exigent case is an exception to the price cap, so as to avoid undercutting the purposes that underlie the cap. This does not, however, require the Commission to interpret the “extraordinary or exceptional” standard in a way that disregards the plain meaning of the terms, because “extraordinary” or “exceptional” by their very nature describe circumstances which are abnormal or unusual, and thus constitute the exception rather than the rule.

Furthermore, despite the AMA’s brazen claim to the contrary, the Postal Service did not “ignore” this issue in its Response to the AMA Motion. The Postal Service specifically noted that the AMA had not demonstrated that *this case* constitutes an inappropriately expansive interpretation of the statutory terms, such that it would eliminate the efficiency incentives of the cap. See Response at 19-20. In its Comments, the AMA once again fails to explain why recognition that the recent volume declines are “extraordinary or exceptional” would sound the death knell for the cap going forward. Nor can it, unless it is prepared to assert that comparable yearly volume declines are now going to be commonplace. Similarly, recognition of the “extraordinary or exceptional” nature of the recession, and its effects on mail volumes, is not inconsistent with maintaining the incentives of the cap, unless one is prepared to assert that financial crises of the same magnitude are now going to be commonplace. Furthermore, even if one was prepared to make these assertions, whatever may happen in the future does not change the fact that the current circumstances are clearly "extraordinary or exceptional" at this point in time, considering past experience, and the historic nature of these volume declines. In the end, to conclude that the current circumstances are not "extraordinary or exceptional" would truly deny those terms of any practical meaning.

iii. The legislative history demonstrates that the "extraordinary or exceptional" standard is broader than the AMA's interpretation

The AMA's comment that the Commission must read the exigent clause "narrowly" in the end provides no guidance as to what circumstances would actually qualify under the statute, even under the AMA's reading of the provision. While the AMA never specifies exactly what circumstances could qualify, it does seem to view the comments of Senator Collins approvingly. See AMA Comments at 9; NAA Comments at 5. Those comments assert that the Postal Service has failed to satisfy the "extraordinary or exceptional" standard under the plain language or legislative history of the provision, based on a claim that the PAEA adopted the Senate exigency standard, and that volume losses due largely to a severe economic recession do not fall within the scope of that standard. Rather, according to the comments, the standard is only satisfied if an event such as a terrorist attack or natural disaster occurs.

As an initial matter, it is settled that post-enactment statements cannot themselves constitute evidence of Congressional intent, but rather reflect personal views. See Heintz v. Jenkins, 514 U.S. 291, 298 (1995) (noting that a statement made after the enactment of a statute "is not a statement upon which other legislators might have relied in voting for or against the Act, but it simply represents the views of one informed person on an issue about which others may (or may not) have thought differently."); Regional Rail Reorganization Act Cases, 419 U.S. 102, 132 (1974) (noting that post-enactment remarks of legislators "represent only the personal views of these legislators, since the statements were (made) after passage of the Act.") (quoting National Woodwork Manufacturers Ass'n v. NLRB, 386 U.S. 612, 639 n. 34 (1967)). Accordingly, as the Postal Service pointed out in its Response, the extent to which such comments are indicative of Congressional intent depends, like all of the other comments in this proceeding, on their consistency with the plain language and pre-enactment legislative history of the statute. See Regional Rail Reorganization Act Cases, 419 U.S. at 132 (noting that "post-passage remarks of legislators, however explicit, cannot serve to change the legislative intent of Congress expressed before the Act's passage.") (citation omitted).[5]

Implicitly recognizing the clarity of this case law, the AMA confines itself to asserting that the comments in question are consistent with the pre-enactment history of the PAEA (and presumably, though the AMA never actually says so,

[5] The Postal Service recognizes Senator Collins as a distinguished legislator who is, and long has been, engaged in postal matters. In the instant proceeding, her comments are entitled to the same consideration as those submitted by any other party. But, the weight given to those comments must, like all other comments, be based entirely on the extent to which they are consistent with the language and history of the PAEA, and not on their source.

the language of the statute). But, this assertion is completely belied by the initial comments of the National Postal Mail Handlers Union (NPHMU), which comprehensively recount the legislative history of the exigent provision and explain how that history clearly demonstrates that the PAEA did not simply “adopt” the Senate “unexpected and extraordinary” exigency standard. See NPMHU Comments at 3-13.[6] Thus, legislative materials that discuss or may have influenced the Senate standard, such as the Senate Committee Report issued in 2004, do not dictate the proper interpretation of the “extraordinary or exceptional” standard ultimately enacted by the full Congress. In particular, such materials do not allow the Commission to permissibly interpret the statutory standard as being limited only to the events that may have been intended by the contemplated-but-not-enacted Senate standard See INS v. Cardoza-Fonseca, 480 U.S. 421, 442 (1987) (noting that, “Few principles of statutory construction are more compelling than the proposition that Congress does not intend *sub silentio* to enact statutory language that it has earlier discarded in favor of other language.”) (citations omitted). Indeed, since there is no legislative history that clearly discusses the meaning of that standard, or indicates that it should mean anything different from what the words “extraordinary” or “exceptional” ordinarily mean, there is no license for the Commission to depart from the ordinary meaning of those terms.

Reference has also been made to then-Chairman Omas’ testimony before the Senate Committee in 2004 that suggested that only extraordinary *cost*

[6] The Postal Service also mentioned, in a much more summary fashion, this legislative history in its Response (at page 17), but AMA tellingly chose not to address it in its Comments.

increases can qualify as exigent circumstances, and that "[v]ariances in volume levels" could never qualify. <u>See</u> Collins Letter at 3. This testimony cannot be relied upon by the Commission in interpreting the meaning of the "extraordinary or exceptional" standard. Hearing testimony has itself never been regarded as particularly relevant legislative history. <u>See, e.g.</u>, <u>Public Citizen v. Farm Credit Admin.</u>, 938 F.2d 290, 292 (D.C. Cir. 1991). This particular testimony is even less relevant, considering Chairman Omas' testimony proposed a standard that would have allowed the filing of an exigent case only due to "extraordinary, unforeseeable *expenses*." No proposed legislation, not even the Senate standard ultimately rejected by the full Congress, used this formulation (the Senate bill allowed increases due to "unexpected and extraordinary *circumstances*"). Thus, this testimony does not even reflect the Senate standard, much less the standard actually adopted by Congress.[7] Nor, furthermore, is it consistent with the position previously expressed by Senator Collins (in a joint letter with Senator Carper in 2007), which noted that "extraordinary or exceptional circumstances" include "events that may cause significant and substantial declines in *mail volume*…that the Postal Service cannot reasonably be expected to adjust to in the normal course of business." <u>See</u> Letter from Senators Collins and Carper to Commission Chairman Blair at 2 (dated April 6, 2007, posted on Commission website April 11, 2007) (emphasis added). As the

[7] The testimony from a representative of the Treasury that has also been referred to is similarly unhelpful (Collins Letter at 2-3), because that testimony merely noted his support of "the Senate's version" of an exigency standard.

Postal Service pointed out in its Response, the current circumstances fit precisely within that formulation. Response at 15.

C. The AMA's Position Would Render the Exigent Clause a Nullity

The Postal Service noted in its Response that adopting the AMA approach would essentially read the exigent provision out of the statute. Response at 20-21. While the AMA asserts that the Postal Service has constructed a "strawman" (AMA Comments at 11), its reasoning simply confirms the Postal Service's point. Under AMA's apparent approach, the only way the Postal Service could utilize the exigent clause is if it (1) completely eliminated every "inefficiency" according to AMA's conception of that term, without regard to whether that "inefficiency" is dictated by the statutory or political context in which the Postal Service operates (a context that reflects policy goals that are broader than AMA's conception of "efficiency"), or (2) could demonstrate that even if it those "inefficiencies" were theoretically eliminated, it would still not have enough money to operate. Considering AMA's expansive conception of what is "inefficient" about the Postal Service, one can only imagine how irredeemably dire the Postal Service's finances would have to be before it could seek to utilize the exigent clause to help restore its financial integrity. This is not a practical interpretation of what is supposed to be a mechanism to help ensure that the Postal Service is able to "continue and maintain" the provision of adequate, universal postal services.

D. Time Warner's Argument Regarding Foreseeability Confirms the Accuracy of the Postal Service's Response on that Topic, and Attempts to Rewrite the Past with Respect to the Commission's Rulemaking and Its Own Comments

In its Motion to Dismiss, the AMA argued, among other things, that the "extraordinary or exceptional circumstances" standard governing this proceeding "implies…unforeseeability." AMA Motion at 14. Moreover, since recessions are according to the AMA a foreseeable "fact of life," the exigent increase sought by the Postal Service is not permissible under the statutory standard. In response, the Postal Service noted that the dictionary definitions of neither "extraordinary" nor "exceptional" include the concept of "unforeseeability," and compared the AMA to Humpty Dumpty in its cavalier approach to word meaning. Response at 16. Time Warner attacks the Postal Service for doing so, in an attempt to rehabilitate the AMA's statutory interpretation, and, indeed, accuses the Postal Service of a fractured reading of the law worthy of "Carroll's imperishable character." Time Warner Comments at 7. The attempt to appropriate the reference to the literary works of Lewis Carroll is fitting in a way plainly not intended, for the argument Time Warner makes is simply an effort to entice the Commission to join yet another adventure, this time down a rabbit hole.

Time Warner does not contest the Postal Service's position that "unforeseeability" is not a required element of meeting that standard. Rather, Time Warner takes issue with the Postal Service's characterization of the AMA's position, at page 15 of its Response, as an argument that the standard "dictates that a circumstance must be 'unforeseeable' in order to qualify." Id. at 7. Time Warner asserts that saying the standard "implies unforeseeability" is not the same as saying the standard dictates that a circumstance must be unforeseeable. Id. Attempting to demonstrate the distinction, Time Warner cites the Normandy invasion as an example of an extraordinary occurrence that was nevertheless foreseeable if the Allies were ever "to drive Hitler's armies from occupied Europe," and goes on to claim that this example is "sufficiently singular to bring home the fact that things which are 'extraordinary or exceptional' are only in rare instances foreseeable or foreseen." Id.

As a critique of the Postal Service's plain language approach to statutory interpretation, it is difficult to take Time Warner's claim seriously. If by invoking the Normandy invasion Time Warner is suggesting a benchmark for determining when "foreseeability" is not an element of "extraordinary or exceptional," then it has proven the Postal Service's point: that Time Warner has had to reach back more than six decades to identify an occurrence illustrating its argument—and one that was uniquely pregnant with import for the course of world history, to boot—demonstrates that, as the Postal Service said, the AMA's argument for all practical purposes amounts to the claim that the "extraordinary or exceptional" circumstance must be "unforeseeable" in order to pass the statutory test.[8]

[8] Despite Time Warner's claims to the contrary, this clearly seemed to clearly be the point that AMA was making in its Motion, when it asserted that the standard "implies…foreseeability." This is evident from the fact that AMA immediately supported that statement by a citation to Order No. 26, which in support of a proposed rule that would have required the Postal Service to "analyze[ ] why the circumstance giving rise to the [exigent] request was neither foreseeable nor avoidable by reasonable prior action," asserted that the exigent clause was "meant to be a safety net for dealing with unforeseeable emergencies." Furthermore, AMA's arguments regarding why certain circumstances were not "extraordinary or exceptional" was predicated predominantly on the fact that they were foreseeable. See AMA Motion at 65-66. It is therefore hard to see how the Motion was making any point other than that the extraordinary or exceptional standard "dictates" unforeseeability.

Moreover, Time Warner's declaration that "things which are 'extraordinary or exceptional'" are rarely "foreseeable or foreseen" is belied by experience and only serves to reveal its myopia. That a physics experiment results in the confirmation of the existence of a particle predicted by theory, exactly as the experiment was designed to do, does not make the achievement less than "extraordinary." A young pitcher's feat of striking out fourteen batters in his major league debut is not made less "exceptional" by the fact that the prospect of such a dominating performance was precisely the reason he was given a multi-million dollar signing bonus in the first place.

Or consider Hurricane Katrina, a natural disaster which most parties would presumably agree constituted an "extraordinary or exceptional circumstance." The fact that a hurricane would eventually devastate New Orleans was understood to be well-nigh inevitable, based on its location and topography. Indeed, in 2002 the New Orleans *Time-Picayune* published a multi-part series (available at http://www.nola.com/hurricane/content.ssf?/washingaway/index.html) that noted that "the big one" was "a matter of when, not if." With regard to natural disasters, or (unfortunately in this age) terrorist attacks, or recessions, or a myriad of other potential "circumstances" that might occur, one can always claim that they were "foreseeable." As such, debates about whether a particular circumstance was reasonably "foreseeable" are not particularly useful to determining whether the "extraordinary or exceptional" standard has been met. Rather, the important question is whether the circumstances giving rise to the question are sufficiently abnormal or unusual to qualify under the plain meaning of those terms.

If Time Warner's approach to statutory interpretation is an excursion down the rabbit hole, then its treatment of the record, including its own comments respecting exigent filings in Docket No. RM2007-1, is an Orwellian attempt to obscure the past. Despite Time Warner's and AMA's claims to the contrary (AMA Comments at 11 n.1), the Postal Service was clearly correct when it stated in its Response that the Commission had recognized that Order No. 26 "incorrectly characterized the nature of the exigency standard," and that it "retracted" the statement that it only applied to "unforeseeable emergencies." See Response at 16. Order No. 26 proposed a rule that would have required the Postal Service to provide "[a] justification for exigent treatment which analyzes why the circumstance giving rise to the request was neither foreseeable nor avoidable by reasonable prior action," and discussed that rule by noting that the exigent clause was "meant to be a safety net for dealing with unforeseeable emergencies." See Order No. 26 at 45, 119. Following parties' comments, however, Order No. 43 revised the rule, and noted that:

> NPMHU and Time Warner observe that the Commission's Order No. 26 discussion and the proposal refer to an exigent filing in terms of unforeseeable and unavoidable events. Both briefly review the legislative history on exigent filings, and point out that although there were variations on what would constitute grounds for a Type 3 case in legislative proposals leading up to the PAEA, the legislation as enacted does not include any reference to unforeseeablity or avoidability of circumstances. NPMHU Comments, September 24, 2007, at 1-2; and Time Warner Reply Comments, September 24, 2007, at 7-11. *See also*, NAPUS Reply Comments, October 10, 2007, at 2-3.

> The Commission agrees with these observations. The text of Order No. 26 and the related rule were inexact in this respect. However, the Commission continues to believe that it is reasonable to require the Postal Service to address these considerations, as the discussion is likely to shed light on matters of considerable concern to mailers. To accommodate this interest and to recognize the commenters' point, the Commission revises rule 3010.61(a)(7) essentially along the lines suggested by Time Warner to read as follows:
>
>> An analysis of the circumstances giving rise to the request, which should, where applicable, include a discussion of whether the circumstances were foreseeable or could have been avoided by reasonable prior action[.]

Order No. 43 at 68-69.

Thus, the Commission quite clearly indicated that the language of Order No. 26 was "inexact," and could not be relied upon as a statement of the legal requirements of 3622(d)(1)(E). While Time Warner does not seem to like the word "retract" (Comments at 8-9), its use by the Postal Service was proper, because the Commission quite clearly "took back" (the commonly understood definition of "retract") its prior comment that exigent circumstances were limited to "unforeseeable emergencies." See WEBSTER'S ENCYCLOPEDIC UNABRIDGED DICTIONARY 1644 (defining "retract" as "to withdraw (a statement, opinion, etc.) as inaccurate or unjustified, esp. formally or explicitly; take back"). This is clearly evident from the fact that the rule in question went from dictating a required justification for the filing of an exigent request, to simply a rule that required the Postal Service to discuss foreseeability "if applicable" in order to "shed light on matters of considerable concern to mailers." Order No. 43 at 69.

Time Warner also criticizes the Postal Service for identifying its comments as indicating that Order No. 26 was incorrect. Two points can be made here.

First, it was the *Commission* itself that specifically identified Time Warner's comments in the rulemaking as demonstrating the flaw of the proposed rule regarding foreseeability, and promoting it to revise the proposed rule. Id. at 68. Second, the quotation from its comments in that rulemaking makes precisely the point that the Postal Service was making in its Response, by noting that foreseeability is "*not*" a "requirement[ ] of § 3622(d)(1)(E)."

As such, Time Warner's view that "extraordinary or exceptional circumstances" will only rarely be foreseeable is not only wrong, but of no help to the Commission or any other party in interpreting the language of section 3622(d)(1)(E).[9] At bottom, this interpretation, and Time Warner's comments regarding the history of Docket No. RM2007-1, amount to nothing more than an effort to cloud the plain meaning of the words in the statute. That an enterprise built on the power of words should find itself in the position of employing such tactics is strange indeed. Or, as Alice would say, "curiouser and curiouser."

E. GCA's Argument that the Extraordinary or Exceptional Circumstances Can Only Justify an Increase Smaller than that Proposed by the Postal Service is Fatally Flawed

As noted above, GCA agrees that "exceptional" circumstances have occurred, in the form of the recent recession. However, GCA presents an analysis that purports to demonstrate that, under the "extraordinary or exceptional" standard, the Postal Service can only legally propose a rate increase of either 3.55 or 3.84 percent, rather than the 5.6 percent average increase actually proposed. GCA Comments at 2. GCA bases this position on

[9] It is also of no help in this case, because even if unforeseeability is required under the "extraordinary or exceptional" standard, the recent volume declines and recession were unforeseeable. See, e.g., Tr. 2/188.

its assertion that “on balance between 35 percent and 45 percent of the 2008-2009 recession was indeed an ‘exceptional’ exigent circumstance” (GCA Detailed Analysis at 23), and that the Postal Service’s requested increase, which GCA claims is based on treating the recession as being “100 percent exigent,” must be lowered as a result.

Leaving to one side the question of whether exigent circumstances and the resulting allowable price increases under that standard can be boiled down to a mathematical formula, which is dubious,[10] (as well as the fact that the exigent circumstances here are the volume declines rather than the depth or duration of the recession), the execution of this formulaic approach is fatally flawed at its inception because it treats the 5.6 percent increase proposed by the Postal Service as if it was the maximum increase that possibly could have been proposed in response to the recession. However, the requested increase is a significant reduction from the amount that would be proposed if the Postal Service sought to offset the full impact of the recession (i.e., if the Postal Service sought to treat the recession as being, under GCA’s rubric, “100 percent exigent”). If the Postal Service was in fact seeking additional revenue to address the full impact of the recession through this rate increase, such as would have been necessary under the breakeven requirement of prior law, the increase

[10] In Docket No. R97-1, Hallmark, one of the key members of GCA, in favoring a purely judgmental approach to pricing over one which included reference to an empirical Ramsey pricing model, quoted Aristotle’s *Nicomachean Ethics* to the effect that the well-schooled man "searches for that degree of precision in each kind of study which the nature of the subject at hand admits." Hallmark Cards Initial Brief at 38 (Docket No. R97-1, April 1, 1998). In presenting in this proceeding its ambitious effort to analyze past recessions back to 1857 in order to develop a “macroeconomic methodology” to “define the maximum legal limits” of “extraordinary or exceptional,” GCA appears to have grossly violated Aristotle’s recommendation to confine its “study” to the degree of precision which the nature of the subject admits.

would have been significantly higher, in the double digits percent-wise. Thus, even assuming that a portion of the recession is "non-exigent" and cannot justify an above-cap increase, that would provide no basis for reducing the very moderate increase that the Postal Service has proposed.[11]

In addition, in considering the severity of the recent recession in calculating how "exigent" it was, GCA takes no account of the magnitude of its effect on the Postal Service. Thus, GCA does not identify what part of the recent recession was "exigent" and what was "normal" by any comparison to mail volumes. As witness Corbett discusses, the current economic downturn has had an effect on volumes that is many times greater than previous recessions. Corbett Statement at 12 (noting that "the current volume decline is six times worse in percentage terms than the decline experienced during the previous recession…and 8.5 times greater than the volume decline experienced during the recession in the mid-1970s.").[12] Considering that section 3622(d)(1)(E) is directed to the regulation of rates set by the Postal Service, and is designed to

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[11] This is true regardless of one's views regarding whether this increase is "necessary" under the second prong of the exigency provision, because GCA's analysis is confined solely to the increase that it believes can legitimately be requested under the "extraordinary or exceptional" standard.

[12] In its Detailed Analysis document, GCA suggests that the much smaller impact on volumes in prior recessions "can also be used to argue that none of the 2008-2009 recession is exigent insofar as its effect on mail volume is concerned because post-war data shows there is little relation between recessions and mail volume. Therefore, the explanation for the volume declines is due to other reasons such as a gross-underestimate of the extent of electronic diversion from the use of long-run rather than short-run own price elasticities as broadband prices continue to fall." See GCA Detailed Analysis at 23 n.25. It does not appear that GCA is actually urging the Commission to come to this conclusion, because it uses the phrase "can also be used to argue," and because GCA itself states that the recession has constituted exceptional circumstances. Id. at 6. In fact, in the exact same document GCA notes that the severity of the recession is evidenced in part by the "depth of postal volume declines." Id. But, to the extent that this is GCA's position, its argument is clearly flawed. For instance, the precipitous decline in Standard Mail during the recent recession is certainly not due to electronic diversion, but to the decline in economic activity in general and advertising in particular. Furthermore, while electronic diversion has accelerated, one important precipitating factor for that acceleration is the recession itself, which has forced businesses to aggressively reduce costs.

ensure that the Postal Service is able to maintain adequate postal services subsequent to unusual or abnormal events that adversely affect Postal Service finances, it stands to reason that application of this provision requires a consideration of whether the Postal Service has itself experienced abnormal or unusual circumstances. Cf. PR Comments at 14-18 (noting that in applying the exigency standard, "[t]he 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."). Nor is it appropriate to skew rates according to some arbitrary calibration of causal factoids, without considering the actual financial impact of a particular set of circumstances on the Postal Service. Theoretically speaking, a particular recession could be relatively minor in terms of the economy as a whole, but have an abnormally severe effect on postal volumes.[13]

[13] GCA's analysis of the severity of the recession is also flawed from another perspective. For instance, it claims that the appropriate point of focus should not be on recessions that have occurred since Reorganization, but on recessions that occurred prior to 1935. GCA Detailed Analysis at 8. But, it produces biased results to compare a recession in which the Government inarguably conducted many countercyclical policies (including a massive stimulus package, the use of quantitative easing by the Federal Reserve, the bailing-out of General Motors, Chrysler, and numerous financial firms) to recessions that predated such measures. While these countercyclical policies may not have been as effective as in prior recessions, it is clear that they had some effect, and prevented the recession from being as bad as it otherwise could have been. "Extraordinary or exceptional circumstances" should be judged by reference to the modern economic environment, consistent with the rule of statutory construction that terms be given their ordinary, *contemporary* meaning. See 2A SINGER SUTHERLAND STATUTORY CONSTRUCTION 47:28 (6th Ed. 2000). In other words, a recession in this day and age can be "extraordinary or exceptional" even if it does not rise to the level of a economic downturn during the Gilded Age.

F. The Public Representative's Arguments Concerning the Effect of Deferring to the Governors' Determination of whether "Extraordinary or Exceptional" Circumstances Have Occurred are Baseless

In its Response to the AMA Motion to Dismiss, the Postal Service pointed out that the statute does not clearly designate the Commission as having the final word over the Governors as to whether "extraordinary or exceptional circumstances" have occurred. See Response at 11; see also Valpak Comments at 13. The Public Representative "strongly disagrees" with this point, arguing that it "would effectively write the 'extraordinary or exceptional circumstances' provision out of the statute," by endowing the "Postal Service with an unfettered ability to set rates at any level." PR Comments at 10. These over-wrought statements are false on numerous levels.

First, the Public Representative presumes that the Governors would, in authorizing the filing of an above-cap increase, ignore the statutory mandate that such increases only occur in "extraordinary or exceptional circumstances." See 39 U.S.C. 404(b). Second, it also requires an assertion that the Governors and Postal Service management blithely raise rates; the moderate nature of the proposed increase (following a year of no increases) demonstrates to the contrary, considering the extreme financial distress in which the Postal Service finds itself. Third, it completely ignores the fact that the Commission would still consider whether the rate adjustment approved by the Governors is "necessary," and thus can be implemented. This clearly constitutes an "effective check[ ] or balance[ ]" against the notion that the Postal Service could "set rates at any level," even if management were able to convince the Governors to do so. Nor does this argument at all suggest that the "necessary" analysis must be "divorced" from a consideration of the circumstances that have precipitated the request.

As the Postal Service noted in its Response, this issue may be necessary to consider in a close case. But, this is not a close case, and the Governors' determination that "extraordinary or exceptional circumstances" have occurred is clearly correct, and should be accepted by the Commission.

II. The Requested Exigent Increase is "Necessary," Notwithstanding Contrary Claims in the Initial Comments of Some Parties

Although various comments make reference to the "necessary" prong of the "reasonable, equitable, and necessary" provision, the totality of comments regarding "necessary" can appropriately be addressed by focusing on the arguments of two of them – the comments of the AMA, and of Time Warner. Neither provides any valid basis for the Commission to reach any determination other than that the requested increases are indeed "necessary" under the applicable statutory standard. Meanwhile, the somewhat related arguments of the Public Representative are premised on the application of a "framework" which does not exist in the Commission's rules, and thus likewise provide no basis to reject the proposed price adjustments.

A. The AMA Unabashedly Seeks to Rewrite the Legal Definition of "Necessary"

As noted in the Postal Service's Request in this proceeding, beyond "extraordinary or exceptional circumstances," and beyond proposed prices that are "reasonable and equitable," the exigent provision of the law also requires that the requested price increases be "necessary." See Request at 4-5. The “necessary” standard actually incorporated into the law is “necessary to enable the Postal Service … 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). This standard intrinsically encompasses both short-term and long-term needs, in order to allow the Postal Service both to maintain, and then continue to develop, adequate postal services. On its face, the language of this provision explicitly precludes any mere short-sighted approach to the evaluation of “necessary” in the context of an exigent request.

Rather than attempting to apply the standard as written, however, the AMA wishes to substitute instead a “necessary” standard that would only be met if the Postal Service could not scrape together enough cash to meet payroll such that employees could continue to deliver mail.

> The testimony of the Postal Service’s witnesses during the hearings on August 10-12 revealed a fundamental hole in the Postal Service’s case: whether or not the Postal Service improves its efficiency, the proposed rate increase is simply not “necessary” under section 3622(d)(1)(E). Even the worst-case scenario offered by the Postal Service does not project that it will stop meeting payroll or delivering the mail before September 30, 2011, the last day of Fiscal Year 2011. Moreover, the exigent rate increase, even if approved and implemented exactly as proposed, would not extend the Postal Service’s operations by a single day. In the most basic and direct sense, the proposed rate increase is not “necessary” under section 3622(d)(1)(E).

AMA Comments at 4. The AMA, in other words, would have the Commission believe that the language of the statute, instead of what it actually says, was something along the lines of “… necessary to allow the Postal Service to meet its immediate cash obligations.” The statute does not say that, and the Commission should not accept the AMA’s strained entreaties that the Commission should act as if it did. Had Congress intended that result, it surely knew how to articulate the entirely different standard which the AMA now seeks to superimpose over the existing standard.

To achieve the actual statutory standard, the maintenance and development of adequate postal service requires financial stability, including retained earnings. Just as a household that continues to run up substantial additional credit card debt cannot claim financial stability merely because it somehow manages to cover its minimum credit card payments each month, the Postal Service could not sustain unremitting multi-billion dollar losses simply because sufficient cash might be eked out to keep the organization operating. Congress recognized this in establishing one of the objectives of the modern system of rate regulation to be:

> (5) To assure adequate revenues, including retained earnings, to maintain financial stability.

39 U.S.C. § 3622(b)(5). Accumulating losses are the diametric opposite of retained earnings, and thus stand in direct conflict with financial stability.

Witness Corbett explained this when responding to questions regarding the as-yet hypothetical effects on cash flow of a potential year-end change in the law regarding Retiree Health Benefit (RHP) prepayment:

> We're looking at a $7 billion loss next year without any price increase. If we would receive $4 billion of relief, for example, like we did last year, we still have a $3 billion loss. We can't continue to run the Postal Service at a deficit, given we're running out of debt funding. So we still do need more than just the RHB.

Tr. 1/54. Witness Masse made the same fundamental point when, once again addressing a hypothetical adjustment in RHB payments, he opined that, notwithstanding the suggested effects of such a favorable legislative scenario, "[y]ou can't lose $3.5 billion a year and expect to be able to pay your bills going forward." Tr. 2/238.

Ironically, not only was $7 billion the figure Witness Corbett cited as the expected *loss* for FY11, but, earlier in the hearing, $7 billion was also the figure he indicated was the minimum acceptable level of *positive* liquidity that the Postal Service is trying to maintain, based on a study of peer organizations by J.P. Morgan.[14] Tr. 1/47-48. As he noted, even assuming enactment of new law at the end of FY10 granting $4 billion of RHB deferral, the Postal Service would instead be at nearly a zero cash balance at the end of FY11, which is far away from anything remotely resembling the $7 billion liquidity management has determined should be associated with financial stability. Id. at 48.

Under the actual legal standard, rather than the imagined standard the AMA seeks to impose, the requested increase is necessary with or without legislative changes in the required FY 2010 RHB payment. The materials provided in conjunction with the statement of witness Masse demonstrate that, without an exigent increase, the Postal Service stands to lose approximately $7 billion in FY 2011. An assumed change in the required FY **2010** RHB payment, such as the $4 billion deferral enacted at the end of FY 2009, would not by itself change the fact that the Postal Service is projected to lose money in FY **2011**.

[14] To put a $7 billion amount of available liquidity in perspective, in FY 2009, page 77 of the Annual Report shows total operating expenses of $71.8 billion. Dividing that amount by 52 weeks reveals that the average FY09 weekly operating expense was $1.38 billion, so $7 billion is barely 5 weeks worth of operating expenses.

To maintain and continue to develop postal services adequate to the needs of the nation, the Postal Service needs to take available steps to address the major revenue shortfall projected for FY 2011, to say nothing of the shortfalls expected in the near and far term thereafter, and to reach a point where it can retain earnings. The requested exigent price adjustments, to be implemented at the beginning of calendar 2011, are clearly "necessary" under the applicable legal standard, as witness Corbett attests. Corbett Statement at 17-19.

To the extent that the AMA is purporting to suggest that the requested increases are not "necessary" because they are not large enough, such a fanciful notion cannot withstand even momentary scrutiny. As quoted on page 4-5 of the AMA's Comments, witness Corbett did agree that the Postal Service's anticipated cash flow crisis reaches a head on the same day with or without the revenue infusion from the requested price adjustments. Tr. 1/39-40. All this suggests, however, is that by the AMA's erroneous "necessary" standard, the requested price adjustments should have been even higher. Sufficiently higher prices would clearly surmount AMA's criticism that the proposed increases fail to "extend the Postal Service's operations by a single day." AMA Comments at 4. The mere fact that AMA has proffered such an argument proves how muddled the AMA interpretation of the "necessary" standard has become. Even if "necessary" were (incorrectly) equated with "sufficient" (Response at 60) under no stretch of the logical imagination can "insufficient" be equated with "unnecessary." [15]

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[15] This entire portion of the AMA's argument brings to mind the scene in Annie Hall in which the Woody Allen character recounts the story of the two women expressing their displeasure with a

For purposes of this proceeding, neither the AMA, nor the Postal Service, nor the Commission, can assume changes in laws until those changes are actually enacted. The Postal Service filed this request based both on the laws as they existed when the case was being prepared, and the most recently available forecasts of general economic conditions when the case was being prepared. As of yet, there have been no changes in the relevant laws. As witness Corbett noted, though, even enactment of legislation allowing deferral of required FY 2010 RHB payments of the same approximate magnitude as the change enacted last year would not return the Postal Service to a revenue surplus situation, or materially diminish the necessity of an exigent increase for January 2011 implementation.[16]

In terms of general economic conditions, more recent forecasts are less optimistic than those upon which the Postal Service's FY 2011 projections in this filing are based.[17] The general unsettling of what had earlier seemed to be a growing consensus that the macro-economy is improving should be a cause for

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restaurant, with the first complaining that "The food there is disgusting," and the second responding, "Yes, and the portions are so small."

[16] Moreover, as indicated in the written response to the request made of Mr. Masse at Tr. 2/215 of the August 11 hearing (filed August 18, 2010), even if one assumes a $4 billion RHB payment deferral at the end of FY 2010 similar to what was enacted at the end of FY 2009, the cash balance at the end of FY 2011 is negative $400 million without the proposed exigent increase, but positive $1.8 billion with the exigent increase.

[17] For example, on August 27, 2010, the Bureau of Economic Analysis of the Dept. of Commerce released its estimate of 2010 Quarter Two GDP growth of 1.6 percent. This was down from the corresponding Quarter One figure of 3.7 percent, and also down from BEA's "advance" estimate on July 30, 2010 of Quarter Two GDP growth of 2.4 percent. While these figures represent estimates of past economic activity, rather than forecasts of the future, they reflect the same factors which have caused forecasts to be revised downward as well. An interesting recent assessment of the risks these factors specifically pose to postal forecasting was presented on August 25, 2010 in the Courier, Express, and Postal Observer by Alan Robinson in an article entitled "Are the Postal Service's Earnings Forecast Too Optimistic?" That piece is posted at: http://courierexpressandpostal.blogspot.com/2010/08/are-postal-services-earnings-forecast.html

concern to the Commission as it contemplates the potential ramifications of denying the Postal Service the authority to implement the proposed increases. The Postal Service assessed what percentage increases seemed reasonable and necessary in light of the anticipated size of the FY 2011 revenue shortfall. If that projected shortfall proves to be understated, the Postal Service's need for this exigent increase is even more urgent.[18] Nothing less than the financial viability of the Postal Service is at stake, and if appropriate actions are not taken in the short run, the long-term prognosis will only deteriorate more rapidly.

B. AMA Distorts the Facts in Claiming that Postal Officials Suddenly Shifted Their Explanation of "Necessary" to Rely on 10-Year Forecasts

As quoted above, the following passage appears on page 4 of the AMA Comments:

> The testimony of the Postal Service's witnesses during the hearings on August 10-12 revealed a fundamental hole in the Postal Service's case: whether or not the Postal Service improves its efficiency, the proposed rate increase is simply not "necessary" under section 3622(d)(1)(E).

The AMA Comments are somewhat confusing in that arguments about postal officials allegedly changing course midstream are made in a section of the Comments (pages 4-8) purportedly addressing the "necessary" standard, but once the AMA gets beyond rhetoric to actual transcript citations (on page 6 of the

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[18] The Postal Service is not suggesting that, for purposes of this proceeding, any adjustment to those estimates is either necessary or appropriate. The short amount of time that the statute allows for this type of proceeding is too brief to permit routine updating of inputs or, in fact, any updating short of much more dramatic occurrences than an increase in general foreboding of the type referenced here. Nonetheless, it merits mention that, based on the most current assessments (which also seem likely to prevail over the one remaining month of the Commission's deliberations), the risk seems to be greater that the Postal Service may have understated its critical need for price adjustments in 2011, rather than overstated that need.

Comments), the details of their claims actually seem to relate more to the AMA's views regarding exigent circumstances, which are ostensibly presented in a distinct section (pages 8-14). Consequently, the thrust of the AMA's assertions were rebutted above in a previous section of these reply comments dealing with the "extraordinary and exceptional" provision. <u>See</u> Part I.A.ii above. Restated briefly here in the context of the "necessary" discussion, since there is no "hole" in the Postal Service's case under the plain language of the "necessary" provision of the statute, there was no need for postal officials to "change course" in the midst of hearings. Moreover, as discussed above, review of the transcript pages that the AMA cites show that postal officials did not make the statements which the AMA attributes to them.

While the Postal Service's presentation supporting its Request in this proceeding was clearly focused on FY 2011, the critical role of the requested exigent increases within the Postal Service's broader March 2 Action Plan was highlighted as well. <u>See</u> Corbett Statement at 8-10, Masse Statement at 12. Particularly in light of the statutory directive regarding rates that enable the Postal Service to maintain and develop adequate postal services, the Commissioners were understandably interested in the relationship between the longer-term aspects of the March 2 Plan and the instant exigent case. For example, even taking the very poor projected FY 2011 results as a given, one could question the reasonableness and necessity of an exigent increase during that period if there were a solid basis to expect a complete reversal of those results in the following year or two. Responding primarily to questions regarding the March 2 Plan, witnesses Corbett and Masse explained that no such complete reversal can rationally be expected, and further explained the relationship between the March 2 Plan and the instant exigent request.

The AMA quotes questions posed by the Commissioners raising concerns regarding that relationship, but conveniently omits reference to the answers given at the hearing which addressed and resolved those concerns. For example, on page 13, the AMA quotes Commissioner Langley's question about the exigent request as part of an approach to long-term solvency. Witness Masse explained that the requested increases are a response to both the extraordinary decline in volume from 2006 to 2009, and the looming liquidity crisis at the end of FY 2011. Tr. 2/206. See also Tr. 2/180 (March 2 initiatives represent a balanced approach to address both short-term and long-term hurdles).

In response to Commissioner Blair's question also quoted by the AMA on page 13, witness Masse appropriately stated that it is too soon to tell whether other liquidity problems might arise in future years after the price increases proposed in this proceeding were implemented, because that will depend on what can be achieved with other stakeholders (i.e., actions beyond the Postal Service's control). Tr. 2/197. Surely, uncertainty regarding potential financial distress in the future would not be a valid basis for failing to respond appropriately to the exigencies which the Postal Service undoubtedly faces now.

With respect to the last quotation from a Commissioner presented by the AMA on page 13, the AMA quotes a small portion of a question by Chairman Goldway at Tr. 181, but once again fails to provide witness Masse's response.

That is perhaps understandable, however, since witness Masse was explaining that if the Postal Service were seeking a complete short-term and long-term solution to its current situation solely from this exigent increase, the necessary increase would be in the range of 25 percent, a figure with which AMA apparently does not want to contend. Tr. 2/181.

Contrary to what the AMA appears to be implying, the proposed increases are fundamentally "necessary" because of the Postal Service's financial circumstances as they exist now, not how they are forecasted to exist over the next ten years. Obviously, however, what might be expected in coming years is not entirely unrelated to an evaluation of the current request and, as acknowledged above, developments that might be expected in the years immediately following are particularly relevant. The Postal Service, though, is not relying on future developments beyond 2011 to justify the necessity of the proposed changes in 2011. Instead, the Postal Service provides the context of expected developments in those years to show that they would provide no basis to justify a failure to act affirmatively to address current circumstances. Moreover, by including moderate price increases as one component of a larger, long-term plan, the Postal Service demonstrates that those increases are not only necessary, but reasonable and equitable as well.

C. Time Warner's Supposition that the "Necessary" Standard Must be Applied to Each Class Separately Does Not Comport with Sensible Application of the Exigency Provision

In its comments, Time Warner attempts to create a framework for exigent cases which, at first blush, may have some superficial appeal, but upon scrutiny quickly evaporates as a practical construct. The basic structure is set forth most prominently in the section headings on pages 10 and 12 of the Time Warner Comments, and the idea is simple. Since the CPI-U price cap applies to each class separately, Time Warner argues, the provisions for authorization to exceed the CPI-U price cap must apply to each class separately as well. Thus, according to Time Warner, both the need for the existence of "extraordinary or exceptional" circumstances, and the standard of "necessary" to maintain and develop adequate postal services, must be applied to each class of mail separately and individually. Time Warner Comments at 10. Taking this approach to its logical conclusion, what the statute requires is not "an" exigent price case, but instead a series of exigent price cases, one for each class.

Perhaps the first good inkling of why such a framework makes no sense in the context of the "necessary" standard comes immediately from reference to the discussion regarding that standard in the AMA Comments, summarized above. Time Warner begins its arguments (on page 5) by stating its support for the AMA arguments. Recall, however, that the AMA Comments seek to evaluate "necessary" against the backdrop of the Postal Service's cash flow situation. The AMA Comments which Time Warner joins do not purport to apply the "necessary" standard by class. More importantly, with an exclusive focus on cash flow, there is no meaningful method to apply the "necessary" standard by class. The nature of any cash flow analysis examines total cash needs versus total cash available from all sources, when cash from all classes is thus aggregated into one fungible cash pool. A class-by-class approach would be entirely antithetical to such an analysis.

It is rather obvious why a mailer of Periodicals such as Time Warner might propose to apply the “necessary” standard on a class-specific basis. Adopting such a postulation would arguably give every class but First-Class Mail and Standard Mail a pass on exigent increases, since individually and collectively the other Market Dominant classes all contribute less than $1 billion towards the recovery of the Postal Service’s institutional costs. In contrast, First-Class Mail and Standard Mail in FY 2009 covered approximately $23 billion of institutional costs. Given those relative proportions, it could be difficult to justify any increase to prices for the other classes and services as “necessary,” when just a small additional increase for First-Class Mail and Standard Mail could instead generate the same amount of contribution. Indeed, in a year like FY 2004, in which the Postal Service had overall revenue over $3 billion in excess of expenses, was paying down debt, and thus was clearly able to continue to maintain and develop adequate postal service, it was nonetheless losing money on Periodicals.[19] Would Time Warner on that basis be prepared to argue that, since losing money on Periodicals is thus apparently not incompatible with meeting the “necessary” standard, it can *never* be “necessary” to raise Periodicals rates?

In the real world, just as it is impractical to evaluate “reasonable and equitable” for each class in isolation, it is impractical to evaluate “necessary” on that basis. As implicit in the framework set forth on page 9 of the Postal Service’s Request (and quoted on page 18 of the Time Warner Comments), the

[19] See FY 2004 PRC Version CRA, Docket No. R2005-1, USPS-LR-K-94, pg. 169.

focus of the “necessary” standard must inherently be <u>total</u> revenue across all classes. Conversely, the “reasonable and equitable” standards amply take into account the class-specific increases, and the relationships within and between classes, as well as the overall increase. Such a framework comports fully with the language and intent of the exigent provision of section 3622, which refers to any “request” by the Postal Service, not a series of requests. Such a framework, moreover, can be meaningfully applied.

In contrast, under the analytic structure advanced by Time Warner, the Postal Service apparently could seek class-specific increases that the Commission determined were both “reasonable and equitable,” which produced an overall increase that the Commission likewise determined was “necessary,” but could still be denied authorization by virtue of failing to demonstrate that each class-specific increase was individually and separately “necessary.” This is an incredibly strained approach to the task set forth in the statute. Essentially, to the extent that Time Warner has raised substantive concerns that need to be addressed, those concerns are much more rationally and directly addressed in the context of “reasonable and equitable,” rather than “necessary.” Stated alternatively, if the Commission determines that it would be unreasonable and inequitable to further raise prices for other classes in order to cover the losses from one class, then it is *ipso facto* “necessary” to raise prices for that class to the level necessary to avoid that result. By protesting that a separate evaluation of “necessary” is required for each class, Time Warner is simply seeking to elevate form over substance.

The Postal Service also does not agree with Time Warner's assertion that the sole justification proffered for an above-average increase was to move closer to compliance with the attributable cost factor of the statute. Time Warner Comments at 20. In reality, witness Corbett discussed the fact, and cited to the Commission's discussion in its Annual Compliance Determination (ACD) of the fact, that certain products do not cover their costs. Corbett Statement at 17.[20] Witness Corbett specifically connected the money-losing status of these products to the overall "need" to increase prices. Id. Although he did not use such pithy language, the import of this portion of his statement is clear – from a business perspective, if you want to get out of a hole (losing $7 billion overall in FY 2011), the first thing that it is "necessary" for you to do is stop digging (losing over $1 billion in FY 2011 on underwater products). In other words, even in the absence of any *legal* considerations, it would still be *financially* "necessary" to begin to take steps (consistent with an evaluation of the effect on customers) to reverse course on money-losing products to be able to maintain and develop adequate postal services.

D. Time-Warner Distorts the Postal Service's Views on the Limitations of an Exigent Price Increase

At one point in its Comments, Time Warner suggests that the Postal Service apparently wishes to assert that once it has established that increases based on the available CPI cap would be insufficient, there is no limit on the level of increases that can be authorized in an exigent proceeding:

[20] In the FY 2009 ACD (March 29, 2010), the Commission on pages 5-6 identified the aggregate loss of $1.7 billion from 14 market dominant products and services as one contributing factor to the Postal Service's overall loss of $3.8 billion.

> [T]he Postal Service appears to adopt the position that, once it is established that "total revenue generated from increases limited by [the applicable] price caps would be inadequate," it may propose and the Commission may adopt *any* "alternative set of higher-percentage price increases" that could have been proposed and adopted in "normal" annual rate adjustment *but for the existence of the rate cap.*

Time Warner Comments at 18 (emphasis in original, footnote omitted). The Postal Service adopts no such position. Indeed, in actual quotations from its Request presented in other portions of Time Warner's comments, the Postal Service repeatedly emphasized the "necessary" limitation on exigent increases, and has deliberately sought moderate price increases that are less than those which could have been justified as "necessary." See, e.g., Request at 4-5, 7. Under a "normal" annual rate adjustment subject to a price cap, as long as the noticed price increases are within the cap, the Postal Service is not required to make any showing regarding the necessity of such adjustments, and the Commission is likewise not required to make any determinations regarding necessity. In contrast, the statute is very clear that the Commission must determine that the above-cap price increases sought by the Postal Service in an exigent proceeding are reasonable, equitable, *and necessary*, and the Postal Service has never disputed that. Why Time Warner would contend otherwise is distinctly unclear.

E. The Public Representative's Proposed "Framework" Provides No Basis for Denying the Postal Service's Request

While the Public Representative concurs that "extraordinary or exceptional circumstances" have occurred (PR Comments at 18), he argues that the Commission should deny the Postal Service's Request, without prejudice, because the Postal Service has not followed a "framework" that he believes should be used to evaluate *all* exigent requests. PR Comments at 11. This "framework," however, is not incorporated into the Commission's rules governing the review of exigent requests, established at 39 C.F.R. Part 3010, Subpart E. As such, there is no legal or practical basis for denying the Postal Service's Request because it may have not adhered to the terms of a "framework" that has never before been articulated. Indeed, the Postal Service has comprehensively followed the requirements of the existing rules through its Request and written Statements, and has responded fully to all Commission inquiries, both at the hearings and through Information Requests. [21] Nothing is to be gained from denying this Request on what amount to procedural grounds.[22]

Furthermore, the Public Representative's application of his "framework" is flawed. The Public Representative claims that it is improper for the Postal Service to use an exigent increase "to raise revenue for general Postal Service operations," or to "improve its financial position." Id. at 18. Under his rubric, the Postal Service can only seek revenue from an exigent adjustment when it is

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[21] Since the Public Representative is agreeing that the Postal Service has cleared the exigent hurdle, his position implicitly must be that its proposals nonetheless fail to pass the "necessary" test, although he does not explicitly couch his argument in those terms. This lack of clarity regarding which legal requirement he is purporting to address, however, underscores a fundamental flaw -- he is trying to impose a new legal standard of his own creation, rather than to apply those actually in the statute or in the rules.

[22] The Public Representative provides two reasons (PR Comments at 12) why he believes that delaying the exigent increase for "a few months" is justified, but neither reason withstands scrutiny. Contrary to his suggestion that such a delay would not materially alter the Postal Service's finances, we know from comparing the results of January implementation with October implementation in witness Masse's Attachments that a three month delay could cost nearly $800 million. Second, in stating his belief that dismissal of this Request is justifiable because it "may focus the Postal Service's attention on taking steps to address the effects of the exigency on its operations," the Public Representative incorrectly acts as if the Postal Service was not already completely engaged in taking such steps, through the aggressive cost-cutting detailed extensively in this proceeding.

“necessary to deal with a particular exigent circumstance.” Id. at 22. But, that is precisely what the Postal Service is doing here: it is directly responding to the financial crisis caused by the recent volume declines, which affected all classes of mail, throughout the nation. The fact that this revenue will be used to fund “general Postal Service operations,” and to “improve [the Postal Service’s] financial position,” is surely not a reason for concluding that the increase is inappropriate, under either the statute or simple common sense. Indeed, funding the Postal Service’s operations is the precise way in which the Postal Service will be able to “maintain and continue” adequate, universal postal services, and there is no conceivable way to segregate “exigent cash” from “non-exigent cash.”

In addition, as discussed elsewhere in this document, the Postal Service’s actions simply cannot be dismissed as a “business-as-usual” response to the financial challenges posed by these volume declines (id. at 20). The Postal Service has set forth a comprehensive Action Plan to address its financial challenges, of which this rate increase is one important, “necessary” part. Witnesses Corbett and Masse also discussed how the Postal Service plans to address the Postal Service’s financial challenges, in addition to this increase. To the extent that the Public Representative is claiming that the Postal Service should have proposed a higher increase in order to address the volume declines, his argument is incorrect, as discussed previously in this document regarding a similar argument by the AMA.

III. Notwithstanding the AMA's and Other Parties' Statutory Contortions and Factual Misrepresentations, the Postal Service Has Exercised Honest, Efficient, and Economical Management as to Factors Within its Control.

In its Response to the AMA's Motion to Dismiss, the Postal Service addressed several criticisms the AMA lobbed at Postal Service management's purported failure to take cost-cutting measures available to private-sector companies. Apart from explaining the nuances of certain management deliberations implicated by the AMA's Motion, the central thrust of the Postal Service's response was to remind the Commission and interested parties that "honest, economical, and efficient management" of the Postal Service can only fairly be judged in light of the legal and pragmatic reality in which the Postal Service operates. Response at 6-7, 25-43.[23] It would be inappropriate to hold Postal Service management responsible for not behaving as radically as a private-sector business when the Postal Service simply does not have the same range of options available to it (e.g., bankruptcy, unilateral cuts to largely non-union workforces, negotiating based on leverage not tied to arbitration, suspending matching contributions to employee retirement savings plans, reducing service, entering new lines of business).

[23] It is odd that the AMA recognizes the concept that statutory language must be read in context, AMA Comments at 10, but gives short shrift to that fact when it comes to the application of the "honest, efficient, and economical management" standard (for instance, by ignoring the fact that the PAEA expressly provided that it should not be read to affect the rights or privileges of postal employees). PAEA § 505(b), 120 Stat. 3198, 3236; see Response at 32-33. Furthermore, the AMA seems to miss the irony of dismissing the Postal Service Response's discussion of the "honest, efficient, and economical management" standard as a "caricature," when its characterization of the Response (e.g., cartooning the Postal Service as a "pitiful, helpless giant") is itself a caricature. AMA Comments at 19. Such pithy rhetoric is apparently the AMA's substitute for truly acknowledging the simple point made by the Postal Service in its Response: that the "honest, efficient, and economical management" standard must be applied with a clear understanding of the legal and political environment in which the Postal Service operates, and with a clear understanding of the tradeoffs inherent in management decision-making.

The AMA and its constituents the Flat-Shaped Mail Users present no serious surrebuttal, preferring instead to rest on citations to the original AMA motion and recitation of some of its highlights as if that screed had not been comprehensively rebutted. Tellingly, the AMA has no reply to the Postal Service's observation that the "honest, efficient, and economical management" standard, as a provision of the PAEA, cannot legally be construed in a manner that demands changes to the rights and privileges of Postal Service employees. PAEA § 505(b), 120 Stat. 3198, 3236; see also Response at 32-33. To the extent the AMA's motion is incorporated into its comments by reference, then the corresponding points from the Postal Service's response are likewise incorporated in this reply, as noted above.

A. The "Honest, Efficient, and Economical Management" Standard

Determined to introduce some welcome realism into this discussion, Valpak encourages parties to recognize that "commendable" and "exceptionally capable Postal Service management" has allowed the Postal Service to weather the current financial storm as well as it has, in the face of near-universally acknowledged political and legal constraints. Valpak Comments at 7, 9. As Valpak reminds parties, the PAEA did not offer the Postal Service any new tools with which to address old or new cost problems, even as it saddled the Postal Service with new obligations and revenue constraints. Id. at 8-10. As the Postal Service and Valpak have noted, the Postal Service would have posted profits since the PAEA's enactment, notwithstanding the difficult financial climate, if it were not for the retiree health benefits pre-funding requirement imposed by the

PAEA. Response at 50-51; Valpak Comments at 7-8. To insist stubbornly on downplaying the true extent of those constraints and their relevance, as the AMA does, is disingenuous and unfair.[24]

As Valpak acknowledges, Congress included the possibility of an exigent rate increase for extraordinary or exceptional events that fundamentally undermine the Postal Service's solvency. Id. at 10-14. The AMA's and the Flat-Shaped Mail Users' rigid approach would turn this important "relief valve" (in Valpak's phrase) into a circular nullity: if "honest, efficient, and economical management" is equated with taking all conceivable means to keep the Postal Service solvent enough to face any potentially foreseeable exigency, then no "extraordinary or exceptional circumstances" would ever require the Postal Service to need additional revenues. Although the AMA posits that some lacuna of permissible relief would yet remain (AMA Comments at 11), it is hard, as noted above, to imagine some other circumstance where this would occur to these parties' satisfaction.

The AMA's comments regarding honest, efficient, and economical management begin by warming over arguments that were insubstantial when made, and all the more so in light of the Postal Service's unrebutted explanations in its Response to AMA's Motion. Rather than accepting that the Postal Service has taken substantial action, to the extent it is able, to cut labor costs in the face of significant constraints, AMA pretends that the Postal Service's Response

[24] The Postal Service notes again the discrepancy between the AMA's views and the more realistic recent submission by Time Warner Inc., the corporate parent of AMA member Time Inc., about the exogenous nature of the labor and network constraints imposed on the Postal Service. See Initial Comments of Time Warner Inc. on ACR2009 Pursuant to Order No. 380, Docket No. ACR2009, February 1, 2010, at 20-21.

“confirm[s] the Postal Service’s failure to show that it would” be facing extraordinary or exceptional circumstances but for its alleged lack of honest, efficient, and economical management. Id. at 14. Even more confusingly, the AMA muddles the statute to the point where it believes honest, efficient, and economical management to be a requirement for the existence of the underlying exigency – which it is not – rather than a qualifier on the amount of price increases sought – which it plainly is.

This confusion is evident with the AMA’s and the Flat-Shaped Mailer Users’ inference that honest, efficient, and economical management requires “living within the CPI cap.” Id. at 17-18; see also Flat-Shaped Mail Users Comments at 5; see also PR Comments at 13-15 (positing a framework whereby “extraordinary and exceptional circumstances” are defined against “normal” events that can be dealt with in the course of honest, efficient, and economical management and that would not warrant more than a CPI-based rate increase). Of course, such an interpretation would read the exigency provision out of the statute, as a Postal Service living up to the AMA’s unrealistic standard of honest, efficient, and economical management would never need to invoke the only safeguard Congress expressly granted the Postal Service to maintain its solvency (and thus continue to provide adequate postal services) in the face of extraordinary or exceptional circumstances. See Response at 20-21. The AMA’s postulation of a statutory mechanism that could never be invoked (until the Postal Service somehow, notwithstanding all legal, political, and business constraints, makes management decisions of which the AMA approves) is particularly inappropriate in contrast to Valpak's straightforward view, that the provision was written as a relief valve for precisely such dire financial situations as that in which the Postal Service now finds itself, despite its management's best efforts, due to extraordinary or exceptional circumstances.

Contrary to the AMA's depiction (AMA Comments at 5-6), the Postal Service is not taking a "business-as-usual" approach of funding operations until the next crisis. Once it recognized the downward trend in First Class Mail volume several years ago, the Postal Service embarked on a path of reducing $1 billion in costs each year. When the current Great Recession hit, the Postal Service accelerated its cost reduction efforts. The chart included as Attachment A to these Reply Comments shows that, between 2008 and 2010, the Postal Service has reduced its workforce by the equivalent of approximately 138,000 employees. In 2009, the Postal Service eliminated more work hours, measured in full-time equivalents, than at any other time in its history. Tr. 1/59-60 ("[M]y guess is that no organization in North America has ever taken out that many people that fast and continued the quality of service that we've continued."); March 2 Action Plan at 4-5. Total cost savings in 2009 alone reached $6.1 billion, thanks to work hour reductions and streamlined operations. Action Plan at 4. Attachment B further shows that, despite Total Factor Productivity (TFP) declines during the first period of the Great Recession, for reasons explained in the Postal Service's Response to AMA's Motion, the Postal Service's responsive efforts have resulted not only in recoupment of all TFP lost, but also in new gains to record TFP levels.

Due to the unprecedented volume declines, the Postal Service has focused its aggressive cuts in areas of the workforce where costs are most responsive to volume, such as Mail Processing and Customer Services, whose workhours have been reduced by a percentage greater than the percentage decline in volume. See Attachment A. However, it has proven more difficult to streamline aspects of the Postal Service network that are more fixed in nature and that are subject to legal restrictions that require six-day delivery and impede the closure of post offices for economic reasons. Consequently, reductions in city carriers, rural carriers, and postmasters have not been proportionate to the volume decline. Of course, to address part of that situation, the Postal Service has initiated efforts to be allowed to reduce most delivery service from six days per week to five.

On March 2, 2010, the Postal Service set forth a comprehensive Action Plan to confront the structural problems facing the Postal Service. The Postal Service's Action Plan reflects serious management deliberation about how to improve efficiency and economy in multiple areas, of which rate-setting is only one. It also focuses on actions within the control of Postal Service management, while going beyond to identify issues where outside stakeholders will be asked to give the Postal Service additional flexibility. Since the announcement of the Action Plan, the Postal Service has already pushed forward with efforts to make the more difficult changes, such as through negotiation of route adjustments and its request for an advisory opinion regarding five-day street delivery.

B. Despite the AMA's Misleading Argument to the Contrary, the Postal Service Does Not Claim that the "Honest, Efficient, and Economical Management" Standard is "Toothless"

In a lengthy footnote on page 23 of its Comments, the AMA accuses the Postal Service of using a discussion of previous attempts to apply the "honest, efficient, and economical" standard as it appeared in former section 3621 of title 39, United States Code, as a basis to assert that the corresponding provision in the PAEA is "toothless." That was clearly not, however, the intent of that discussion in the Postal Service's Response to the AMA Motion. Rather, the intent was to question why, on the one hand, the AMA had chosen in its Motion to argue that the "honest, efficient, and economical" standard under the Postal Reorganization Act had been written out of the statute by the court in Newsweek, Inc. v. United States Postal Serv., 663 F.2d 1186 (2d Cir. 1981), when, on the other hand, one key member of the AMA had argued quite vociferously in Docket No. R2000-1 precisely the opposite, and the Commission had agreed with that argument. That long-standing conditions, fundamentally outside the control of postal management, are not grist for evaluating "honest, efficient, and economical management" does not mean the standard under the PAEA is "toothless."

The "exceptional or extraordinary" circumstances that triggered the need for this filing were the precipitous drop in mail volume and the accompanying drop in revenue that is no longer available to cover either attributable or institutional costs. When considering whether the requested increases are "necessary" under this particular set of circumstances, the Postal Service submits that application of the "honest, efficient, and economical management" standard appropriately leads to consideration by the Commission of the following questions:

- First, could management have done more to prevent the volume losses? The answer to that question, given the tidal wave of the recession, seems rather clearly to be no.
- Second, could management have done a better job of reducing costs that are identified under the Commission's established costing methodologies as responsive to changes in volume? The answer to this question is probably always going to be more controversial. However, examination of the actual evidence demonstrates that the Postal Service did all that it could do to reduce its volume-variable costs, given that those costs cannot be adjusted either instantaneously or completely.
- Finally, can management be faulted for failing to eliminate more network-related institutional costs in response to the rapid drop in volume? Perhaps even more so than the first question, the answer to this question is clearly no, because the very nature of institutional costs requires that they not respond to changes in mail volume.

Just because the Postal Service submits that sensible answers to the relevant questions indicate no basis to question the "necessity" of the Postal Service's modest proposed increases in this proceeding, however, does not support the conclusion that it views the "honest, efficient, and economical" standard to be universally "toothless," as the AMA erroneously asserts.

C. Processing Facility Closures and Consolidations

Lacking new points, the AMA merely adds some new detail to old points. The AMA asks why the Postal Service has not done more to close Processing and Distribution Centers (P&DCs) and other mail processing facilities. AMA Comments at 19. The Flat-Shaped Mail Users join the fray by blaming the underwater status of certain products on "chronic excess capacity in mail processing facilities." Flat-Shaped Mail Users Comments at 11, 19-21.[25] The Postal Service would refer the AMA and the Flat-Shaped Mail Users to pages 41 to 43 of its Response to the AMA's Motion, which describe both the constraints on the Postal Service's ability to rationalize its network and its efforts to do so to the extent possible. By way of further explication, the Postal Service submits the following additional information on this point.

As is the case with other facilities, the closure or consolidation of processing facilities frequently raises public and legislative scrutiny that can place a heavy thumb on the scales against rationalization. The very Government Accountability Office (GAO) report cited by the AMA recognizes that, in "realign[ing] and consolidat[ing] some mail processing, retail, and delivery operations, … USPS has faced formidable resistance to facility closures and consolidations because of concerns about how these actions might affect jobs, service, employees, and communities, particularly in small towns or rural areas." Report GAO-10-455, <u>U.S. Postal Service: Strategies and Options to Facilitate</u>

[25] The Flat-Shaped Mail Users also claim that years of data showing the relevant products as not covering their costs should be corrected by factoring excess capacity into cost coverage calculations. For the Commission to reach such a conclusion, however, would likely require a cost attribution methodological change that is beyond the scope of this proceeding.

Progress Toward Financial Viability, April 2010, at 30; see also Response at 28-29 (discussing specific instances of Congressional intent to dissuade Postal Service management from efficiency-oriented consolidation decisions); Kevin R. Kosar, Congressional Research Service Report No. 7-5700, The U.S. Postal Service's Financial Condition: Overview and Issues for Congress, July 29, 2010, at 12-13 (proposing three options for addressing "congressional intervention in proposed mail facility closures" and citing as an example the directive in S. Rep. 111-43, Financial Services and General Government Appropriations Bill, FY2010, at 131, that the Postal Service not proceed with an AMP study regarding a Quincy, IL, facility). Even where processing facilities do not offer a direct retail interface, the Postal Service has established formal processes to solicit public input. See Handbook PO-408, Area Mail Processing Guidelines. See also Postal Accountability and Enhancement Act, P.L. 109-435, § 302(c)(3)(D), (5), 120 Stat. 3198, 3219-21 (2006) (requiring the Postal Service to establish public notice, disclosure, and comment procedures for certain persons in the context of "proposed rationalization decision[s]"). The real or perceived public interest in keeping a facility open, often channeled through Congress, can legitimately give the Postal Service (a body of the Federal Government) pause, to a degree that the private companies behind the AMA might not fully appreciate.

It is also not enough to cite a purportedly small number of P&DCs that have been closed since 2005, as the AMA does. For one thing, a citation merely of facilities closed or consolidated masks other alignments that promote efficiency. In fact, several steps have been taken to shift or merge operations between facilities even where it does not result in a wholesale closure. See, e.g., Explanation of Cost Reductions, Other Programs, and Corporatewide Activities at 16, 17-18 (describing equipment realignments and transfers around the Philadelphia Network Distribution Center, as well as planned Remote Encoding Center (REC) consolidations), filed with Response of the United States Postal Service to Informal Question Regarding Cost Reduction Programs Posed at the Technical Conference on July 19, 2010, Docket No. R2010-4, July 27, 2010. Additionally, even the AMA's P&DC statistic omits other types of processing facilities the Postal Service has closed or consolidated. From 2005 to the present, the Postal Service has actually closed or reclassified 80 Airport Mail Centers (AMCs), for an estimated operational savings of over $99 million. The Postal Service has approved 47 Area Mail Processing (AMP) studies during that period, for an estimated operational savings of approximately $140 million. In 2010 alone, leases expired on, or the Postal Service otherwise disposed of, 19 network facilities (e.g., Annexes, Logistics and Distribution Centers, P&DCs, RECs, International Service Centers). Leases terminated so far in 2010 were worth an estimated $9.1 million per year.

Indeed, the AMA cherry-picks one statistic in a GAO report while omitting others in the same paragraph of the report that present a fuller picture of the Postal Service's network rationalization efforts. Report GAO-10-455 at 31 (acknowledging, as of the date of GAO's research, 68 AMC closures and 12 REC closures, as well as 13 AMP studies worth a projected $31 million, with a further

16 AMP studies having been approved and 30 remaining under consideration). Testimony in this proceeding has also attested to the measure of savings from AMP studies initiated in the past year. Tr. 1/60; Responses of the United States Postal Service to Questions from the Bench at the Hearing for Mr. Corbett, Docket No. R2010-4, August 17, 2010, at 5. Although it may not play conveniently into the AMA's favored narrative, a fuller portrait of the Postal Service's network activities shows that, in spite of the existing constraints, Postal Service management is not as reticent in this area as the AMA would have the Commission believe.

Not only is the 2005-to-April-2010 time period reflected in the AMA's citation exclusively backward-looking, it also largely predates the current financial crisis. It says nothing about ongoing and planned network optimization efforts reflected, for example, in the Flats Strategy documents filed in Library Reference USPS-R2010-4/9 or in multiple Postal Service submissions in Docket No. N2010-1 about its plan for five-day street delivery (assuming, of course, that Congress permits implementation of that plan upon the Commission's advisory opinion).[26] Surely, developing a more aggressive strategy to realize greater network efficiencies is consonant with "honest, efficient, and economical management," which might account for the AMA's seeming disinterest in discussing the Postal

[26] This is not to say that the five-day street delivery plan at issue in Docket No. N2010-1 is a substitute for the emergency relief sought in this proceeding. As stated by witness Corbett, "the Postal Service [cannot] count on future changes in the law" when developing the projections necessary to evaluate its exigent rate increase request. Corbett Statement at 3-4. Moreover, the relief sought here would have a more immediate effect on the Postal Service's ongoing financial shortfalls than the also-necessary cost savings projected for five-day street delivery, even if Congress were to approve the latter. Tr. 2/177-178. In the context here, however, the five-day street delivery plan is relevant merely to show that the Postal Service is exercising "honest, efficient, and economical management" in seeking additional flexibility to adjust service and enable greater cost-savings potential through optimization.

Service's actual strategy. If the Postal Service believes it simply is unable to attain enough cost savings through such initiatives to make up the projected shortfall, then this is precisely why other financial relief is necessary. Perhaps the AMA put it best of all, in the end: "Even a Postal Service with considerable inefficiencies would be entitled to relief under section 3622(d)(1)(E) if curing the inefficiencies would still leave the regulated firm short of funds necessary to operate." AMA Comments at 11. The fact that "inefficiencies" or, more accurately, financial shortfalls will persist after Postal Service management does what it can to "cure inefficiencies" is the very basis for this Request.

At any rate, the AMA's criticism does not account for the fact that honest, efficient, and economical Postal Service management must balance potential financial benefits of network optimization (like other cost-cutting efforts) against other important goals, such as the degree to which facilities and staffing levels are necessary to maintain the levels of "postal services of the kind and quality adapted to the needs of the United States" (to borrow the phrase germane to this rate proceeding). 39 U.S.C. § 3622(d)(1)(E); <u>see also</u> <u>id.</u> at §§ 101(a)-(b), 3661(a), 3691. As noted, the exigent rate provision focuses on the maintenance of adequate services as the primary determinant of whether a rate increase should be implemented. Even assuming that some greater level of consolidation would not jeopardize service levels, the AMA's submission does nothing to suggest the potential financial benefit that could be gained from such consolidations, much less whether that benefit would obviate the need for a rate increase worth an estimated $3 billion. <u>See</u> Report GAO-10-455 at 31 ("When determining whether to close a particular mail processing facility, key factors include the role of the facility in providing secure and timely delivery in accordance with its service standards as well as the expected cost reductions or productivity gains."). Without any evidence to that effect, it is not clear how the numbers of processing facilities closed and consolidated to date establish a managerial misstep severe enough to disallow the requested relief.

D. Labor Arrangements

The AMA also returns to arguments from its Motion about activities the AMA thinks the Postal Service can and should take in the labor context. For example, the AMA thinks the Postal Service should "ask[its] employees to reopen existing collective bargaining agreements" because other businesses have allegedly done so. AMA Comments at 20. The AMA points to the upcoming expiration of existing agreements as an opportunity to negotiate new ones that save costs, particularly in the area of compensation. Id. at 20-21. Finally, the AMA would have the Commission read into 39 U.S.C. § 3622(d)(1)(E) an unstated requirement that the Postal Service exhaust all options for labor arbitration, no matter how worthwhile the Postal Service might reasonably deem them to be, before seeking an exigent price increase. Id. at 21-22. None of these suggestions or criticisms form a serious basis to reject the Postal Service's request.[27]

[27] For their part, the Flat-Shaped Mail Users claim that flats fail to cover their costs because the workforce has not dropped commensurate with volume and the Postal Service's resulting "desire to keep surplus workers busy." Flat-Shaped Mail Users Comments at 4, 11, 13-15. To the extent that the Flat-Shaped Mail Users' comments on this point complain about an oversized workforce at a general level, the Postal Service respectfully refers the Commission to pages 29-41 of its Response to the AMA Motion. Therein, the Postal Service explains the high degree to which any excess labor capacity is due to factors beyond the Postal Service's control and not to any lack of

At the outset, the AMA has ignored the fact that, under the law, the Postal Service cannot unilaterally force its unions to reopen collective bargaining agreements mid-term. Nonetheless, the Postal Service did collaborate with its unions mid-term to achieve a number of cost reductions, including restructuring of delivery routes, reductions in work hours and employees, and the facility consolidations discussed above. See Response at 37-38; Responses of the United States Postal Service to Questions 1-32 of Presiding Officer's Information Request No. 5, Docket No. R2010-4, August 25, 2010 (responses to questions 4 to 7). To the extent these can be considered "reopening the agreements," then Postal Service management has already pursued this option to the extent possible with the relevant employee organizations. Again, the Postal Service cannot unilaterally modify labor contracts, and so it cannot realize gains in this area beyond those to which employee organizations are willing to agree.

Regarding future contracts, the Postal Service can hardly be faulted for failing to achieve a hypothetical outcome of labor agreements that have yet to be negotiated. The AMA's exhortation of the Postal Service to seek cost reductions through its negotiations is well-taken, and the Postal Service is committed to doing so as best it can within its statutory context and consistent with the requirements and obligations of collective bargaining. However, the sheer existence of an opportunity for negotiation does not provide a basis for assuming the outcome will be inconsistent with "honest, efficient, and economical management." Nor does the possibility that "[s]uccessful negotiations could

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honest, efficient, and economical management by the Postal Service. As noted above, the Postal Service's Response is incorporated into this reply by reference.

narrow … the forecast 10-year shortfall" (AMA Comments at 20) mean that one can bank on the relief requested in this proceeding being unnecessary in the end. Any benefit from upcoming labor negotiations could only be realized in the medium- or long-term, whereas the relief requested in this proceeding is necessary to address real, exigent, short-term needs. In light of the AMA's concession that an exigent price increase can be necessary even after accounting for other management actions, the AMA's compounded speculation does not provide a basis for arguing that management should not be seeking relief based on current projections of need.

The AMA's only attempt at a concrete point about upcoming labor negotiations relies on a mischaracterization of the record. Citing witness Corbett's oral testimony, the AMA somehow infers that the Postal Service "appears to have taken the renegotiation of … compensation premiums off the table" and is "[i]nstead … content simply to try to reduce its share of the total cost of the health benefit packages." Id. at 20-21. It is unclear how the AMA reaches this conclusion based on the cited statements from witness Corbett, or why it would ever imagine that the Postal Service would use a public Commission hearing to make negotiating concessions prior to the actual onset of negotiations. The AMA and other parties interested in this point would do well to review the actual transcript text cited by the AMA:

> THE WITNESS: There are, I mean the union contract is multifaceted, a price you charge a customer is binary. So whether it's 42 cents or 44 cents that is the entire pricing for the contract. With unions there are, if we are successful in negotiating flexibility in the workforce and changes to healthcare, we will do far better good for the Postal Service than if we were to go to try, from a

> monetary standpoint, than a actual labor rate reduction for example. So and work rules and other things, there are probably about a dozen key things in a labor contract that you have to look at, not just the COLA, in order to determine whether or not you have a fair and a flexible arrangement going forward. So I don't think the two are apples and apples.

Tr. 1/120-121. Rather than displaying a myopic obsession with health benefit cost-sharing to the exclusion of wage factors, witness Corbett's testimony simply indicates that the Postal Service intends to engage with unions on many aspects of labor costs, which must be balanced to a degree that the AMA and its largely non-unionized constituents might not appreciate. See also Tr. 1/98-100. Witness Corbett also emphasizes that the Postal Service's focus will be, naturally enough, on maximizing benefit to the Postal Service, even if that ends up meaning choices beyond the scope of the AMA's fixation on compensation.[28]

Equally mystifying is the AMA's quibble that not enough cost savings would result from a reduction in health benefit packages to a level comparable to that paid by other federal agencies. If the AMA's aim is to exhort the Postal Service to eke out any and every cost cut imaginable before seeking a rate increase, then it seems odd to attack a given cost-cutting effort that the Postal Service has indicated it could pursue, simply because the results would not be big enough on their own to fix the Postal Service's total financial woes. This is particularly puzzling in light of the AMA's own view that, for the statute to retain any legal meaning, exigent rate increases do not require the Postal Service to achieve full solvency through cost-cutting, just that the Postal Service take what

[28] The AMA appears to have moved on from its preoccupation with 2008 COLA increases, which consumed three pages of its Motion. One can only assume that the AMA now realizes that its objections do not withstand the Postal Service's explanation of the extrinsic causes behind those increases. See Response at 35-37; Tr. 1/119, 121.

measures it can within the scope of "honest, efficient, and economical management." See AMA Comments at 11. The very GAO report touted by the AMA elsewhere as a standard for judging Postal Service management includes health benefits cost-sharing comparability as a key recommendation. Report GAO-10-455 at 28. Rather than distorting the record and manufacturing an excuse to blame the Postal Service, the AMA should note that the Postal Service has publicly discussed its intention to explore a range of cost-cutting options in labor negotiations.

As for arbitration, it is difficult to understand how it would be consistent with "honest, efficient, and economical management" for an organization saddled with the Postal Service's constraints to break contracts and create conflicts that require months of arbitration (at significant institutional expense) simply to prove a point to outside parties about already-known legal constraints. See Response at 31-34. Surely reasonable business judgment or "honest, efficient, and economical management" does not require the pursuit of every potentially fruitless, wasteful, or bad-faith possibility for financial relief.[29] In the private sector, arguably misguided or feckless management efforts are often checked by derivative suits from shareholders, not relied upon as preconditions to institutional relief. If "honest, efficient, and economical management" is to mean anything at all, it must inhere a substantial dose of deference to management's discretion to weigh the risks and expected payoff of various courses of action – that is, their efficiency and economy – and to choose reasonably among them.

[29] In fact, as noted above, Congress provided that nothing in the PAEA – including the PAEA provision that governs this proceeding – would affect the rights or privileges of postal employees. PAEA § 505(b), 120 Stat. 3198, 3236; see USPS Response at 32-33.

Cf. 39 U.S.C. § 202(a) (placing direction of the Postal Service in the hands of the Board of Governors). That the AMA would make a different choice, or that it would prefer some other class of stakeholders to sacrifice more for the Postal Service's financial stability, is immaterial to the question of whether the Postal Service is making decisions within the scope of sound management practices.

Conspicuously missing from the roster of complaints that the AMA rehashes are those about furloughs and layoffs. The Postal Service cannot help but assume that this is a tacit acknowledgment of the Postal Service's explanation in its Response that countervailing considerations, such as service needs and administrative burden, can reasonably limit the extent to which Postal Service management can be expected to take such actions. Response at 38-41.[30] Again, the Postal Service has taken what action it can in this regard, in an exercise of honest, efficient, and economical management. Id. at 39-40 (quoting and citing USPS Institutional Responses to MPA/USPS-T2-9 and 10 and NNA/USPS-T2-3(e), Docket No. N2010-1).

As the Postal Service pointed out in its Response to the AMA's Motion – and the AMA did not dispute – the Commission should be wary of heeding comparisons based exclusively on the AMA's native private-sector world, where businesses can restructure their labor arrangements (for the slim portion of the workforce that is unionized) and other obligations by entering bankruptcy. Id. at

[30] For example, nearly half of the Postal Service employees not protected from layoffs are part-time rural carrier associates "on call" to substitute for career rural carriers who are on leave or otherwise off-duty, and approximately three-quarters of non-bargaining-unit personnel are supervisors or postmasters, many in low-staffed offices. Response at 40-41.

30-35. Congress did not give the Postal Service these options.[31] Instead, in addition to other tools the Postal Service is already deploying to cut costs and raise revenue, Congress gave the Postal Service the option to seek an above-inflation price increase to remedy extraordinary and exceptional circumstances, which is precisely what it is doing here.

IV. The Proposed Prices are Reasonable and Equitable as Among Types of Users of Market Dominant Products.

The hallmark of the Postal Service's proposed pricing in this filing is its balance. The proposed pricing is designed to be one component – an important one but not the only one – in the set of solutions to help bridge the Postal

[31] In further response to the Postal Service's Response regarding the AMA's comparison of the Postal Service's handling of the recession with that of UPS and FedEx, AMA Comments at 15-16 fn.5, the AMA tellingly does not challenge the Postal Service on the point that the cost-cutting measures taken by those firms were unavailable to the Postal Service. This is significant, because nowhere in the Postal Service's Response did the Postal Service indicate, as the AMA asserts, that UPS and FedEx "rode out the recession" predominantly through price increases, as opposed to cost-cutting. (Nor, indeed, is the Postal Service attempting to do so, since this increase is but a fraction of what could have been proposed and goes hand-in-hand with significant cost-cutting initiatives.)

The AMA focuses instead on the Postal Service's point that, in addition to such cost-cutting, UPS and FedEx also raised their prices each year of the recession. The AMA claims that these price increases are irrelevant, because UPS and FedEx "routinely" give customers discounts from those rates, and asserts that witness Kiefer "admitted" that the published price increases are "meaningless" in the July 23 technical conference. This does not change the fact, however, that UPS and FedEx, held up by the AMA as paragons of "honest, efficient, and economical management," did in fact raise their prices on the presumably significant segment of their customers who pay published prices, and quite likely many or all of their customers who pay discounted prices, during each year of the recession. (The diminished revenue-per-piece ratio touted by the AMA does not undermine this assertion, as lower revenue-per-piece is not necessarily a function of lower prices: lower revenue-per-piece can result from customers shifting to lower-revenue services or otherwise cutting back their consumption of high-revenue services, especially when the company raises its prices.) Surely those companies saw such action as having a beneficial financial effect.

To correct another misleading AMA characterization, witness Kiefer never described the published prices as "meaningless." During the technical conference, witness Kiefer was asked about the comparison between the price of a one-pound Standard Mail Parcel and competitor's prices and his belief that Standard Parcels were under-priced. While witness Kiefer agreed that many customers do not necessarily pay the published prices, and that the Postal Service was not privy to the discounted prices, he simply noted that the list prices and assumptions about the level of discounts could be used to make pricing decisions.

Service's financial gap, projected to be $7.0 billion in FY 2011 absent any price change. See Masse Statement, Table 3. While the Postal Service fully understands that its customers should not bear the burden of closing the entire gap of its financial shortfalls, an exigent price increase is an absolute necessity to help improve the Postal Service's financial situation.

In determining what price increases should be proposed for individual products, balance was again the guiding principle. In general, the proposed pricing gives larger increases to those products not covering their costs. The Postal Service believes that all of its products have the potential to cover their costs and yield a positive contribution towards the bottom line; the proposed prices in this filing move forward in that direction.

For products that did not cover their costs in FY 2009, the need for above-average price increases to move toward 100% cost coverage was weighed against several factors:

- the extent to which users of each product had been affected by the current deep recession;
- the extent to which postage was a large portion of their overall expenses;
- the extent to which planned improvements in operating efficiency would tend to lower their costs;
- availability of other commercially available means of delivery; and
- availability of a competitive market against which to assess the pricing decisions.

Kiefer Statement at 29 -31 (Standard Mail Flats and Parcels) and 39-40 (Periodicals).

This will be the first price change for market dominant products in nearly two years. While the price increase exceeds the very low (in fact extraordinary) inflation rate during that period, the proposed price increase is moderate, with an overall average of 5.6 percent. Id. at 10.[32] For products covering their costs, the average price increases will be within a narrow range of 4 percent to 6 percent. Tr. 3/440. In fact, products accounting for about 87 percent of Mailing Services (market dominant) revenue lie within this 4 percent to 6 percent range. Kiefer Statement at 10; Masse Statement, Attachment 11. The increase in the Single-Piece stamp price was kept at the low end of the range (4-6 percent) to protect households and small businesses. To help retain and grow mail volume, two innovative incentive pricing programs are also included in this filing.

A. The Balance Between Single Piece and Bulk First-Class Mail Prices, Including some Worksharing Passthroughs Greater than 100 Percent, is Appropriate

In FY2009, First-Class Mail accounted for 78 percent of the contribution by Mailing Services products towards the Postal Service's institutional costs. Single-Piece First-Class Mail letters accounted for 24 percent of total Mailing Services contribution, while presort First-Class Mail letters accounted for 45 percent. Kiefer Statement at 12-13. Given the profitability of these products, and given that First-Class Mail volumes continue a long-run decline due to electronic diversion and market factors, it is extremely important to strike the right balance

[32] Once the time period since the May 2009 price increase is considered, approximately 19.5 months between the two increases, the annual increase on a non-compounded basis is only 3.3 percent. Corbett Statement at 19, note 9.

in the pricing of these products. Mailers have options beyond mail. So price increases that are too large will drive mail out of the system and exacerbate the financial situation.

The proposed pricing appropriately balances three important considerations: 1) the impact of the price change on customers and their mail volumes; 2) the need for additional revenue and contribution to replace what was lost by the volume decline; and 3) the extent to which mail volumes will continue to decline, regardless of actions taken by the Postal Service. The result of this balancing is a proposed 5.4 percent overall average increase for First-Class Mail, including a 4.7 percent average increase for single-piece letters, and a 5.9 percent average increase for presorted letters. Id. at 12-14. These reasonable increases effectively balance the short-run need for additional contribution with the long-term need to retain volumes.

While the subject of worksharing passthroughs is and has been a matter of great debate, the Postal Service's proposed pricing stands on solid and reasoned ground. The Postal Service understands the statutory requirement that discounts not exceed avoided costs; however, this statutory requirement includes mechanisms that permit the Postal Service to justify circumstances where this is necessary. As witness Kiefer noted, "Customers pay prices, not 'discounts'", and "price increases exceeding the overall average proposed in this request would cause many presort mailers to decide to abandon hard copy mail permanently and damage the core business supporting the Postal Service." Id. at 17-18. In evaluating pricing decisions it is necessary to consider the effect that a change in a discount has on the Postal Service's ability to retain high contribution volumes such as presorted letters. Some passthroughs exceeding 100 percent are necessary to prevent large volume declines that would harm the Postal Service's finances. Id. at 16-20.

The parties' comments reflect the different factors discussed above. On one side of the spectrum are arguments that the worksharing passthroughs are too high and should be adjusted to 100 percent. American Postal Workers Union (APWU) Comments at 5. On the other side of the spectrum are arguments that reducing the passthroughs could not possibly push major mailers to revert to single-piece, but, through higher prices, could intensify their efforts to leave the mail altogether. NPPC Comments at 29-33; ABA Comments at 10-13; National Association of Presort Mailers Comments at 4-5. The Postal Service seeks a middle ground which moves toward the 100 percent passthrough standard while protecting as much as possible a large and profitable mail category that is quite vulnerable to diversion. Kiefer Statement at 17.

The proposed prices move one of the key passthroughs (BMM to Mixed AADC) closer to 100 percent. At the same time, the Postal Service believes that the evaluation of worksharing passthroughs must be much more than simple mathematical exercises linking two fundamentally different products. Rather, these decisions must be made in the context of impacts on customers and dynamics in the marketplace a view which is clearly supported by the statute. 39 U.S.C. §§ 3622(c)(3), (c)(4), and (e)(3)(A).

In developing the First-Class Mail prices the Postal Service attempted to respond appropriately to the Commission's ACD directives in light of the many facts and uncertainties presented by the current extraordinary and exceptional circumstances.

The APWU, in upholding its extreme views of the world, the law, and the facts, accuses the Postal Service of proffering a sham response to the Commission's concerns, calling it "lip service." Quoting the statute, APWU points out that the justification rests on the fact that the "amount of the discount above costs avoided" is necessary to avoid rate shock. APWU Comments at 4. The APWU then argues that the Postal Service has not justified its pricing because it has only provided an illustration of just how high prices would have to rise to eliminate all the excess discount. APWU ignores the reasoning provided in the Kiefer statement that these pricing categories were given the maximum amount of increase consistent with avoiding rate shock:

> As shown in Table 3, presorted letters and cards are being given a average 5.9 percent increase. This increase is well above the current increase in the CPI. Given the importance to the Postal Service of this category in terms of revenue and contribution, and its fragility, especially its vulnerability to electronic diversion as discussed above, the Postal Service believes that any larger increase would be too large at this time, as it would raise unacceptable risks of damage to the automation letters mail category.

Kiefer Statement at 24.

This reasoning is well supported by lengthy discussions in earlier parts of the Statement demonstrating the importance of First-Class Mail and its vulnerability to diversion from the hardcopy mail stream. See, e.g., id. at 17-20. The Postal Service has amply and adequately justified its determination that exceeding the prices it proposed would raise unacceptable risks of rate shock. The illustration on pages 24-25 of the Kiefer Statement, while showing the severe consequences of pushing the discounts all the way to avoided costs, is not the basis for the Postal Service's justification under 3622(e)(2)(B).

The APWU continues its attack by asserting that because one of the presorted First-Class Mail workshare passthroughs increased, *ipso facto*, the discount could not be justified under 3622(e)(2)(B). Nothing in the statute or the Commission's rules requires the phasing out of the discounts above avoided costs "over time" to follow an absolutely monotonic path. The language of the statute allows for judgment to be exercised as to whether there are special circumstances that allow for some curves in the road to the final destination.

There is no ratchet requirement built into the law for good reason. Both the statute and the Commission's rules allow for the inescapable reality that the facts that the Commission must take into account when it does an annual compliance determination are never quite exactly the same as when the Postal Service files its next price adjustment, no matter how closely the latter follows the former. A mechanical interpretation of section 3622(e)(2)(B) as stipulating an inviolable ratchet mechanism could easily undo the protections for mailers that Congress built into the rate shock exception. Facts do change between ACD and price adjustment filings, and sometimes even maintaining the same passthrough may require increases so large as to constitute rate shock. Those are the facts in this case. Raising the price for automation AADC letters beyond what the Postal Service has proposed, would in our view, constitute an unacceptable risk of rate shock. The Postal Service and the Commission must have the flexibility to evaluate and respond to changed circumstances. APWU's assertion would deny the Postal Service and the Commission the ability to use its judgment and force it to require that passthroughs always go down, no matter how high a price increase that would require mailers to absorb.

It is precisely this context of impacts on customers in a rapidly changing marketplace that makes it futile to "submit a firm timetable for the elimination of the excess amounts of workshare discounts" as suggested by APWU. APWU Comments at 5. As stated in the Responses of the United States Postal Service to Questions from the Bench at the Hearing for Dr. Kiefer, Tr. 3/382 (August 19, 2010), the Postal Service does not believe that such timetables are feasible or good policy.

As Dr. Kiefer points out, the passthroughs for a given presort level should not be evaluated in isolation. Kiefer Statement at 24-25. On the surface, the set of prices and passthroughs suggested by the National Association of Presort Mailers (NAPM) seems to move passthroughs closer to 100 percent of the cost avoided. NAPM Comments at 9. In reality the price difference between single-piece letters and 5-Digit Automation increases under their proposal. The current difference between single-piece and 5-Digit letters is 10.5 cents (44 cents minus 33.5 cents). The Postal Services proposal moves this difference to 10.4 cents (46 cents minus 35.6 cents) while the NAPM alternative pricing moves it in the opposite direction, to 10.6 cents (46 cents minus 35.4 cents).[33] Kiefer Statement at 20.

B. The Proposed Standard Mail Prices are Reasonable and Equitable.

The Postal Service designed the proposed Standard Mail pricing to be reasonable and equitable, especially in light of several important considerations unique to this exigent request. Pricing Standard Mail required balancing multiple elements, each calling for a different pricing response, including:

1. a severe loss in volume, particularly heavy among flats;
2. the extraordinary delicacy of certain customer segments and how that might affect their decisions to remain in the mail or not;
3. the fact that certain products are not covering their costs by wide margins; and
4. the need to integrate fulfillment parcels with the rest of the Postal Service's parcels business.

Kiefer Statement at 28-31, 60-61.

The Postal Service's pricing for Standard Mail strikes a reasonable and equitable balance of these considerations, as discussed below. Because these considerations do not affect all products the same way, of necessity the balance struck differed across products and categories. In general the pricing for Standard Mail achieves the following goals:

[33] In these comments, the Postal Service incorporates by reference its view, expressed during the still pending rulemaking Docket No. RM2009-3, that single-piece and bulk First-Class Mail are separate products and the workshare requirements should not apply. The Postal Service articulated the myriad reasons why this regulatory requirement is unnecessary given the statutory definition of worksharing.

1. It considers the potential effect of the price change on customers. Where customer segments are weak and have few other alternatives it mitigates the requested increases.
2. It moves products that do not now cover their costs closer to being fully compensatory.
3. It improves Standard Mail revenue and contribution without pushing prices past a point where mailers may decide to abandon hard copy mail altogether.

Id. at 6-7, 29-30, 61, 68; Masse Statement, Attachments 10-12; Tr. 3/386, 390.

For over 95 percent of Standard Mail (based on revenue – Masse Statement, Attachment 11) the price changes are close to the average price change requested in this docket. However, for two products, specific issues have been highlighted by intervenors or by the Commission during the hearings or in POIRs. The following discussion describes how the competing considerations listed above were applied to the two products presenting the greatest pricing challenges: Standard Mail Flats and Standard Mail NFMs/Parcels.

Due to the challenging economic environment of the last few years, Standard Mail volume has been affected significantly along with the advertising market as a whole. As Dr. Kiefer notes in his statement, the Standard Mail Flats product has been particularly hard hit, as fewer mailings, including reduced catalog volumes, have produced volume declines in excess of 20 percent. Kiefer

Statement at 28. For Standard Mail products currently covering their costs, the overall average proposed increase is 4.9 percent. Id. at 29.

However, Standard Mail Flats and Standard Mail NFMs/Parcels failed to cover their costs in FY 2009: Standard Mail Flats and Standard Mail NFMs/Parcels. Different pricing approaches have been taken for these products because of their different marketplace dynamics. A more cautious approach has been taken with the Standard Mail Flats product given the fragility of the catalog industry and more generally the advertising industry, as noted above. The Postal Service, moreover, wishes to avoid a substantial volume loss from catalogs that might result from a larger price increase, because "the catalog industry generates mail with a total cost coverage of approximately 132 percent." Response to Presiding Officer's information Request No. 3, Question 7 (Tr. 3/415). The Postal Service has taken a judicious step with a proposed 5.1 percent increase for Standard Mail Flats to move that product gradually towards covering all of its costs. In developing prices, the Postal Service evaluated the short term potential for additional revenue from Standard Mail Flats (resulting from a higher than average price increase) against the potential long-term effect on postal volumes and revenue. Economic theory suggests that, when prices increase, a volume decline will occur. However, for many catalogers, the decision not to mail today has subsequent effects on the mail volume. Once a customer is "lost," the cost associated with re-acquiring that customer (convincing them to purchase from a catalog or other solicitation) increases substantially. ACMA Comments at 15-16. As Dr Kiefer noted, it would be shortsighted to increase Standard Flats prices to fully cover costs in one step. Given the relatively large share of cataloger costs associated with postage, this could have the result of not only driving potentially profitable customers out of the mail stream but also driving them out of business. Tr. 3/423; Kiefer Statement at 32.

The market dynamics facing Standard Mail NFMs/Parcels differs from that facing Standard Mail Flats. While Standard Mail NFMs/Parcels have a low cost coverage (significantly lower than that of Standard Mail Flats – see Masse Statement at 10), other private sector alternatives exist for pieces that are typically sent using this product. Docket No. MC2010-36, Attachment B to Postal Service Request, at 9-10. Standard Mail parcel prices are and have been well below the parcel prices offered by the Postal Service's competitors. Competitive alternatives exist, and an active market of consolidators and private sector end-to-end delivery firms provide this service. The Postal Service has recently proposed transfer of Standard Mail fulfillment parcels to the competitive category (Docket No. MC2010-36) in recognition of the market conditions facing this product. The proposed price increase is designed to move this mail category toward 100 percent cost coverage as is appropriate for a competitive offering. The Postal Service has proposed that Standard Mail fulfillment parcels become "Lightweight Parcel Select," a category of the Parcel Select product. As described in Attachment B to the Request in Docket No. MC2010-36, a requirement for a competitive product (Parcel Select, in this case) is that revenues for the product as a whole (not its constituent components) cover costs. *Id.* at 2. Moreover, it makes good business sense to price the fulfillment parcels category above costs so that it supports Parcel Select meeting its statutory cost coverage requirement.

In this proceeding, the initial comments filed by some parties challenge the reasonable and equitable nature of the proposed Standard Mail pricing. For example, the American Bankers Association (ABA) falsely asserts that the Postal Service "acknowledges that rate increases are not equitable..." ABA Comments at 8. While the ABA cites to Dr. Kiefer's statement on page 39, nowhere does that statement hint that the Postal Service's proposed price increases are not equitable. In fact, page 69 of Dr. Kiefer's statement explicitly asserts that the increases are both reasonable and equitable.

Valpak raises the signaling effect of prices on page 11 (fn 10) and again on page 26 of its comments, when it suggests that pricing that encourages mailers to move Standard Mail Flats to other categories would improve contribution by the differences between the average (negative) contribution of Standard Mail Flats and the average contribution of the category into which these pieces would migrate. There is no factual basis on the record to support this analysis. The Postal Service does not know, for example, what the unit contribution of letter-shaped catalogs is, or even that it is positive. Pricing may affect the decision on how to configure a mail piece (as a letter or flat, for example); however these decisions are not without a cost to a mailer.

Valpak also attempts to raise the cost coverage argument as a "fairness" issue, suggesting that High Density and Saturation prices are higher because prices for Standard Mail Flats do not cover attributable costs. Valpak Comments at 23-25. But with the passage of the PAEA, the Postal Service no longer sets prices based on markup of subclass or product costs. Moreover, in the context of an exigent increase, there is no applicable requirement to balance all increases within a class to average out to a predetermined overall class average increase (as would be the case in a routine price cap adjustment), creating the push up/pull down effect that Valpak hypothesizes. There is no evidence that High Density and Saturation mail increases would have been any lower in this price request if the Postal Service had given Standard Mail Flats an increase sufficient for it to cover its costs all in one step. In fact, the example of the proposal for Package Services suggests the opposite conclusion. Both Parcel Post and Bound Printed Matter (BPM) Parcels were given above average increases large enough to cause them to cover their costs by 2011 (assuming the new prices were in effect for the full year). But above-average increases for those products within the class did not cause the other principle part of the class, BPM Flats, to receive any compensating lower increase in return. BPM Flats received a 5.0 percent increase, comparable to that of High Density and Saturation letters and flats.

In supporting its "fairness" argument, Valpak cites the FY 2009 Annual Compliance Report (ACR) to prove that the Postal Service has "conceded that [High Density and Saturation products'] coverages are <u>much higher than can be justified</u> and that coverage for all Standard Mail products <u>should be approximately the same</u>. See, e.g., 2009 ACR at 29-31." Valpak Comments at 41 (emphasis added). Valpak's statement thoroughly mischaracterizes the

Postal Service's 2009 ACR. Nowhere in the cited pages can one find even the slightest hint that the Postal Service "concedes" either of Valpak's two assertions. Indeed the ACR states the opposite regarding the High Density and Saturation products, that they are "reasonable and fairly priced for the value its customers receive." USPS FY2009 ACR page 29-30 (letters), 31 (flats and parcels).

On another note, despite its many complaints, Valpak does not seriously engage the following Postal Service rationales for giving Standard Mail Flats average increases.

- the users of this product are already struggling with postage prices, and could drop out of the mail if increases are too high;
- in the long run this product should be profitable, but that potential could be lost if the price is forced up too fast; and
- the catalog industry currently provides contribution to the Postal Service.

Kiefer Statement at 29-30, 32; Tr. 3/414-16, 421-22; Initial Comments of ACMA, Exhibit 1: Statements of Impact of Exigent Rate Increase on Catalogers.

The Parcel Shippers Association (PSA) focuses on the pricing for Standard Mail Parcels/NFMs. Its argument rests on three basic contentions: (1) that the parcels price increases are so high that they are unreasonable and inequitable; (2) that the size of the increase undermines predictability and stability of prices; and (3) that various cost analyses do not support these changes in price.

In response to the first contention, it should be noted that the Commission has been urging the Postal Service to make sure noncompensatory products cover their costs. See, e.g., FY2009 Annual Compliance Determination at 86-87; FY2008 Annual Compliance Determination at 61-62. Nevertheless, in pricing this product, the Postal Service balanced the need to move toward fully covering costs against the impact on customers, keeping in mind the fact that the Standard Mail parcels product exists in a competitive marketplace where parcel shippers have shipping options other than the Postal Service, and the marketplace itself acts as a mitigating factor to ensure that prices do not rise to unfair levels. In this way Standard Mail NFMs/Parcels differ from other major noncontributory categories like Periodicals and Standard Mail Flats. Furthermore, it is not inherently inequitable to give a money-losing product higher than average prices to help close the contribution gap, particularly when that product faces a competitive marketplace.

Regarding PSA's second contention, since 2006, the Postal Service has been increasing Standard Mail Parcels prices to harmonize them with its other parcels products and to address the cost coverage issues. E.g., Docket No. R2006-1, USPS-T-36 (Testimony of James M. Kiefer), at 17. In pursuit of that goal, the Postal Service has given this product large, above-average increases in recent years, forming a regular and predictable pattern that can come as no surprise to PSA. These include, most recently, an increase in Docket No. R2009-2 of more than 16 percent, when Standard Mail as a whole had an increase below 3.8 percent. It should be noted that this 16 percent increase was higher, relative to the class average increase, than the NFMs/Parcels increase requested in this docket is relative to the Standard Mail average. The Commission reviewed the 16 percent price increase in its ACD for FY 2009 (page 87), and made no suggestion at that time that such an above-average increase had been inappropriate under the circumstances, or otherwise violated any requirements of the law.

In its third contention, PSA tries to assert that various cost analyses do not support the proposed prices. PSA Comments at 13-18.[34] The cost studies and conclusions that PSA brings forth, however, no longer constitute the driving forces behind pricing that they may have been under the previous PRA pricing regime. Prices (except for worksharing discounts) are no longer driven solely or predominantly by costs. In this case the Postal Service is pricing Standard Mail parcels based on market factors, as well as consideration of the need to move Standard Mail NFMs/Parcels toward (and even beyond) full cost coverage. When developing the proposed NFMs/Parcels prices, the Postal Service utilized the pricing flexibility provided by the PAEA to balance both cost and market factors in its parcels pricing decisions. Consequently, even if the cost projections for the product were overstated to the degree which PSA alleges, suggesting materially less of a gap between costs and revenues than the Postal Service has forecasted, the proposed price adjustments would still need to be the same, in order to appropriately align the prices for this product with other market prices.

[34] Since the page numbering for PSA's filed comments restarts at 1 after page 12, this citation refers to the first six pages after page 12 in the filed comments.

In fact, however, the Standard Mail NFMs/Parcels costs are not overstated to the degree that PSA (based on calculations presented in Appendix A to the PSA Comments) alleges on pages 13-14 of its comments. PSA claims that the cost adjustments it is advocating are based on the same rationale as "Final Adjustments" previously made in the roll-forward model during omnibus rate cases. Id. at 13-14. "Final Adjustments" were necessary in rate cases to align cost estimates with revenue estimates, when the revenue estimates reflected adjustments in mail mix, and the cost estimates did not. For example, for purposes of determining whether revenues cover costs or not, it is best to keep the foundations of the cost estimates and the revenue estimates aligned. PSA appears to be correct in its assertion that, within the forecasts presented in the Masse attachments, there may be mail mix changes affecting the NFMs/Parcels revenues, but not fully reflected in the same product's costs. Based on the spreadsheet attached to its comments as PSA Appendix A, PSA argues that the estimated costs for the product should be reduced approximately $125 million (or "about 15 percent").

Even assuming that the basic methodology incorporated into PSA Appendix A were correct, however, PSA has used the wrong set of billing determinants to calculate its suggested $125 million adjustment.[35] Specifically,

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[35] The Postal Service is not prepared to make the assumption that the Appendix A methodology is correct. As a product, data for Standard Mail parcels and NFMs are combined together in the CRA (and therefore, in the PCCEM/rollforward used to generate the Masse attachments). In preparing its Appendix A, PSA dutifully looked at the mail mix *within* machinable parcels, separately from the mail mix *within* irregular parcels, separately from the mail mix *within* NFMs. They then readjusted the mail mixes *within* each of those three categories and tied back to the total volumes *within* each of those three categories. However, the share of NFMs to the combined total (of machinable parcels plus irregular parcels plus NFMs) dropped from 19.77 percent in FY 2009 to 14.86 percent in the two quarters of FY 2010. To the extent that NFMs, on

the cost estimates in the Masse attachments are implicitly based on an FY09 (Q1:Q4) mail mix, while the revenue estimates are based on a hybrid year (FY09Q2:FY10Q1), reflecting the most recent data available when the volume and revenue forecasts for this case were prepared. PSA, however, has jumped way beyond the hybrid year used for revenue forecasts, and attempts to base its cost adjustment solely on Quarters 1 and 2 of FY10. Rather than correctly aligning the foundation of the cost and revenue estimates, PSA would push them even farther off plumb.

Attached to these reply comments electronically (Corrected.PSA.APP. A.xls) is a revised version of PSA's Appendix A. When the appropriate mail mix is inserted in the PSA spreadsheet (by replacing Column [2] "FY 2010 (Q1 & Q2)" with a new Column [2] "2009Q2-2010Q1"), the adjustment amount, using PSA's methodology, drops from $124 million to $38 million (cell V39). Hard copy of the relevant portion of the corrected PSA spreadsheet is included as Attachment C to this pleading. Instead of the "about 15 percent" adjustment claimed on page 14 of the PSA Comments, correcting the inputs into PSA's own spreadsheet drops that to less than 5 percent. Even making such an adjustment, there would still be a substantial gap between product cost and revenue.

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average, are cheaper than parcels (see, e.g., USPS-FY09-27 (Dec. 29, 2009)), Tab "Disaggregated Parcel Costs," Column B), this means that, if one were going to attempt to make all necessary mail mix adjustments, the mail mix for the total Parcels and NFMs line in the CRA and PCCEM would have shifted toward more expensive parcels and away from NFMs, worksharing notwithstanding. In the short time available to prepare reply comments, the Postal Service has not attempted to perfect PSA's methodology, as the input revisions discussed below are sufficient to demonstrate that the magnitude of the adjustment proffered by PSA has been grossly overstated.

The Direct Marketing Association (DMA) asserts that the Postal Service's justification for the larger than average increase for Standard Mail parcels "represents neither an extraordinary nor exceptional circumstance." See Additional Comments of the DMA at 2. This statement puts the cart before the horse. The extraordinary and exceptional circumstances justify and necessitate the filing of an exigent request. Going above the 4 percent to 6 percent price increase range received by most products does not have to be justified by the extraordinary and exceptional circumstances, although increasing product prices so that the product no longer incurs losses (provided customers can handle the increases) is indeed an appropriate response to extraordinary and exceptional circumstances, as the Postal Service discusses above in Part II.C.

DMA also states that these proposed price increases should be deferred to the product transfer case and not "hidden" in the exigent case. See Initial Comments of DMA at 2-3. This suggestion is wrong for several reasons. First, there is no assurance that the Commission will approve the requested transfer. This price increase allows parcels to make strides toward covering their costs even if they remain in the market dominant category. Moreover, the Standard Mail parcels product is a competitive product that is priced below the market. See Kiefer Statement at 30-31. It is appropriate to adjust the price of this product to market levels, even if it were already covering its costs. Finally, the proposed price increase is far from hidden – it is fully visible in Table 4 of Dr. Kiefer's pricing statement. See Kiefer Statement at 28.

C. The Periodicals Increases Appropriately Reflect the Fact that Higher Prices are Necessary for the Class to Cover its Costs in the Future

The proposed pricing for Periodicals is balanced, reasonable, and equitable. Because Periodicals has been losing money as a class for years, with a 76 percent cost coverage presented in the Commission's 2009 Annual Compliance Determination, Periodicals is receiving an above-average price increase, averaging 8 percent for the class as a whole. This proposed increase recognizes not only that the cost coverage problem must be addressed, but also that the PAEA's application of the price cap at the class level has made it challenging to achieve full cost coverage. This exigent price change request thus presents a unique opportunity to address the Periodicals cost coverage problem.

This aforementioned consideration is balanced with another important consideration: namely, that the Periodicals industry has faced significant challenges due to the economic impact on advertising, falling subscription levels, and the increasing emergence of electronic publishing. Id. at 39. See also Affordable Mail Alliance Mailer Impact Statements (August 18, 2010). Therefore, the Postal Service has proposed an 8 percent increase (moderate relative to the approximately 25 percent price increase needed to achieve 100 percent cost coverage – Kiefer Statement at 41) to achieve a gradual improvement in cost coverage, thereby mitigating the impact on customers in the Periodicals industry. Not only was the overall increase moderated, but also the increases generally were kept within a narrow band across the various rate cells, so as to keep virtually all publications to an increase of less than 10 percent.

This approach has received the support of the Commission's Public Representative. In his comments at page 49, the Public Representative states:

> 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 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. 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."* (emphasis added)

The Users of Flat-Shaped Mail, on the other hand, argue that the proposed increases for Periodicals (and Standard Mail) flats are unjustified. The Users of Flat-Shaped Mail compare cost data for 2009 with cost data from the late 1990s, and claim the increase in unit costs results from the Postal Service failure to address the problem of "excess capacity" for at least a decade. Comments of Users of Flat-Shaped Mail at 6-18. This assertion is false and is based on a misinterpretation of cost information. An important point the Users of Flat-Shaped Mail fail to recognize is that the gap between "postal inflation" and the CPI makes meeting the CPI a major challenge. <u>See, e.g.</u>, Response of the United States Postal Service to Questions from the Bench at the Hearing for Dr. Kiefer (August 19, 2010) (Tr. 3/416); Response at 48-49. The Users of Flat-Shaped Mail's contention ignores all of the Postal Service's cost-cutting and staff reduction efforts performed over the last decade. By including FY2007 to FY2009 in their cost comparison, the Users of Flat-Shaped Mail have selected a period that was unduly influenced by the recent volume drops. The Postal Service has openly admitted that the suddenness and magnitude of the volume drops experienced in the last 2-3 years left it unable to adjust workhours as fast as the volume declined. This was indicated in witness Masse's response to a question on the subject: "This led to excess capacity in delivery costs and in plant and equipment costs, as indicated in the Summer Sale 2009 filing. Going forward, as excess capacity is eliminated, there should be some offsetting reductions." Tr. 2/229. Rather than being chronic, this problem of excess capacity is temporary and is disappearing as the Postal Service right-sizes its workhours. See Responses to POIR No. 5, Questions 8-10 (August 25 2010), Questions from the Bench at Tr. 2/229 to Masse (filed Aug. 18, 2010), and Questions from the Bench at Tr. 3/416-17 to Kiefer (filed Aug. 19, 2010).

The Users of Flat-Shaped Mail argue that rates already cover costs by using the Docket No. RM2009-3 short-run attributable costs for FY 2009, developed for the Summer Sale period (July, 2009 to September, 2009) and applying this to all of FY 2009. The extent of any excess capacity in 2009 is really beside the point. The Postal Service is not seeking to raise its prices retroactively for 2009. Rather, it proposes price increases to start in January 2011. The Postal Service, moreover, is eliminating excess capacity. Responses of the United States Postal Service to Questions from the Bench at the Hearing for Mr. Masse (August 18, 2010) (Tr. 2/229 question). See also Docket No. R2010-3, United States Postal Service Notice of Market-Dominant Price Adjustment, at 6-7 and Appendix A (Feb. 26, 2010) (indicating that delivery is not anticipated to have excess capacity in FY 2010). The cost projections in Mr. Masse's statement reflect the ongoing reductions in excess capacity.[36] The Users of Flat-Shaped Mail focus on 2009 costs, while ignoring the adjustments to Postal Service capacity being made between 2009 and 2011. Their objections, based as they are on history and not on the implementation year, are therefore fundamentally irrelevant.

Regarding the structure of the proposed Periodicals pricing, Halstein Stralberg, on behalf of Time Warner, Inc., states that "Any increase in Periodicals rates should be structured differently, to encourage the most efficient preparation." Comments of Halstein Stralberg at 12. He specifically says that "In raising the carrier route rate more than the average, the Postal Service sends the wrong signal and appears to have ignored the limits on the FSS Program," and also states that the proposed structure "seem(s) designed to punish the most efficient mailers." Id. What is overlooked in this assertion is that the proposed price differential between 5-digit automation and Basic Carrier Route pieces actually remains unchanged at 9.8 cents (27.6 cents minus 17.8 cents (current); 29.2 cents minus 19.4 cents (proposed)). Kiefer Statement at 40. In no way should a price differential that is held constant be construed as a way to "punish" anyone. Rather, the design is to help ensure efficient mail preparation in the

[36] Masse Statement, Attachment 12 shows FY2011 unit attributable costs for Periodicals and Standard Mail flats of 32.5 cents and 42.6 cents respectively. The FY 2009 CRA attributable unit costs for Periodicals and Standard Mail flats were 33.7 cents and 44.8 cents respectively. The declines in the unit costs for Periodicals and Standard Mail flats are forecasted to be 3.4 percent and 4.8 percent respectively, while at the same time the CPI is projected to rise nearly 3 percent over this two year period.

advent of the Flats Sequencing System (FSS) environment.[37] As Dr. Kiefer pointed out, "[w]hile a carrier route sortation will continue to have value in non-FSS zones, expanding this discount would tend to encourage customers to undertake work that may not be necessary in an FSS-environment." Id.

Furthermore, the fact that origin-entered pallets would receive a 21 percent price increase under the proposed pricing further refutes the suggestions that the Postal Service is not encouraging the most efficient mail preparation and that it is any way "punishing" the most efficient mailers. This above average increase encourages mailers to enter mail closer to its destination so that it avoids postal transportation costs. Id.

V. The Classification Changes Included in the Exigent Request Are Appropriate

The Association for Postal Commerce (PostCom) argues that none of the proposed changes in Mail Classification Schedule (MCS) is appropriately included as part of the exigent filing.[38] They instead believe that all of the changes should be included in requests under 39 U.S.C. § 3642, using the rules in 39 C.F.R. § 3020.30. PostCom Comments at 6-8.

The Postal Service disagrees. By its title, section 3642 is limited to "new products and transfers of products between the market-dominant and competitive

[37] The Postal Service recently issued optional mail preparation rules that allow 5-digit scheme sortation to qualify for Carrier Route prices, as long as Carrier Route density is maintained. 75 Fed. Reg 51668 (August 23, 2010).

[38] Similarly, in an August 10, 2010, letter to Chairman Goldway, Postmaster General Potter, and Postal Service Chairman of the Board Giuliano, IDEAlliance asked that the classification changes be delayed until May, 2011 to provide enough time to complete the associated software changes. The Postal Service has responded to these concerns in an August 27, 2010, letter from Postmaster General Potter, which is provided as Attachment D to this pleading.

categories of mail." Section 3642(a) describes the purposes of section 3642 as follows: "change the list of market–dominant products under section 3621 and competitive products under section 3631 by adding new products to the lists, removing products from the lists, or transferring products between the lists." Similarly, the § 3020.30 rules are limited to modifications of the market dominant or competitive product lists, where "modification" is defined as "adding a product to a list, removing a product from a list, or moving a product from one list to the other list." 39 C.F.R. § 3020.30. None of the MCS changes included in the Postal Service's exigent request qualifies as a new product, product removal, or product transfer.

Significantly, the Postal Service was preparing a product transfer filing at the same time as the exigent request. Kiefer Statement at 31. But, recognizing that an actual product transfer needs to be filed separately from an exigent request, the Postal Service filed that product transfer separately as Docket No. MC2010-36.

PostCom argues that these classification changes should have been filed separately from the exigent request, so that they can be subject to a "more thorough review process." PostCom Comments at 11. It is true that section 3642 product transfers receive an undefined period of review. But all of the proposed MCS changes could have been filed as classification changes under PRC Rule 3020.90, receiving 15 days of review, or prices changes under Commission Rule 3020.30, receiving 45 days of review. If filed separately, all of the changes which

PostCom challenges therefore would have received much less time for review than they did as part of this exigent filing.

The proposed MCS changes are price changes (or are closely related to price changes) that make sense to include in the exigent case, and are appropriate for the exigent case review. Similar MCS changes also have been included in the annual price changes for market dominant products subject to the CPI limitation. In Docket No. R2009-2, for example, the Commission reviewed and addressed Postal Service proposals for a Full Service IMb option, a Saturation Mail Volume Incentive Program, a new Move Update charge, changes to the Confirm pricing structure, and new premium options for personalized stamped envelopes. These changes are very similar to the MCS changes in the exigent case. Like the exigent case, the Commission was primarily focused on price changes, but it was able to address the classification changes within a period half the length of the 90-day period for the exigent case.

The exigent filing, on the other hand, receives 90 days of review, and provides hearings which included questions submitted by the parties. Thus, contrary to PostCom's claim that consideration of these changes as part of the exigent filing would violate due process (PostCom Comments at 10-12), the inclusion of these changes in the exigent filing actually provided more due process than separate filings under the provisions of section 3622. In addition, it allows both the Postal Service and the Commission to evaluate a suite of price changes and associated classification changes as a comprehensive whole. This promotes administrative efficiency while providing due process.

The Public Representative accepts that most of the MCS changes are appropriate for the exigent filing, but argues, without citing a statutory or regulatory basis, that substantial MCS changes are not appropriate within an Exigent filing, unless they are essential to it. In particular, the Public Representative believes that the Reply Rides Free Program and the Saturation and High Density Incentive Program should not be part of the exigent filing. PR Comments at 62-63. The Postal Service disagrees that the exigent filing is limited to insubstantial MCS changes. Moreover, both the Reply Rides Free Program and the Saturation and High Density Incentive Program are price changes that not only fit within the exigent request, but also are essential to it, because they are needed to retain the mail volumes that provide Postal Service revenues.

VI. The National Postal Policy Counsel Provides No Sound Basis to Question the Proposed Prices for Bulk First-Class Mail Because of Forecasting Concerns

The National Postal Policy Council (NPPC) uses its comments to oppose the exigent price adjustments, and to criticize the Postal Service's forecasting methodology for Bulk First-Class Mail as it relates to the electronic diversion of mail. NPPC also attaches to its comments a summary of the results of a survey it conducted which ostensibly demonstrate that the Postal Service has understated the mailers' volume response to the proposed increase in prices for Bulk First-Class Mail. The survey results do not provide reliable support for NPPC's assertions, and the other criticisms of the forecasting methodology are likewise not valid.

One criticism of the volume forecasting presentation is basically cosmetic, and is to a large extent blunted by materials referred to within the NPPC Comments themselves. NPPC expresses concern that the full range of the lagged effects of increases implemented in January 2011 will not play out until some time after the end of FY 2011, the period which the Postal Service has selected to present the financial results on which its Request is based. NPPC Comments at 14-18. Yet the NPPC Comments also present the results of the Postal Service's forecast which hypothetically assumes an October 1, 2010 implementation. Those October-implementation results were presented specifically to illustrate the scale of the effects over a full fiscal year, given the partial-year nature of the post-increase period in FY 2011 with the actual January implementation date. So, for example, the table on page 17 of the NPPC comments shows the full-year effect (525 million pieces) versus the partial-year effect (307 million pieces). Granted, there remains a further quarter of lagged effects but, as NPPC (to its credit) admits, the Postal Service is not hiding the ball on the further lagged effects, and they could be calculated using the lagged elasticities presented with the forecasting material. Moreover, all of the lag effects are encapsulated in the long-run elasticity, which is the one the Postal Service and everyone else generally use to describe the effects of the price increases on mail volume and, most importantly, to compare those effects across products. Other than to point out that the further lagged effects are out there, NPPC never explains exactly why that has any significance to evaluation of the Postal Service's exigent proposal.

The lagged effects, however, do have some potential bearing on the survey results submitted by NPPC. See NPPC Comments at 22-24. The survey involved asking very large and sophisticated mailers how they would respond to a very specific proposed price increase on a date certain. While the Postal Service is interested in customers' outlooks, it must consider the nature of the study before giving it much credence. Since the purpose was to suggest that the Postal Service's projections understated the volume loss due to a price change, it behooves the respondents to claim a larger loss. Also, assuming that the respondents are not exaggerating, such a study still suffers from the possibility that those with a different story to tell are more likely to respond. But even if, contrary to what the Postal Service views as a sound methodology for predicting volume, the survey results are taken at face value, they do not support the claims that NPPC makes.[39]

Initially, as noted above, the Postal Service included a full four-quarter post-implementation forecast (as presented on page 17 of the NPPC comments), and it shows a volume reduction of 525 million pieces. It is this figure, not the three-quarters 307 million figure on the same table, which provides a basis for

[39] On September 1, 2010, NPPC filed responses to POIR No. 7, providing more information on the survey procedure. In those responses, NPPC candidly acknowledges that there were no formal scripts, and that the survey began as an informal attempt to quantify volume impacts. There is no indication, for example, whether the companies that were contacted were selected on the basis of relative size, or what other criteria might have been employed, particularly as it became clear that there was not enough time to attempt to contact all NPPC members. None of these features reflect favorably on the reliability of the survey results as a basis to question much more broad-based volume forecasts. One particularly critical omission from the discussion topics identified was any attempt to gather information from respondents regarding what volume response they would have expected if faced with a smaller proposed increase, or a larger proposed increase. Nor were respondents apparently asked what alternative procedures they intended to substitute for mail, why they were not already using those alternatives for the mailpieces they expected to convert, or what portion of their mail volume would remain as mail after they completed the conversions they were anticipating as a result of the price increase.

comparison to the four-quarter NPPC survey responses. NPPC cites from its survey a claimed four-quarter loss of 344 million pieces from its members. NPPC Comments at 22. Thus, of the 525 million pieces that the Postal Service forecasts to lose on a four-quarter basis, NPPC members are allegedly estimated to account for 344 million, or approximately 66 percent. On page 10 of its Comments, NPPC notes that its members "account for a very substantial portion" of Bulk First-Class Mail volume. Even taking the survey results at face value, an exercise which the Postal Service does not recommend, there seems to be no necessary inconsistency between those results and the Postal Service's forecasts, if mailers who account for "a very substantial portion" of existing volume turn out to account for a very substantial portion (two-thirds) of the volume losses from the price increase. So, even though there is reason to have some skepticism about the survey results based on the admittedly informal nature of the procedures employed, those results are not that out of line with the Postal Service's own projections.[40]

There is another way in which the NPPC survey results do not appear to support the story that NPPC is trying to tell. Throughout its comments (e.g., pages 9, 12, 13, 18, 19, 24), NPPC repeatedly refers to mailers abandoning hard copy mail altogether in favor of electronic alternatives, and NPPC even goes so far as to claim that its survey shows that "the 'tipping point' is here and now."

[40] As described in the NPPC response to POIR No. 1 (September 1, 2010), there are no assurances that this survey was undertaken with sufficient analytical rigor to avoid any number of biases. While NPPC may have intended an unbiased survey methodology, it is difficult to ensure that the apparently anecdotal nature of the data generated does not reflect the preconceptions about this price change that are illustrated on the NPPC website. http://www.postalcouncil.org/ (note the reference to "[t]oday, July 6, 2010").

NPPC Comments at 24. Yet 2011 Bulk First-Class Mail volume is forecast to be nearly 42 billion pieces. The 344 million piece decline claimed from the survey constitutes less than one percent of that amount, from mailers who are identified as providing a “very substantial portion” of existing volume. The materials presented with the survey did not identify any of the respondents as claiming that the requested increase would cause them to abandon hard-copy mail entirely. Indeed, given that relatively small fraction of the product total volume that the survey projects to be converted, it seems highly unlikely that any of these major mailers could claim to be hitting any “tipping point” price that would, by itself, result in total (or even substantial) conversion to electronic communication with customers to whom they currently mail.

The NPPC mailers are currently paying rates in the 35-cent to 40-cent range. Necessarily, for each piece they mail, they must value the mail service they purchase more than any alternative available at the postage price they are paying, or they would already be using the alternative. More importantly, to the extent that there are available alternatives which NPPC members would value more than mail service, the difference in value must be less than the difference in price, or, once again, they would already have switched to the alternative. Of course, as postal prices go up, some mailers would find the new price difference between mail and the available alternative sufficient to switch some or all of their mail to the alternative. Since the “traditional elasticity” evaluates only the change in *total* mail volume, it takes account of volume changes both from mailers who switch some of their volume, and from mailers who switch all of their volume. Both types of responses are encapsulated in the estimated elasticity.

What the "traditional elasticity" also assumes, however, is that the distribution of mailers who will hit a switching point in value between mail and alternatives is roughly the same with each percentage increase in postage.[41] Although individual mailers may show a much smaller or much larger response (up to and including abandoning mail altogether), the estimated elasticity is intended to reflect the response on average to any given change in price. Specifically with respect to the estimated elasticity, however, the Postal Service agrees with NPPC, among others, who note the materially higher elasticity estimate for Bulk First-Class Mail relative to Single Piece First-Class Mail, which, in conjunction with its higher unit contribution, suggests a comparatively greater detrimental impact on net efficiency from any relatively higher potential price increases for bulk mail.

In contrast, the "tipping point" theory is that, at some point as postage prices rise, a significant line will be crossed because there is some alternative available for which the value difference between mail and the alternative has now been exceeded for a large number of mailers (or for mailers presenting a large portion of volume, perhaps such as NPPC members). In other words, there must be a larger concentration of mailers for whom the value difference between the two products is found at or immediately above the "tipping point" than is found in

---

[41] That is, this assumption is implicit if the "traditional elasticity" measurement is predicated on a "constant elasticity" model, as those of the Postal Service are.

the portion of the demand curve over which the "traditional" elasticity has been estimated.[42]

Recall that, in the Postal Service's Request In this proceeding, the Automation rate increases of most apparent concern to NPPC are in the range of 2.1 to 2.3 cents. So, assuming rational decision-making regarding conversion, for the assertion that the tipping point "is here and now" to be true, there must be some (presumably electronic) widely available alternative for which the value difference is in the neighborhood of something around 2 cents or less. Although theoretically possible, there seems to be no practical basis to believe this to be the case. Yet although there is no empirical evidence proving the existence of a tipping point, much less the price at which it would be reached, the Postal Service does not believe it prudent, in the words of the old adage, to assume that the absence of evidence is conclusive evidence of absence. Evaluating the magnitude of the increase in this light, Dr. Kiefer invoked the term "tipping point" when discussing various percentage increases: "On the other hand, when we start going much higher, if we say that well, why didn't you raise the prices, you know, 10, 15, 20 percent; well, then we are concerned that perhaps some of this, I called it tipping point effect might occur." Tr. 3/470.

But when claiming (page 13) that "the Postal Service never presents any analysis of how the rates that it is now proposing would prevent an accelerated loss of high-margin First-Class Bulk letters to electronic alternatives," NPPC is

[42] To give a concrete historical example of a "tipping point" in the postal context, the rate for First-Class Post Cards dropped below the rates for certain portions of what is now Standard Mail in Docket No. R87-1, with the result that Post Card volume grew nearly 27 percent from FY87 to FY89.

asking the Postal Service to prove a negative --- that is, instead of relying on its own forecasting techniques that show a volume loss due to price increases, the Postal Service should endeavor to prove that a myriad of alternative outcomes (such as an even greater volume loss) will *not* happen. NPPC, though, does not present a more affirmative credible analysis to suggest that those rates would cause an accelerated loss to electronic alternatives. The NPPC survey is presented to show that respondents will reduce their volumes, purportedly in excess of the amount suggested by the Postal Service's estimated elasticity. However, in fact, NPPC's survey, when contrasted with the Postal Service's elasticity-based forecast, illustrates essentially that the magnitude of the volume decrease is consistent with those projected by the forecasting models, NPPC, therefore, fails to provide a valid basis to support the claim that the Postal Service's forecasting methodology is deficient because it relies on the historically observed relationship between price changes and volume declines, applied to a well-established forecasting methodology, in the context of proposed price increases in the range of 2.1 to 2.3 cents.

In a more technical vein, NPPC claims that the forecasting methodology is not correctly specified to capture recent changes in electronic diversion. NPPC Comments at 18-22. The gist of NPPC's concern is that the diversion trend used in the forecast imposes a constant quarterly increase in the growth rate of diversion of 0.8 percent (which is an annual growth rate of 3.2 percent). Id. at 20. Specifically, NPPC feels that the 0.8 percent figure, which it more-or-less correctly describes as based on the level of diversion over the previous six years, should be higher going forward to reflect the macro-economic effects of the recession, which created pressure for more diversion. Id. at 19-22. NPPC claims that “the Postal Service’s historical-based volume forecast for First-Class Bulk letters cannot accurately project volume declines going forward in the new, post-recession business environment.” Id. at 22.

There is a logical flaw in NPPC’s argument, however. If heightened economic pressure during the recession created conditions which led to higher rates of diversion, then in a “post-recession business environment,” that pressure would have eased, and one would thus rationally expect a return to more typical rates of diversion. That expectation is, in fact, incorporated into the Postal Service’s forecast.[43] Moreover, even assuming *arguendo* that the Postal Service had to some extent failed to “capture recent changes in electronic diversion”, that (contra factual) failure would occur in both the “before” and “after” rate scenarios, but would not affect the forecast of volume lost because of the price increase.

In summary, neither the survey results presented by NPPC, nor its criticisms of the forecasting model, provide a legitimate basis to challenge either the volume forecasts or the proposed price increases for bulk First-Class Mail. Certainly the recently experienced volatility in the national economy and in mail volumes makes forecasting, which is always an inherently challenging exercise,

[43] NPPC identifies the recession years as FY2008 and FY2009. Id. at 22. In the pre-recession year of FY 2007, when the Employment index (which is the macro-economic variable in the bulk First-Class Mail equation) showed growth of 1.3 percent, the growth rate in diversion was 3.2 percent. In the Global Insight forecasts used in the preparation of this case, the Employment index was projected to show an (expected post-recession) growth of 1.4 percent. The Postal Service’s forecast for the FY 2011 growth in Internet diversion is 3.3 percent. In other words, if there are expectations of comparable macro-economic activity in FY 2007 and FY 2011, then expectations of comparable rates of Internet diversion are reasonable. NPPC is confusing a temporary intensification of diversion *during* the recession with a permanent shift in the level of diversion going forward, which is a conceptually distinct phenomenon.

even more daunting. Many observers are justifiably skittish about potential reactions to substantial price increases, and the Postal Service has deliberately sought moderate rate increases. NPPC, on the other hand, has failed to support any tangible claims that the Postal Service's forecasting model is not adequate for the purpose presented within the range of proposed increases.

CONCLUSION

For the reasons stated herein and in its Response to the AMA Motion to Dismiss (incorporated by reference herein), the Postal Service respectfully requests that the Commission approve the implementation of the prices proposed by the Postal Service in its Request.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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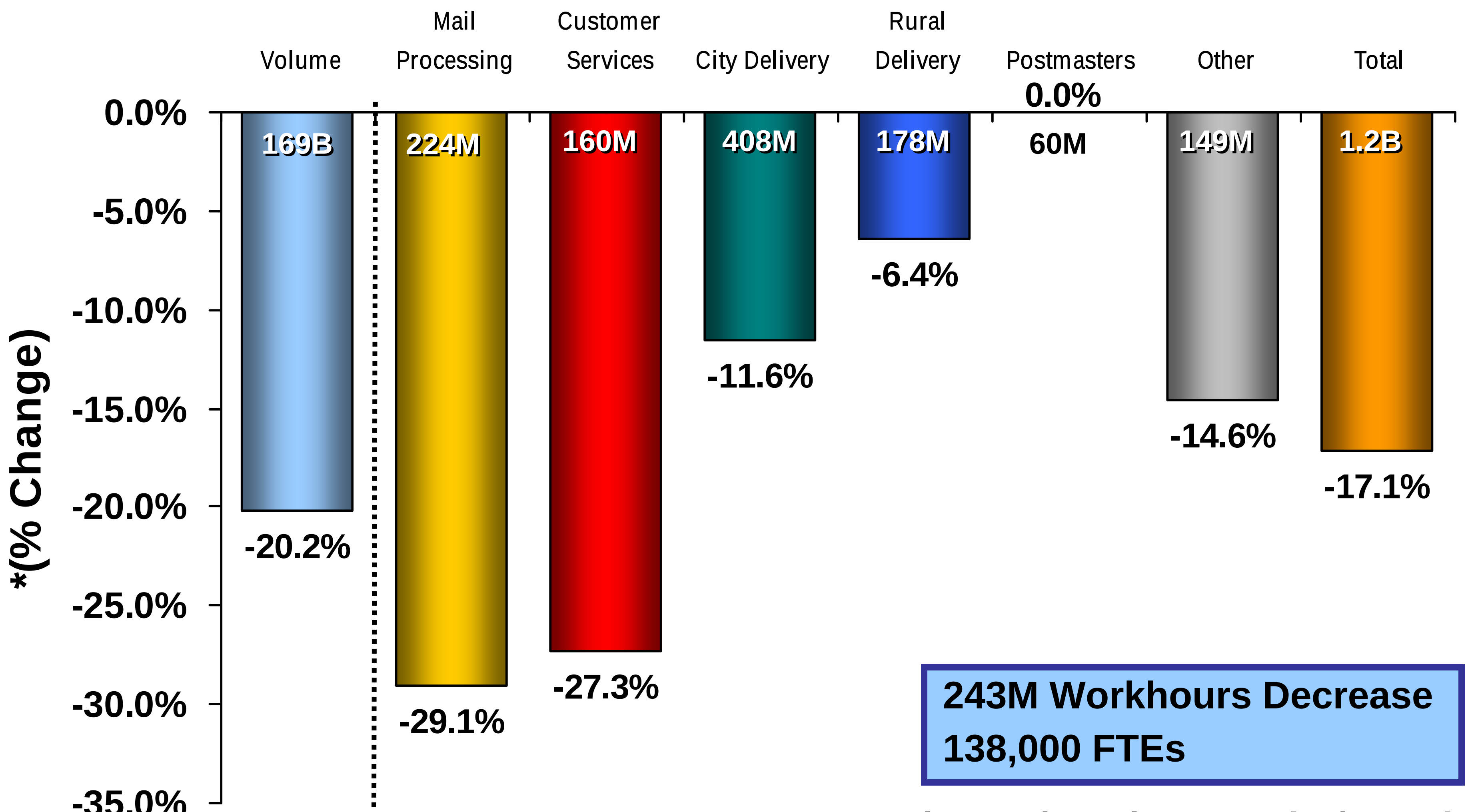
Workhour and Volume Changes 2008 – 2010

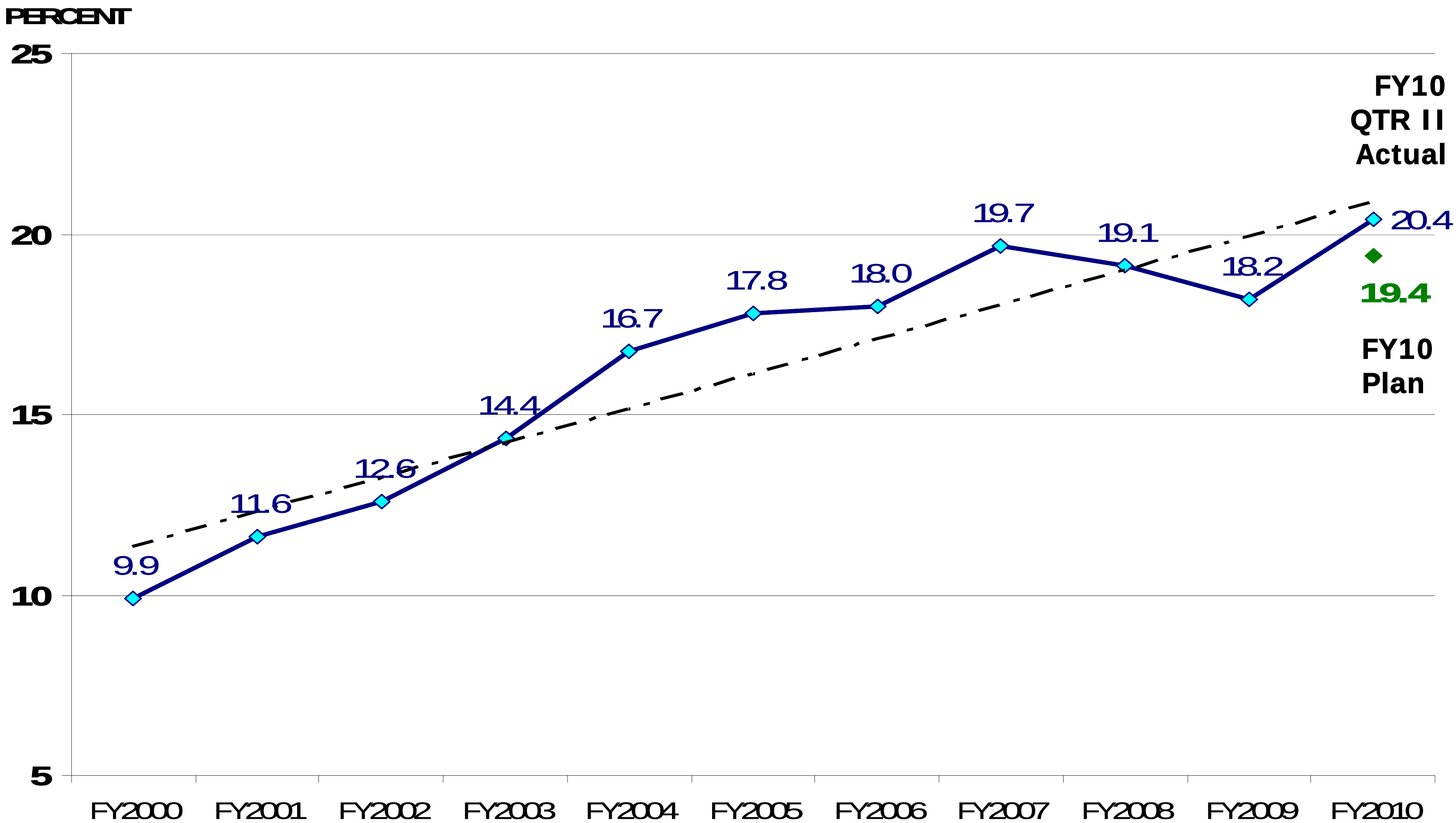


2010 estimates based on actuals thru July

*** Base Year – FY 2007**

ATTACHMENT A

Total Factor Productivity



Source: Christensen FY 2009 & 2010 TFP Report

Corrected PSA Appendix A

	FY 2009	Hybrid Year 2009Q2 - 2010Q1	2009Q2 - 2010Q1 Percentages	FY 2009 (Hybrid Mail Mix)	Cumulative Cost Avoidance
	[1]	[2]	[3]	[4]	[5]
Presorting					
Parcels (Pieces)					
Machinable					
Mixed NDC	11,745,825	13,051,622	4.9%	13,127,991	
NDC	145,767,361	122,800,671	46.1%	123,519,219	$0.218
5-digit	110,336,323	130,439,055	49.0%	131,202,298	$0.631
TOTAL	*267,849,509*	*266,291,348*	*100.0%*	*267,849,509*	
Irregular					
Mixed NDC	15,344,358	15,517,872	5.4%	14,970,325	
NDC	14,136,175	11,849,394	4.1%	11,431,289	$0.984
SCF	136,549,331	134,244,926	46.9%	129,508,105	$1.968
5-digit	109,861,579	124,370,112	43.5%	119,981,723	$2.150
TOTAL	*275,891,443*	*285,982,304*	*100.0%*	*275,891,443*	
NFMs (Pieces)					
Presorted					
Mixed NDC	14,590,607	14,885,317	12.7%	17,004,140	
NDC	39,344,569	31,603,462	26.9%	36,101,998	$0.984
SCF	32,637,233	26,130,485	22.3%	29,849,981	$1.968
5-digit	47,434,868	44,689,862	38.1%	51,051,158	$2.150
TOTAL	*134,007,277*	*117,309,126*	*100.0%*	*134,007,277*	
Destination Entry (Pounds)					
Origin	108,408,127	84,960,686	28.2%	86,077,808	
DNDC	64,673,174	61,029,181	20.2%	61,831,635	$0.770
DSCF	96,984,266	108,971,575	36.1%	110,404,408	$1.060
DDU	35,388,022	46,527,957	15.4%	47,139,739	$1.159
TOTAL	*305,453,589*	*301,489,399*	*100.0%*	*305,453,589*	

FY 2009 Total Cost Avoidance	**$1,018,787,459**
FY 2009 [Hybrid Year Mail Mix] Total Cost Avoidance	**$1,057,099,991**
Cost Reductions From Increased Worksharing	**$38,312,532**

BOARD OF GOVERNORS

UNITED STATES POSTAL SERVICE

August 27, 2010

Mr. David J. Steinhardt
President and Chief Executive Officer
IDEAlliance Mailing Software Development Group
1421 Prince Street, Suite 230
Alexandria, VA 22314-2805

Dear Mr. Steinhardt:

Thank you for your letter of August 10 expressing your concerns about the timing of the Postal Service's exigent price change request, which the Postal Regulatory Commission (PRC) has docketed as R2010-4. We welcome the opportunity to respond on such important issues with a valued partner.

In your letter you stated that the proceeding only allows 90 days for implementation, but necessary software changes to accommodate certain aspects of it will require significantly more time. For that reason you request that the PRC limit any approval in Docket No. R2010-4 to price adjustments that can be accommodated within 90 days. You further ask that the PRC require implementation of any classification changes to be delayed until May 2011, which you believe to be necessary to allow mailing software developers and technology users to adapt.

First, the Postal Service filed its exigent price request on July 6, including all Mail Classification Schedule changes established by the Governors of the Postal Service. This gave the public, including your organization and its members, 180 days' notice in advance of the planned January 2, 2011, implementation date. In fact, as early as July 7, the Postal Service held an initial meeting by telephone with IDEAlliance, during which the Postal Service provided technical specifications for the proposed classification changes. The current process is comparable to, if not more certain and predictable than, the Postal Service Governors' practice before the Postal Accountability and Enhancement Act of 2006, whereby they would generally allow 60 days to 90 days between adoption of a final Governors' Decision and its implementation. In this case even if the PRC determines that the classifications must be adjusted in some manner, the public will have fully three months in which to make any necessary changes, approximately the same as under the former regulatory framework. We emphasize, again, that the public will have had 180 days advance notice of the intended classification changes.

We believe that even if the PRC determines that some adjustments to the Postal Service's classification changes are necessary, this would not necessarily warrant a blanket deferral of implementation for all changes. The Postal Service and other stakeholders have already expended resources planning for a January 2, 2011, implementation date, in light of the half-year of advance notice. Any deferral would cause inconvenience and further expense for the Postal Service and those stakeholders that have begun their preparations. Therefore, in the event of a PRC ruling at variance with some aspects of the Postal Service's classification changes, the Postal Service's Governors would have to consider the particular circumstances of each change before making any decision regarding a change in implementation dates.

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For example, some classification changes are intrinsically associated with price changes and cannot easily be deferred without affecting the price structure's integrity. Others might be relatively minor adjustments that could easily be accommodated. Any assessment must await the outcome of the PRC proceeding and an evaluation of the particular circumstances.

Second, you ask for clarification about your assumption that the Postal Service is shifting implementation of its regular market-dominant product and pricing changes from May to January. We are unsure as to the source of this understanding, and we are unable to confirm any such intention at this time. However, please be advised that discretion to establish prices and classifications, including their timing, is reserved to the Governors of the Postal Service under 39 U.S.C. § 404(b). Although the PRC has jurisdiction to consider various aspects of those prices and classifications, we are unaware of any authority under current law for the PRC to determine when they are to occur. Your views and interests are important to the Postal Service, but the full range of business and policy issues would have to be weighed, including the potential effect on all stakeholders, before such a decision could be made.

Finally, you suggest that Postal Service guides and publications appear to be attaining official or quasi-regulatory status, leading to confusion with the Domestic Mail Manual (DMM) regarding classification issues. The Postal Service reaffirms that the DMM serves as the authority for the Postal Service's domestic mail classification standards. The *Guide to Move Update* is a document that provides the technical information necessary to comply with DMM classification standards. This guide is not unique in this approach; several other guides and handbooks provide the technical information needed to comply with other DMM standards. It is neither practical nor desirable to include this level of technical detail in the DMM.

We hope this information diminishes your concerns. We look forward to continuing our relationship as we create our new, mutually beneficial, future Postal Service.

Sincerely,

Louis J. Giuliano
Chairman
Board of Governors

John E. Potter
Chief Executive Officer and
Postmaster General

cc: Chairman Goldway

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

Eric P. Koetting

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September 2, 2010