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

RATE ADJUSTMENT DUE TO EXTRAORDINARY OR EXCEPTIONAL CIRCUMSTANCES	Docket No. R2013-11R

INITIAL COMMENTS OF THE UNITED STATES POSTAL SERVICE IN RESPONSE TO COMMISSION ORDER NO. 2540
(June 26, 2015)

I. INTRODUCTION

The Commission's task on remand from the Court of Appeals is relatively straightforward. The court upheld the Commission's findings of how much incremental mail volume was lost each year "due to" the Great Recession. The court also broadly upheld the Commission's "new normal" analytical framework under which both new incremental volume losses and ongoing losses from previous years would cease being deemed "due to" the Great Recession once the Postal Service was able to adjust its operations in response to the lower level of contribution produced by the new and lower level of mail volume.

However, the court vacated the Commission's "count once" rule – under which, even before the Postal Service could adjust to the lower level of mail volume, the Commission would count mail volume as lost only in the year it was originally lost rather than also counting recession-related losses that endured over multiple years – because it was inconsistent with the Commission's "new normal" framework, which ceased counting volume losses only when the Postal Service could adjust to them. Further, although the court upheld the Commission's "new normal" framework as a general matter, it made clear that the Commission on remand may reconsider its specific conclusion concerning when the Postal Service was able to adjust to its recession-related volume losses in light of the conflicting findings in Order No. 1926. In all other respects, however, the court upheld the Commission's Order.

As discussed below, correction of the "count once" error involves nothing more than a simple set of computations derived entirely from volume figures that the Commission has already established as representing incremental recession-related volume losses in each year. The results of such computations correcting the "count once" error are detailed in section IV of these comments. As for the date that the Postal Service had the ability to adjust to the permanently lower levels of mail volume, section III of these comments demonstrates that, given findings the Commission has already made both in Order No. 1926 and in its FY2013 Financial Analysis Report, the date should be set no earlier than the end of FY2012. Alternatively, and at the very least, the date on which the Postal Service could adjust its operations in response to the shift in the level of mail volume should be a *single* date rather than a series of separate dates corresponding to specific classes of mail, and should by no means be set earlier than the end of FY2010, the date at which the Commission concluded that the precipitous decline in First-Class Mail ceased being "due to" the recession. As such, the Commission should at least treat the "new normal" for Standard Mail as occurring at the same time as the "new normal" for First-Class Mail. Computations consistent with those two potential dates are set forth in section IV of these comments.

II. THE COURT OF APPEALS' DECISION ON REVIEW OF ORDER NO. 1926

The Postal Service sought review of Order No. 1926 in the U.S. Court of Appeals for the District of Columbia Circuit, challenging several bases of the Commission's estimate that only 25.27 billion mail pieces left the system "due to" the Great Recession, causing the Postal Service to lose only $2.776 billion in contribution from such lost mail volume.[1] Among other things, the Postal Service contended that (1) the Commission erred in determining that volume losses ceased being "due to" the recession once a "new normal" was established for a given class of mail, and (2) the Commission imposed an arbitrary "count once" rule under which mail volume was treated as lost "due to" the recession only in the year in which such volume initially left the system, even where such volume did not return in subsequent years.

The court granted the petition in part. It vacated the "count once" rule, determining that it was arbitrary on its own terms and "at war" with the Commission's premise that, before the establishment of the "new normal," the Postal Service was unable to adjust to the lower mail volume caused by the recession, even when such depressed volume endured beyond the calendar year in which the volume first exited the system.[2]

As for the "new normal" analysis, the Postal Service argued that the statutory phrase "due to" refers to simple, but-for causation, and further that the existence of a "new normal" – insofar as that term means the point at which annual mail volume settled at a new and permanently reduced level – cannot represent the point at which lost volume ceases being caused by the recession. In the Postal Service's view, just as a flood does not stop causing damage at the point the waters reach their peak, the recession does not stop suppressing volume at the point where volume losses stop growing on a year-over-year basis. Put simply, and paraphrasing an observation in

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[1] Order No. 1926 (Dec. 24, 2013) at 106,193.

[2] *Alliance of Nonprofit Mailers v. Postal Regulatory Comm'n*, Nos. 14-1009 & -1010, slip op. at 3, 8, 11, 15-17 (D.C. Cir. June 5, 2015).

Commissioner Taub's dissenting opinion in Order No. 1926, the existence of a "new normal" level of volume is itself due to the recession.[3]

The court upheld the Commission's "new normal" framework against the Postal Service's argument, concluding that the "due to" provision is ambiguous and need not "woodenly" refer to simple causation.[4] Instead, the phrase may also incorporate other factors, particularly the Postal Service's ability to adjust its operations in response to recession-related volume losses, to determine the extent of the impact of an extraordinary past event.[5] Accordingly, under the analysis upheld by the court, mail-volume losses may cease being deemed "due to" the Great Recession once the Postal Service was shown to be able to adjust its operations to such recession-related losses, on the basis that at such a point the adverse impact of the Great Recession has lost its "exceptional character," even if its "effects in some literal, but-for cause sense linger."[6]

The remaining question is when the Postal Service in fact had such an ability to adjust its operations in response to the volume (and consequently the contribution to institutional costs) lost because of the recession. In Part IV of Order No. 1926, the Commission held that the Postal Service's ability to adjust occurred at the same point

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[3] Order No. 1926, Dissenting Opinion of Vice Chairman Taub, at 4-5 (noting that the "new normal" reflects the point where "volume decline has stabilized," and asking "[h]ow is this 'new normal' *not* 'due to' to the exigent circumstance – the Great Recession?" (emphasis in original)).

[4] Alliance of Nonprofit Mailers, slip op. at 11, 13.

[5] *Id.* at 11 (noting that the "new normal" represented the time at which the Postal Service could "identify and adjust to" the downturn in mail volume); *id.* (describing the Commission's conclusion that effects of recession are "due to" extraordinary circumstances only "until the Postal Service had an opportunity to adjust to the 'new normal' in the mail economy").

[6] *Id.* at 12 (noting that the "new normal" framework is permissible because it "is designed to capture precisely the time when the exigent character of a circumstance dissipates—when its effects lose their exceptional character—even though the effects in some literal, but-for causal sense linger.").

that the level shift in mail volume occurred.[7] But in Part V of Order No. 1926, discussing the statutory term "necessary," the Commission recognized the constraints that inhibit the Postal Service's ability to adjust, and identified no steps that the Postal Service could have taken, but failed to take, to respond to the contribution lost by the recession-related decline in mail volume.[8] The court declined to reach the question or address the evident conflict in the Commission's Order, stating that the question was not squarely presented, but noted that the Commission is "free to consider that argument on remand."[9]

In all other respects, the court upheld the Commission's order.[10]

III. THE AMOUNT OF VOLUME DETERMINED TO BE LOST "DUE TO" THE RECESSION MUST BE ADJUSTED

A. The Vacated "Count Once" Rule Must Be Eradicated.

The specific dollar limitation imposed by Order No. 1926 on the amount of the exigent surcharge was premised on the majority's $2.776 billion estimate of total

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[7] *Id.* at 3-4 ("The Commission reasoned that, by 2011, the Postal Service should have adjusted to a 'new normal' business environment in which mail volumes appeared to be permanently lower than their pre-recession levels."); *accord id.* at 8, 16. *See generally* Order No. 1926 at 94 (deciding, based on one indicator, that the Postal Service was able to adjust its operations beginning in 2010).

[8] Order No. 1926 at 122-46 (rejecting, in light of the public policy constraints on the Postal Service, various commenters' allegations that the Postal Service ought to have taken additional adjustment measures); *see also id.* at 31-32 (noting that the "necessary" clause is designed to "incentiviz[e] efficient operations of the Postal Service" by denying an exigent adjustment where the Postal Service failed to follow "best practices of honest, efficient, and economical management" in response to the exigent event).

[9] *Alliance of Non-Profit Mailers*, slip op. at 17 n.3. Footnote 3 in turn cited page 19 of the oral argument transcript, in which counsel for the Postal Service argued that the Commission's discussion of the Postal Service's ability to adjust to volume losses in Part IV of its order is "completely inconsistent" with its lengthier discussion of the same issue in Part V of its order.

[10] Specifically, the court rejected the Postal Service's arguments that the Commission acted arbitrarily in establishing its "new normal" dates by class of mail rather than by sub-class, that the Commission provided insufficient notice of its "new normal" test, and that the Commission undercounted annual volume losses by discounting linear intervention variables from the models the Postal Service presented. The court also rejected in its entirety the separate petition for review filed by a group of major mailers, who argued that the Commission should have either denied the request for relief outright or attributed even fewer annual volume losses to the Great Recession.

cumulative harm from volume losses associated with the Great Recession. The court has now determined that estimate to be flawed. Specifically, the court found the Commission's "count once" rule "makes no sense on this record,"[11] and therefore reversed and vacated that portion of the Order.[12] The court rejected the "count once" rule because "the rationale that the Postal Service should have been able to identify and adjust to that downturn immediately is at war with the Commission's 'new normal' holding, which openly endorsed a longer period of time for such adjustments."[13] Thus, the court held, neither of the two rationales upon which the "count once" rule is premised "makes sense juxtaposed against the Commission's immediately preceding explanation [of] 'new normal.'"[14]

While the court upheld the validity of limiting the duration of the exigent surcharge utilizing a "new normal" analysis, it rejected the "mechanical tally" embodied in the "count once" rule.[15] Consistent with the court's ruling, the first step in the remand process must be for the Commission to eradicate the effects of the "count once" rule that the court has now vacated. Achieving that result is computationally simple, as the "count once" rule had merely been mechanistically superimposed on the conventional method of distinguishing and accounting for the multiple factors affecting mail volume that the Commission previously had specifically endorsed as the appropriate procedure for purposes of this exigent exercise.[16] The quantification provided in the Postal

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[11] Alliance of Non-Profit Mailers, slip op. at 3.

[12] *Id.* at 11, 17, 20.

[13] *Id.* at 11.

[14] *Id.* at 16.

[15] *Id.* at 17.

[16] *See* Order No. 864 (Sept. 20, 2011), at 50.

Service's Motion to Suspend (and reiterated in section IV of this document) demonstrates that the simple step of reversing the "count once" rule, consistent with its vacation by the court, requires the Commission to increase the estimate of lost volume and contribution "due to" the Great Recession.

B. The Commission Should Reconcile Its "New Normal" Analysis with its Findings Concerning the Postal Service's Ability to Adjust to the Level Shift in Mail Volume.

Although the court did not require the Commission to revisit its assumption that the Postal Service could have adjusted its operations simultaneously with the time at which the Commission determined that the Great Recession had caused mail volume to settle at a permanently lower level, the court explicitly invited the Commission to revisit the issue in light of the inconsistency in Order No. 1926 that the Postal Service identified at oral argument. For the reasons stated below, the Commission should accept the court's invitation.[17]

1. The Commission's "New Normal" Formulation Contains Two Inquiries That Must Be Addressed Separately

The inherent conflict within the Commission's analysis stems primarily from the fact that the same term, "new normal," has been used to refer to two discrete inquiries. At one level, the "new normal" phrase has been used to refer to the business environment confronting the Postal Service: specifically, to denote the point in time

[17] In their response to the Postal Service's motion to establish remand procedures, the Association for Postal Commerce, *et al.*, suggest that the Postal Service should pursue the inconsistency in the Commission's order via a petition for rehearing in court rather than through the instant proceedings on remand. Response of PostCom et al. to the Motion of the United States Postal Service to Suspend the Exigent Surcharge Removal Provisions of Order No. 1926 and to Establish Remand Procedures at 5-6 & n.2 (June 11, 2015) (*hereinafter* "PostCom Motion"). There is no reason to require further judicial intervention, however, in order for the Commission to address the patent inconsistency in Order No. 1926. The court has already authorized the Commission to consider the matter on remand, and, if the Commission acknowledges that such an inconsistency exists, as it must, sound administrative practice under the Administrative Procedure Act (APA) dictates that the Commission correct it even without an explicit command to do so from the court.

where the year-over-year decline in mail volume (or, more accurately, the class-specific volume declines attributed to the Great Recession) had stopped, and thus where mail volume settled at a level that is permanently lower than its pre-recession level.[18] The dates chosen by the Commission to represent the "new normal" – the beginning of FY2010 for Standard Mail and Package Services; FY2011 for First-Class Mail; and FY2012 for Periodicals[19] – are, for the most part, consistent with that definition.[20]

But, in terms of the specific test employed by the Commission and upheld by the court, the "new normal" phrase has also been used to denote the point in time that the Postal Service should have been able to adjust its operations to that environment by shedding costs or right-sizing its network in response to the loss in contribution caused by the shift in mail-volume levels.[21] Taken together, then, the Commission's holding is essentially that the "new normal" is the point at which Postal Service was able to adjust its operations in response to the shift in the level of mail volume.

Conjoining the two separate inquiries – the lower level of mail volume, and the ability to adjust to it – into a single all-purpose "new normal" date has led to an

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[18] *See Alliance of Nonprofit Mailers*, slip op. at 3 ("new normal" is the "business environment in which mail volumes appeared to be permanently lower than their pre-recession levels"); *see also, e.g.,* Order No. 1926 at 98 ("Quantification of such volume losses is independent of how the Postal Service has reacted to the volume loss in terms of shedding mail capacity or how it should adjust its network to the new normal"); *id.*, Separate Views of Commissioner Acton, at 4 (new normal "defines the business environment in the post-Great Recession world," and "[t]he Postal Service's future . . . lies in its ability to adapt to this 'new normal' environment"); *id.*, Dissenting Opinion of Vice Chairman Taub, at 4-5 (noting that the "new normal" reflects the point where "volume decline has stabilized").

[19] Order No. 1926 at 94.

[20] While not necessarily germane to the immediate discussion, it bears noting that the models accepted by the Commission in Order No. 1926 unambiguously continued to attribute further volume losses in Single Piece First-Class Mail to the macro-economic effects of the Great Recession through both FY2011 and FY2012. Thus, it is certainly questionable to use of the end of FY2010 as the line of demarcation for First-Class Mail for any purpose, but that potential *empirical* problem is unrelated to the tension between the two conflicting *theoretical* inquiries to which "new normal" has been applied.

[21] *See Alliance of Non Profit Mailers*, slip op. at 16 ("new normal" defines when the Postal Service can adjust to the lower volumes) (citing Order No. 1926 at 86); *id.* at 16-17 (recession stopped having exigent impact on mail volume when the Postal Service had the ability to adjust to the losses).

irreconcilable conflict in the Commission's order. Specifically, Part IV of Order No. 1926 concludes that the Postal Service was able to adjust to the lower level of Standard Mail in October 2009 and First-Class Mail in October 2010, and thus the lost contribution resulting from the continuing effects of the Great Recession in those classes after those dates cannot be considered "exceptional" in nature. By contrast, Part V of the same Order recognized the constraints that inhibit the Postal Service's ability to adjust its operations immediately to the level shift in volume, and in fact held that the Postal Service responded appropriately at that time (and beyond) to the shift in volume. As discussed more fully in section V of these comments, *infra* at 48-52, Part V of the Order rejected arguments that the Postal Service had not done enough to cut costs or streamline operations, recognizing the "unique framework within which the Postal Service must operate," which requires that it balance cost savings with the need to provide adequate and effective service and comply with statutory and regulatory requirements.[22] At no point in Part V did the Commission identify how the Postal Service could have adjusted its institutional costs or statutorily mandated obligations immediately in response to the level shift in mail volumes or suggest that it had not done enough to adjust to the extent that it could.

Similarly, the central holding of Order No. 1926 (that the Postal Service cannot recover lost contribution to institutional costs from those mail classes after FY2009 or FY2010, because it should have been able to adjust to the lost contribution by then) is inconsistent with the Commission's view, expressed in its FY2013 Financial Analysis

[22] Order No. 1926 at 118-21, 127-28, 131-36.

Report a mere three months later,[23] that the Postal Service did not effectively offset the losses in its attributable costs, let alone institutional costs, before FY2013.[24]

The Commission can resolve the conflict by rationally examining the point at which the Postal Service could reasonably have been able to adjust to the lost volume (and thus lost contribution to institutional costs) produced by the Great Recession. The "new normal" dates that Order No. 1926 established may be an appropriate measure of the time at which the recession-related volume losses appeared to be permanently lower than their pre-recession levels, and the Commission could reasonably conclude that any further *incremental* losses after that point were caused by something other than the Great Recession. However, as articulated by the Commission and approved by the court, the "new normal" framework looks to more than simply when the level shift in volume occurred, but also to when the Postal Service had the ability to effectively adjust to that level shift. Therefore, the Commission should reconsider whether those same dates *also* reflect the point at which the Postal Service could have adjusted to the reduction in volumes and contribution, such that those dates would also warrant the cutoff for *continuing* losses caused by the downward recession-produced shift in mail volume. Because there is inherently a gap between the time when the permanent shift in mail volume occurred and the time when the Postal Service could meaningfully respond to it, the Commission on remand should not continue to act as though both dates necessarily or logically fold together under the phrase "new normal."

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[23] *See* Analysis of United States Postal Service Financial Results and 10-K Statement for Fiscal Year 2013 (Apr. 10, 2014) [hereinafter "FY2013 Financial Analysis Report"].

[24] *See infra* section III.B.2.

Before resolving that issue, there remains a threshold question concerning what it means for the Postal Service to be able to "adjust" to the ongoing contribution it lost by virtue of the permanent shift in mail volume. To "adjust" might not mean to adjust *completely*: that is, to completely offset the amount of contribution lost because of the reduced volume.[25] If it did, then it is virtually beyond dispute that the Postal Service has not, and could not have, "adjusted" even to this date. The Commission has recognized that the Postal Service's institutional costs – which are largely outside the Postal Service's control and do not fall along with declining volume – have risen 6 percent since 2007 and will likely continue to rise as a share of total costs.[26] The Postal Service's combined institutional and attributable costs continue to exceed its revenues even though, as the Commission has already found, it has taken appropriate steps to adjust its network in response to the decline in mail volume, consistent with needed levels of service.

On the other hand, to "adjust" must mean something more than merely to "respond," and thus cannot simply involve pinpointing the moment at which the Postal Service first cut costs or increased its productivity in the face of the level shift. As the court noted, the "new normal" framework is a reasonable application of the "due to" clause because it is designed to determine when the impact of the Great Recession lost its "exceptional character." Rationally applied, this did not happen immediately upon the level shift. Rather, the "exceptional character" of the volume losses extended further, until such time as the Postal Service demonstrated the ability to *effectively* adjust in

[25] *See* Order No. 1926, Dissenting Opinion of Vice Chairman Taub, at 5 ("However, unlike entities in the private sector, the Postal Service cannot suddenly eliminate institutional costs in response to volume declines by shrinking the size and scale of its networks.").

[26] FY2013 Financial Analysis Report at 23-24.

response to the level shift. Indeed, the Commission stated in Order No. 1926 that the impact of the Great Recession on the Postal Service was in how it "caused an extraordinary and rapid reduction [in mail volume] that could not be dealt with effectively."[27] Certainly, the lost contribution resulting from the Great Recession retained its "exceptional character" for the period of time in which the Postal Service was undertaking efforts to downsize at the rapid pace necessitated by the Great Recession, but the Postal Service's operating results showed that it had not yet reached a point where those losses had been "dealt with" in anything approaching an "effective" manner.

Such an approach also appropriately recognizes that, when considering whether a circumstance continues to impact the Postal Service in an "exceptional" way, the Commission must rationally consider the magnitude of the challenge facing the Postal Service resulting from those circumstances, and therefore when its efforts could reasonably be expected to show effective results. This flows naturally from the plain definition of "extraordinary or exceptional," and the Commission's recognition that this standard is predicated on the impact of the particular circumstances on the Postal Service.[28] It is fundamentally illogical to say that the circumstances facing the Postal Service are no longer "extraordinary or exceptional" when the Postal Service has not been able to effectively adjust to those circumstances, even though it is taking appropriate actions to do so, but is instead in a period of upheaval. For these reasons, as discussed in the next section, an appropriate measure of "adjustment" should be the

[27] Order No. 1926 at 178.

[28] *See*, *e.g.*, Order No. 547 at 53.

point at which the Postal Service's cost-cutting and right-sizing efforts began to meaningfully improve its fiscal position.[29]

2. Carryover Losses Should Be Counted Until the Postal Service Regained Its Ability to Adjust in FY2013

The Commission's own Financial Analysis Reports amply demonstrate that the Postal Service did not regain its ability to adjust to the post-Great Recession environment until FY2013, at the earliest. The exclusive focus of Order No. 1926's discussion of the "ability to adjust" factor was total factor productivity (TFP),[30] but TFP is not a good indicator in that respect. The fact that TFP increased in FY2010, after declining in FYs 2008 and 2009, indicates only that the Postal Service increased its efficiency, but the fact that the Postal Service was operating more efficiently in that year does not demonstrate that the Postal Service had at that point demonstrated anything approaching an effective ability to adjust, such that the level shift was no longer having an "exceptional" impact on the Postal Service.[31] Much more useful indicators in answering the question as to when the Postal Service demonstrated the ability to adjust to the level shift can be derived from the Commission's Financial Analyses.

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[29] This is *not* an argument that the "new normal" inquiry "must allow the Postal Service to recover through exigent rate increases any and all costs whose recovery is 'necessary' within the meaning of 39 U.S.C. § 3622(d)(1)(E)." PostCom Motion at 6-7. Rather, it is a rational application of the "due to" causation standard as specified by the Commission, and approved by the court, which looks to the Postal Service's ability to adjust to determine when the circumstances necessitating that adjustment lose their "exceptional character." Clearly, an exigent surcharge that fully covers the costs needed to provide "postal services of the kind and quality adapted to the needs of the United States" would be significantly larger than the surcharge being proposed here by the Postal Service, considering the Postal Service's current financial condition and operating and capital needs. *See infra*, Part V.

[30] Order No. 1926 at 94.

[31] Thus, TFP is a measure of operational efficiency, but does not itself indicate that the Postal Service has been able to adjust to an adverse business environment. Indeed, historically the Postal Service has had decreases in net income even while TFP increased: for example, in 2000-2001, the Postal Service had negative net income both years (aggregate loss of nearly $2 billion), but TFP growth both years (aggregate increase of 3.7 percent). In those years, the Postal Service was operating more efficiently, but certainly had not demonstrated an ability to effectively adjust to the more challenging business environment in which it was operating.

As the below chart from the Commission's FY2013 Financial Analysis Report shows, the Postal Service's net loss, after filtering out the wide variations in legislated obligations to the Retiree Health Benefits Fund (RHBF), grew through FY2011, and then remained at approximately the same (alarmingly high) level in FY2012.[32] The Postal Service also exhausted its borrowing authority in FY2012, effectively using up its last immediately available bandage with which to staunch its bleeding of cash due to the mismatch between its operating expenses and revenues.[33] The Postal Service's financial situation was exceptionally precarious in this time period, characterized by rapidly declining liquidity.[34] Only in FY2013 did the Postal Service's financial situation begin to manifest noticeable evidence of improvement, with the net non-RHBF loss (although still a loss) reduced to approximately $1 billion. Critically, this improvement has been sustained, with the results in FY2014 showing even further improvement (even if one disregards the effects of the exigent surcharge in that year).[35]

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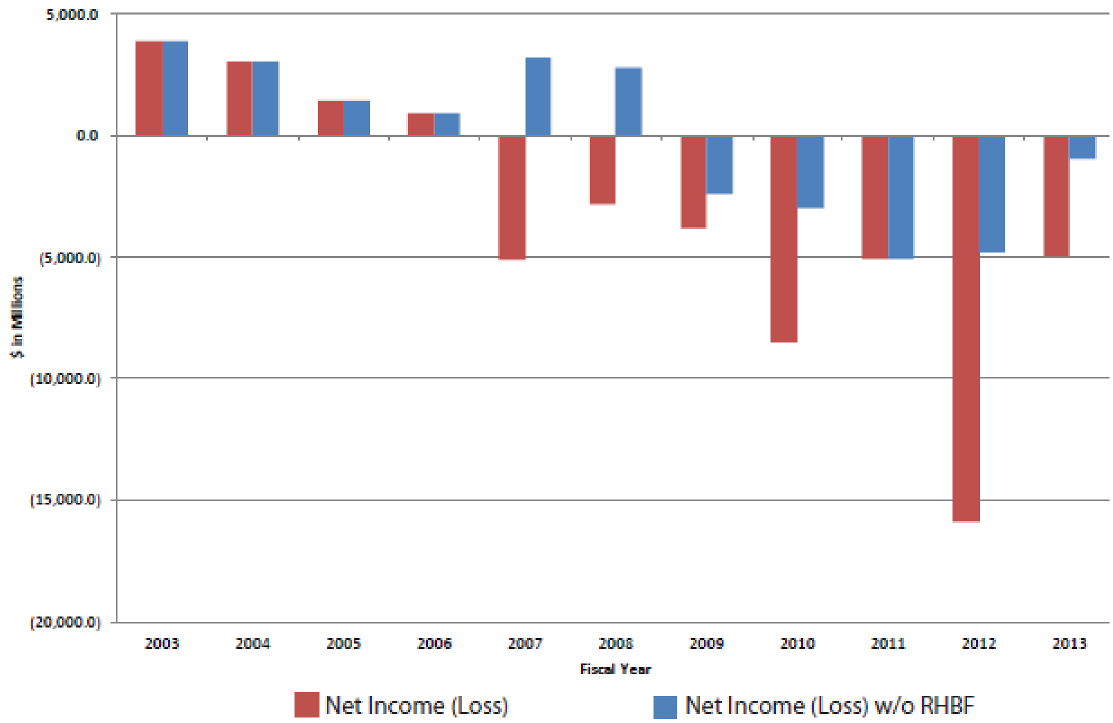
[32] FY2013 Financial Analysis Report at 1.

[33] *Id.* at ii, 18-19. The Postal Service did not make its RHB payments in either 2011 or 2012, meaning the increase in debt in those years was unrelated to making the RHB payment.

[34] *See, e.g.*, Order No. 1926 at 116-17.

[35] FY2013 Financial Analysis Report at 3. In FY2014, net non-RHBF income, aided by the 4.3 percent surcharge, moved (barely) back into positive territory, although actual net income was still a loss in the $5 billion range; even without the additional revenue from the surcharge, the controllable operating results would have slightly improved from FY2013. Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2014 (Apr. 1, 2015), at 3, 7 [hereinafter "FY2014 Financial Analysis"]. The net income/loss chart on page 3 of the FY2014 report controls not only for RHBF obligations, but also for certain other factors outside the Postal Service's control. Nonetheless, the slightly reformatted chart still shows that it was not until FY2013 that the Postal Service was able to turn the corner and therefore to achieve a measure of equilibrium concerning its controllable income.

Figure 1
Postal Service Income/(Loss) in $ Millions



Source – USPS Forms 10-K, Forms 10-Q and USPS Annual Reports

Therefore, the Postal Service's controllable financial results show that a turning point began in FY2013, in which the Postal Service was first able to achieve some degree of stability following the years of upheaval resulting from the Great Recession.[36] This achievement represents the fruits of the Postal Service's earlier endeavors to

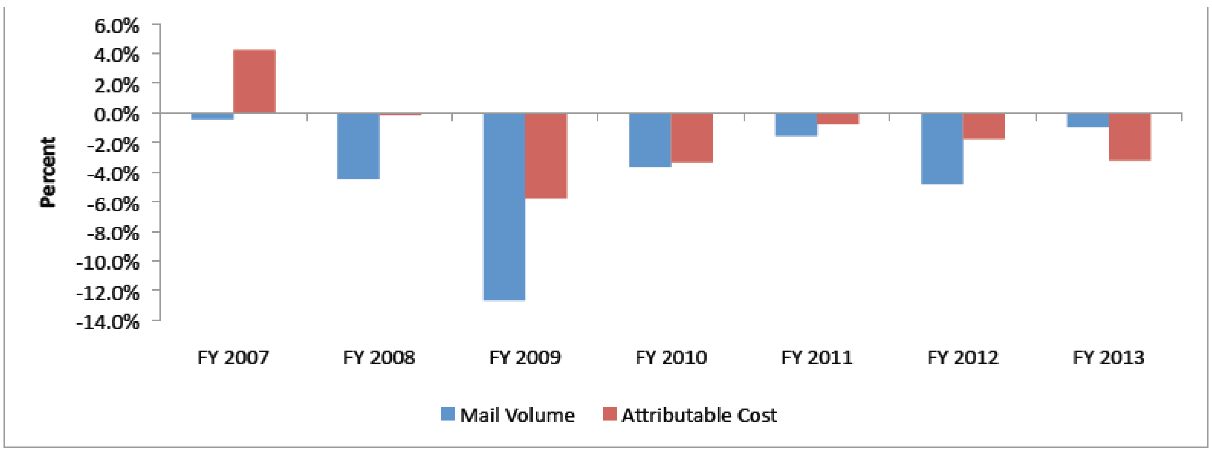
[36] Of course, this stability is being maintained only by defaulting on the statutorily required RHB prefunding payment. Furthermore, the Postal Service's financial position remains very precarious, considering its current low liquidity and its anticipated operating and capital needs. *See infra,* Part V. So, stability in this context does not mean true financial stability, considered even in the short-term (much less in the long-term). Rather, it means that for purposes of the application of the "new normal" standard, FY2013 was the first year following the Great Recession in which the Postal Service was able to reach a manner of equilibrium regarding its controllable finances, which it has been able to sustain since then (disregarding the effects of the exigent surcharge).

adjust to the level shift caused by the Great Recession.[37] As the Commission itself noted:

> Since FY 2010, the Postal Service has reduced operating expenses and increased efficiency in order to better align operating expenses with the current volumes. *The Postal Service began to realize noticeable savings from those efforts in FY 2013.*[38]

The Commission then presented a chart illustrating "the strategy relating to the decline in attributable costs corresponding to diminishing mail volumes."[39]

Figure 2
Mail Volume and Attributable Cost - Precent Change in Prior Year



Source – PRC Annual Compliance Reports, FY 2007 – 2012, Appendix D, Table D-1, Fiscal Year Volume, Revenue, Cost and Cost Coverage by Class Current Classification and FY 2013 Financial Report, Appendix A.

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[37] Those endeavors are described in detail at Renewed Exigent Request at 22-35 and Postal Service Reply Comments (Dec. 6, 2013) at 91-94, and they need not be rehashed here. Suffice it to say that the Commission has already credited them with demonstrating the Postal Service's exercise of honest, efficient, and economical management. Order No. 1926 at 131-38 (noting that "the positive trends identified in Order No. 547 have continued"); Order No. 547 at 61 n.48, 80-86 (stating that Postal Service management had done a "commendable job" at managing costs and improving efficiency, such as by reducing work-hours and improving total factor productivity, in response to volume declines).

[38] FY2013 Financial Analysis Report at 1 (emphasis added).

[39] *Id.* at 2.

Based specifically on the results reported in this chart for FY2013, the year in which the relationship between the blue bar and the red bar flipped, the Commission concluded:

> *For the first time in 10 years*, the percentage decline in attributable costs has exceeded the percentage decline in mail volume. *This is an important indicator of the ability of the Postal Service to effectively manage costs* and, if continued, can improve the financial picture in the future.[40]

Although the immediate focus of the Commission's remark is on attributable costs (rather than the institutional costs which are actually more critical to this proceeding), the Commission's discussion in the FY2013 Financial Analysis Report leaves no doubt that it was FY2013, not any earlier year, that marked the beginning of a new era in terms of the Postal Service's ability to adjust to the staggering volume losses triggered by the Great Recession.

In contrast, the Commission's focus in Order No. 1926 was solely on data suggesting the general magnitude of the Postal Service's adjustment actions (work-hour reductions, total factor productivity), and not on whether and when those actions led to material improvement in the Postal Service's circumstances. The emergence of strived-for financial improvement in FY2013 recognized by the Commission indicates not merely that the Postal Service was *acting*, but that those actions were actually beginning to have the desired effect on the Postal Service's controllable operating results. Therefore, considered rationally, the volume losses caused by the Great Recession did not lose their "exceptional character" beginning with FY2010 for Standard Mail and FY2011 for First-Class Mail, but instead retained such character until at least

[40] *Id.* (emphasis added). The Commission's prediction has been borne out so far, as noted in footnote 35 above.

the beginning of FY2013, when the Commission has itself found that the Postal Service's efforts to adjust produced a measure of stability that has persisted since then.

It bears emphasizing that a convincing argument could be made that FY2014 is a more logical starting point for a "new normal." Setting aside RHBF obligations, the Postal Service's net loss in FY2013 ($1.004 billion) remained sizable, and indeed was nearly identical to its net loss in FY2009 ($1.051 billion), the first full year of the Great Recession. By contrast, FY2014 is when the Postal Service roughly broke even (disregarding the beneficial effects of the exigent surcharge).[41] For instance, it was in FY2014 that the Postal Service began to fully realize the savings from cost-cutting efforts such as Phase I of Network Rationalization and the maximization of its non-career workforce.[42] Therefore, it should be noted that the Postal Service's proposal is conservative in treating FY2013 as the year when it regained an ability to adjust to the "new normal."[43]

The start of FY2013 appears all the more conservative in light of when various macroeconomic indicators – the subject of factor 1 of the Commission's "new normal" test – returned to pre-Great Recession levels. Mr. Thress addressed this extensively in his Reply Statement:

> Based on two decades of research on my part, the two macro-economic variables which best track with mail volumes are private

[41] To be abundantly clear, the Postal Service is not arguing that the beneficial results of the exigent surcharge are relevant as to when the Postal Service demonstrated an ability to adjust to the level shift in volumes.

[42] Order No. 1926 at 118. *See also* United States Postal Service 2014 Report on Form 10-K at 11 (noting that the Postal Service closed 97 and 44 mail processing facilities in FYs 2013 and 2012, respectively, and 2 facilities in FY2014); *id.* at 20 (noting that the number of non-career employees increased by approximately 26,000 employees in FY2013, but by only approximately 3,000 employees in FY2014).

[43] It also happens to coincide with the timeframe of data in the Postal Service's initial (renewed) request, which projected losses only through FY2012. As a result, the Commission and other stakeholders will be spared the need to scrutinize fresh evidence about FY2013 during this abbreviated proceeding.

> employment (which tracks most strongly with First-Class Mail) and real gross private domestic investment (which tracks most strongly with Standard Mail).
>
> Private employment per adult (the independent variable used in my econometric work) peaked pre-recession in 2007PQ2, did not begin to consistently grow again until 2011PQ1, and remained 8.5 percent below its pre-recession high in 2012PQ4.
>
> Moreover, employment has remained particularly weak in the mail-intensive industries which were hardest hit by the Great Recession. Total private employment (overall, not per adult) in December, 2012, was 2.5 percent below its December, 2007 level. Total employment in financial activities was down 5.4 percent from December, 2007, to December, 2012. Total employment in real estate was down 9.0 percent over the same time period. Total employment in advertising and related services was down 8.6 percent.
>
> Real gross private domestic investment per adult peaked pre-recession in 2006PQ2, did not begin to consistently grow again until 2011PQ3, and remained 20.9 percent below its pre-recession high in 2012PQ4.[44]

In terms of where another relevant macro-economic indicator was at the start of 2013 relative to pre-Great Recession levels, Mr. Thress noted that "real median household income declined year-over-year for five consecutive years from 2008 through 2012 by a total of more than 8 percent."[45]

These are the types of macro-economic indicators on which the Commission relied in Order No. 1926 as "Indicators of the New Normal."[46] Another indicator

[44] Thress Reply Statement at 14. Meanwhile, seasonally adjusted total nonfarm payroll employment did not reach its December 2007 peak (138,350,000) until April 2014 (138,385,000), months after Mr. Thress submitted his Reply Statement and Order No. 1926 had been issued. Federal Reserve Bank of St. Louis, All Employees: Total Nonfarm, http://research.stlouisfed.org/fred2/series/PAYEMS (June 5, 2015). It also bears noting that seasonally adjusted payroll employment in the "couriers and messengers" sector, which consists of private delivery companies providing similar services to the Postal Service, did not approach pre-Great Recession levels until November 2014. Federal Reserve Bank of St. Louis, All Employees: Transportation and Warehousing: Couriers and Messengers, http://research.stlouisfed.org/fred2/series/CES4349200001 (June 5, 2015).

[45] Thress Reply Statement at 14.

[46] Order No. 1926 at 86-87, 90-92. Order No. 1926 also referenced Retail Sales. *Id.* at 91-92. While Mr. Thress did not address Retail Sales specifically in his Reply Statement, examination of the InputData tab of his folder USPS-R2010-4R/10 suggests that per adult Retail Sales peaked in 2007Q2, began consistent growth in 2010Q1, but was still well under the 2007 levels at the end of 2012.

discussed at some length was Gross Domestic Product (GDP).[47] As Mr. Thress explained, even this broader measure had yet to recover to its pre-Great Recession level at the end of 2012 and the start of 2013:

> Real per-capita GDP peaked in 2008PQ1 at $49,438. In 2012PQ4, real per-capita GDP was $49,256, less than in 2008PQ1. So right away, we see that the macro-economy had *not*, in fact, "recovered" by the end of FY 2012 on a per-capita basis.[48]

Even by the GDP measure, therefore, things had still not returned to "normal" two years after when the Commission previously allowed.[49] To summarize, although the Postal Service's own controllable operating results show that its finances were perhaps beginning to achieve some degree of stability in FY2013 for purposes of determining the Postal Service's ability to adjust under the "new normal" standard, that date represents a conservative "new normal" cutoff in terms of both the Postal Service's ability to adjust and the macroeconomic perspective.

The "ability to adjust" point should apply to all categories of mail across all market-dominant classes. Class-specificity (actually category-specificity) might make sense in the context of factor 2 (trends in category-specific macroeconomic variables), but at the heart of the Postal Service's "ability to adjust" are actions taken at the institutional level. For example, the Postal Service's consolidation of delivery routes, reduction of work-hours, and savings on compensation and benefits through FY2012 reduced costs for all mail handled by Postal Service employees, regardless of whether that mail was First-Class Mail, Standard Mail, or something else. Therefore, a "new

[47] *See id.* at 87-88.

[48] Thress Reply Statement at 13 (emphasis in original).

[49] Order No. 1926 at 88.

normal" cutoff based on the Postal Service's ability to adjust should apply across all mail classes.

The Postal Service took well-documented actions to adjust its cost structure through FY2012 – actions that the Commission itself has commended as being consistent with the requirement to exercise honest, efficient, and economical management. As the Commission explicitly observed in its FY2013 Financial Analysis Report, those actions did not begin to manifest a true positive "adjustment" to the Postal Service's financial results until FY2013. Even this timeframe is conservative, particularly in light of when key macroeconomic indicators show that the economy overall was also starting to adjust back to pre-Great Recession levels. Even if it makes sense to stop counting *new* year-over-year losses when category-specific variables begin to trend upward, as the Commission did in Order No. 1926, it would be a much more rational application of the "new formal" framework to choose the beginning of FY2013 as the point when the Postal Service, as an institution, regained its ability to adjust to the post-Great Recession "new normal," after which *aggregate* losses could stop being counted. The effect of this change on contribution, revenue, and the recovery period is discussed in section IV below.

3. Even If the Commission Does Not Adopt a Longer Overall "Ability to Adjust" Period, Standard Mail and First-Class Mail Losses Ought to Be Counted for the Same Amount of Time

In the alternative, even if the Commission were generally to insist that the Postal Service somehow could have adjusted much more rapidly to the shift in mail volume, the disparate treatment of First-Class Mail and Standard Mail losses in FY2010 cannot be justified in light of the cross-class nature of the Postal Service's volume losses and adjustment actions. The flaw is readily apparent in the following table of Great

Recession-caused volume losses, as determined by the Commission in Order No. 1926 and adjusted for the "count once" rule, per section III.A above:[50]

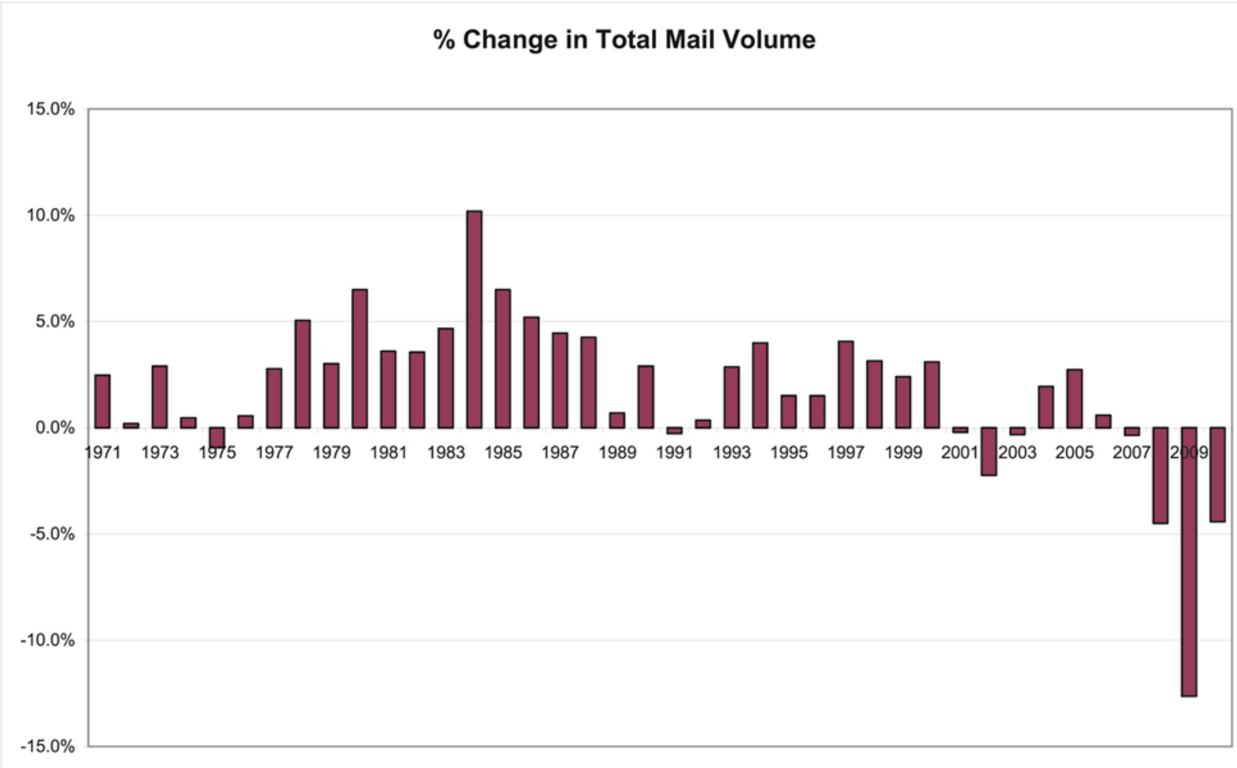
	FY2008	FY2009	FY2010
FY2007 Benchmark:			
First-Class Mail	95,347.0	95,347.0	95,347.0
Standard Mail	102,968.6	102,968.6	102,968.6
Total Market-Dominant	209,401.3	209,401.3	209,401.3
Actual Volume:			
First-Class Mail	90,671.2	82,727.0	77,591.6
Standard Mail	98,561.3	81,913.3	81,945.5
Total Market-Dominant	199,896.3	174,127.2	168,187.7
Actual Lost Volume from Benchmark:			
First-Class Mail	(4,675.8)	(12,620.0)	(17,755.4)
Standard Mail	(4,407.3)	(21,055.3)	(21,023.1)
Total Market-Dominant	(9,505.00)	(35,274.10)	(41,213.60)
Loss Recognized as Great Recession:			
First-Class Mail	(582.7)	(2,446.7)	(3,490.0)
Standard Mail	(5,350.0)	(20,922.0)	0.0
Total Market-Dominant	(6,043.0)	(23,859.5)	(4,329.7)

The first three sections of this table once again show the familiar story of unprecedented mail volume losses across the FY2008-FY2010 period. As illustrated by the Commission's own chart reproduced below,[51] the overall (year-after-year) percentage loss in FY2010 is of roughly the same magnitude as the percentage loss in FY2008, and the losses in each of those years exceed anything experienced since 1970

[50] *See* Further Statement of Thomas E. Thress on Behalf of the United States Postal Service, PRC Docket No. R2013-11 (Sept. 26, 2013), at 8, 10 ("starting volume" benchmarks; actual volumes); Order No. 1926 at 101 (year-over-year losses due to Great Recession); USPS Motion to Suspend at 6 (Order No. 1926 volume loss estimates after elimination of "count once" rule).

[51] *See* Order No. 547 at 43.

by a very wide margin. Without question, the Postal Service was reeling from vanishing volume over all three years.



The fourth segment in the table, however, shows how the Commission has chosen to treat volume losses for the two major classes and for total Market-Dominant mail over those same three years. For First-Class Mail, the Commission, utilizing the two organizing principles of its “new normal” test, has acknowledged that some portion of the actual mail lost (relative to the benchmark) is properly attributed to the Great Recession *in each year* from FY2008 through FY2010, while simultaneously concluding, looking backward from December of 2013, that the Postal Service should have been able to adjust to the lost volume commencing in FY2011. In contrast, the Commission acknowledges that monumental amounts of Standard Mail were lost to the Great Recession in FY2008 and FY2009, but at the same time concludes, without explanation, that the Postal Service was able to adjust to the hemorrhage of Standard Mail by FY2010.

This result, however reached, makes no sense. The Commission's findings indicate that the Postal Service lost over 20 billion pieces of Standard Mail due to the Great Recession in FY2009, of which nearly 16 billion disappeared for the first time that very year. Both of those figures exceed, by a wide margin, not only the largest other loss in annual volume by a class of mail since 1970, but also any other overall annual volume loss *across all classes of mail* during that period. Standard Mail experienced the biggest single-year loss in modern postal history only the year before, and that lost volume had not returned. Meanwhile, mail in other classes was clearly still in flux in FY2010. Nevertheless, the Commission apparently concluded that the Postal Service "should have been able to identify and adjust to that downturn [specific to Standard Mail] immediately," rather than being allowed "a longer period of time for such adjustments."[52]

This disparate treatment is all the more illogical in light of what an "ability to adjust" would mean in the context of Standard Mail. In the face of massive, system-wide volume declines and a largely institutional cost base, the Postal Service responded by reducing work-hours, consolidating processing and delivery operations, reforming compensation and benefits, and other across-the-board cost-reduction maneuvers. As discussed in the previous section, these efforts reduced costs for all classes of mail

[52] *See Alliance of Nonprofit Mailers*, slip op. at 11. While the quoted language in the court opinion nominally refers to the tension between the Commission's "count once" and "new normal" rules, the same logic applies to the tension between the treatment of Standard Mail and First-Class Mail within the "new normal" analysis. Given the Commission's finding that the Postal Service could not have adjusted to the massive loss in First-Class mail volume before FY2011, it simply makes no sense that the Postal Service could have "immediately" adjusted a year earlier to the far greater loss in Standard Mail volume.

moving through the postal network, since First-Class Mail, Standard Mail, Periodicals, and so forth are all processed in the same facilities and delivered by the same carriers.[53] The Postal Service did not – indeed, could not – adjust its network specifically for Standard Mail losses in one year but make First-Class Mail-specific adjustments in another year. Indeed, if the Postal Service, as a whole, would be expected to take longer to adjust to the overall losses from one of the two mail classes, it stands to reason that *Standard Mail* losses would require more time, given that they comprised fully 88 percent of total market-dominant volume losses in FY2008 and FY2009, compared with First-Class Mail's smaller 10-percent share of total losses.

To rectify the patently arbitrary asymmetry, the final portion of the above table should, if nothing else, be modified to appear as follows:

	FY2008	FY2009	FY2010
Losses Recognized as Great Recession			
First-Class Mail	(582.7)	(2,446.7)	(3,490.0)
Standard Mail	(5,350.0)	(20,922.0)	**(20,922.0)**
Total Market-Dominant	(6,043.0)	(23,859.5)	**(25,251.7)**

With such a change, as this table indicates, the loss recognized for Standard Mail (unlike the increasing loss recognized for First-Class Mail) would remain constant over the FY2009-FY2010 period, consistent with actual Standard Mail volume. Such a straightforward revision is necessary to achieve a reasonable parity in the treatment of Standard Mail and First-Class Mail in FY2010. Holding the recognized FY2010 Standard Mail loss constant at the FY2009 level, while allowing the First-Class loss to grow, appropriately accounts for the different volume trends in FY2010, while

[53] It bears noting that the indicator of "ability to adjust" on which the Commission relied – TFP – applies across all mail categories, and does not warrant an earlier cutoff for Standard Mail than for other categories. *See* Order No. 1926 at 94.

recognizing the practical reality that the Postal Service lacked the ability to make immediate, Standard Mail-specific adjustments in FY2010 even as First-Class Mail was continuing to decline. The effect of this change on contribution and revenue appropriately considered as lost “due to” the Great Recession is discussed in section IV below.

IV. QUANTIFICATION OF THE PROPOSED ADJUSTMENTS

The previous section explains that the Commission should adjust the amount of contribution lost “due to” the Great Recession, and therefore extend the surcharge period, to account for (1) the counting of losses that continue after their first year (i.e., remedying the “count once” error); and (2a) the fact that the Postal Service could not adjust to the volume loss associated with the Great Recession until FY2013; or (2b) at the very least, the fact that the Postal Service could not realistically adjust to Standard Mail losses a year before First-Class Mail losses. This section details the quantitative impact of each adjustment, in terms of volume losses, contribution, and surcharge timing.[54]

A. Counting Continuing Losses Until Order No. 1926 Cutoff Dates.

The Postal Service has previously described the quantitative effect of fixing the “count once” error,[55] and reiterates that description here.

As shown below, merely by eliminating the “count once” rule and recognizing that the actual annual volume loss in each year is the combination of volume first lost in that year, plus annual volume lost in the previous year, the “total impact” volume loss

[54] Because the estimated effects of the Great Recession on Package Services are so insignificant under the Commission’s framework, however, each of the quantification exercises in this document simply leaves the Package Services contribution effects constant at the virtually zero level reflected on page 106 of Order No. 1926.

[55] USPS Motion to Suspend at 5-6.

estimate increases from 25.2708 billion pieces to *35.0877 billion pieces*. Specifically, in the table below, the 2008-2012 total for each row is the sum of the FY2008 column, plus any non-zero values in the Annual column for each of the subsequent years.

Impact of the Great Recession on Market-Dominant Mail Volumes									
PRC Estimates: Year-over-Year Changes due to the Great Recession (Eliminate Count Once)									
(Market-Dominant mail, millions of pieces)									
	FY2008	FY2009	FY2009	FY2010	FY2010	FY2011	FY2011	FY2012	**2008 -12**
	First Time	First Time	Annual	First Time	Annual	First Time	Annual		
First-Class Mail	(582.7)	(1,863.9)	(2,446.7)	(1,043.3)	(3,490.0)	0.0	0.0	0.0	**(6,519.4)**
Standard Mail	(5,350.0)	(15,572.0)	(20,922.0)	0.0	0.0	0.0	0.0	0.0	**(26,271.9)**
Periodicals Mail	(110.3)	(377.2)	(487.4)	(352.3)	(839.7)	(15.8)	(855.5)	0.0	**(2,292.9)**
Package Serv.	0.0	(3.4)	(3.4)	0.0	0.0	0.0	0.0	0.0	**(3.4)**
TOTAL	**(6,043.0)**	**(17,816.5)**	**(23,859.5)**	**(1,395.6)**	**(4,329.7)**	**(15.8)**	**(855.5)**	**0.0**	**(35,087.7)**

As comprehensively shown in the following table, the above increased volume-loss estimate resulting from elimination of the “count once” rule directly translates into an increase in lost contribution from $2.766 billion (in Order No. 1926) to *$3.957 billion*. As stated, this $1.2 billion increase in the lost contribution estimate reflects nothing more than correction of the “count once” flaw, holding all other assumptions and methodologies constant.

CORRECTED COMMISSON ESTIMATES OF "TOTAL" VOLUME AND CONTRIBUTION LOST TO GREAT RECESSION AFTER ELIMINATION OF "COUNT ONCE" RULE					
	(A)	(B)	(C)	(D)	(E)
	FY 2014 AR Unit Contribution	PRC "Total" Volume	PRC "Total" Contribution	Corrected "Total" Volume	Corrected "Total" Contribution
First-Class Mail (domestic)					
Single-Piece Letters	0.2430	(1,830.2)	(444.8)	(3,753.6)	(912.2)
Single-Piece Cards	0.1137	(100.9)	(11.5)	(208.8)	(23.7)
Presort Letters	0.2770	(1,318.7)	(365.3)	(2,104.0)	(582.9)
Presort Cards	0.1831	(87.7)	(16.1)	(140.1)	(25.7)
Flats	0.5789	(159.8)	(92.5)	(325.7)	(188.5)
International Mail	0.2064	7.3	1.5	12.8	2.6
Total First-Class Mail		(3,490.0)	(928.6)	(6,519.4)	(1,730.3)
Standard Mail					
High-Density & Saturation Letters	0.0916	(769.0)	(70.4)	(921.6)	(84.4)
H-D & Saturation Flats & Parcels	0.1033	(2,005.9)	(207.2)	(2,421.5)	(250.2)
Carrier-Route	0.0886	(1,797.7)	(159.4)	(2,176.2)	(192.9)
Letters	0.1096	(13,861.6)	(1,519.0)	(17,562.1)	(1,924.5)
Flats	(0.0271)	(2,438.9)	66.0	(3,126.9)	84.6
Non-Flat Machineables & Parcels	(0.0081)	(48.8)	0.4	(63.6)	0.5
Total Standard Mail		(20,922.0)	(1,889.6)	(26,271.9)	(2,366.9)
Periodicals Mail	(0.0611)	(855.5)	52.2	(2,292.9)	140.0
Package Services					
Bound Printed Matter Flats	0.2742	(0.8)	(0.2)	(0.8)	(0.2)
Bound Printed Matter Parcels	0.2415	(0.7)	(0.2)	(0.7)	(0.2)
Media and Library Rate Mail	(0.1405)	(1.8)	0.3	(1.8)	0.3
Total Package Services		(3.4)	(0.1)	(3.4)	(0.1)
TOTAL MARKET-DOMINANT MAIL		**(25,270.8)**	**(2,766.1)**	**(35,087.7)**	**(3,957.3)**

Assuming, for purposes of illustration, that the expectation in Order No. 1926 of $1.809 billion in annual contribution from the exigent surcharge continues to hold,[56] this additional $1.2 billion in contribution would extend the approximate surcharge period from Order No. 1926's original estimate of 1.53 years to a corrected estimate of 2.19 years.

[56] Of course, the actual amount of contribution per year and, consequently, the actual surcharge period will likely change with the dynamics of the mail market.

B. Counting Continuing Losses Until FY2013.

As discussed in section III.B.2 above, even if it is rational to stop counting new *incremental* losses as of the timeframes of the level shift established in Order No. 1926, it is all the more rational to count *continuing* losses until the Postal Service regained its ability to adjust to that level shift in FY2013, consistent with the Commission's overall framework and the court's decision. Doing so (coupled with counting continuing losses until the Order No. 1926 cutoffs, per the previous section, but keeping all other variables and methodologies consistent with Order No. 1926) yields a figure of *105.689 billion* pieces lost due to the Great Recession.

PRC Estimates: (Eliminate Count Once, Carry Over All Classes Through FY2012)									
(Market-Dominant mail, millions of pieces)									
	FY2008	FY2009	FY2009	FY2010	FY2010	FY2011	FY2011	FY2012	**2008 -12**
	First Time	First Time	Annual	First Time	Annual	First Time	Annual	Annual	
First-Class Mail	(582.7)	(1,863.9)	(2,446.7)	(1,043.3)	(3,490.0)	0.0	(3,490.0)	(3,490.0)	**(13,499.4)**
Standard Mail	(5,350.0)	(15,572.0)	(20,922.0)	0.0	(20,922.0)	0.0	(20,922.0)	(20,922.0)	**(89,037.8)**
Periodicals Mail	(110.3)	(377.2)	(487.4)	(352.3)	(839.7)	(15.8)	(855.5)	(855.5)	**(3,148.5)**
Package Serv.	0.0	(3.4)	(3.4)	0.0	0.0	0.0	0.0	0.0	**(3.4)**
TOTAL	**(6,043.0)**	**(17,816.5)**	**(23,859.5)**	**(1,395.6)**	**(25,251.7)**	**(15.8)**	**(25,267.5)**	**(25,267.5)**	**(105,689.0)**

As the table below shows, this volume loss translates into a contribution loss of *$11.431 billion*.

	FY08-FY12		Total
	Lost Vol	Unit Cont	Lost Cont
First-Class Mail	(13,499.4)		$ (3,587.5)
Single-Piece Letters	(7,414.1)	$0.2430	($1,801.7)
Single-Piece Cards	(410.6)	$0.1137	($46.7)
Presort Letters	(4,741.4)	$0.2770	($1,313.5)
Presort Cards	(315.4)	$0.1831	($57.8)
Flats	(645.3)	$0.5789	($373.6)
International Mail	27.4	$0.2064	$5.7
Standard Mail	(89,037.8)		$ (8,035.8)
High-Density & Saturation Letters	(3,228.7)	$0.0916	($295.6)
H-D & Saturation Flats & Parcels	(8,439.1)	$0.1033	($871.8)
Carrier-Route	(7,569.4)	$0.0886	($671.0)
Letters	(59,146.9)	$0.1096	($6,481.6)
Flats	(10,443.7)	($0.0271)	$282.5
Non-Flat Machineables & Parcels	(210.0)	($0.0081)	$1.7
Periodicals Mail	(3,148.5)	($0.0611)	$192.2
Package Services	(3.4)		$ (0.1)
Bound Printed Matter Flats	(0.8)	$0.2742	($0.2)
Bound Printed Matter Parcels	(0.7)	$0.2415	($0.2)
Media and Library Rate Mail	(1.8)	($0.1405)	$0.3
TOTAL MARKET-DOMINANT MAIL	**(105,689.0)**		**$(11,431.2)**

This contribution loss is $8.665 billion more than the $2.766 billion estimate in Order No. 1926. Assuming, again, a constant annual contribution rate of $1.809 billion from the exigent surcharge, this approach would extend the approximate surcharge period from Order No. 1926's 1.53 years to a corrected estimate of 6.33 years.

As previously emphasized, all 105.7 billion of these are pieces recognized in the Commission's spreadsheets as lost to recession-related factors. Therefore, nothing in these estimates would require reconsideration of any of the econometric models, or how the econometric models were interpreted by the Commission in Order No. 1926. This is entirely in accord with the court's rejection of the various "econometric" challenges posed from either side.[57] Thus, for example, consistent with the approach adopted in Order No. 1926, in which the direct effects of the Employment variable encapsulated the entirety of the effects of the Great Recession on domestic First-Class Mail, all of the component pieces of the above domestic First-Class Mail estimates come straight out of the Employment column in the Commission spreadsheet.

When compared with the FY2008-FY2012 actual total Market Dominant cumulative volume loss of 183.5 billion pieces, these 105.7 billion pieces may appear to constitute over one-half of the actual volume loss. But it must be recalled that the actual loss of 183.5 billion is, in fact, the net result of factors (population, trends, inflation, and other factors) that *increased* volume in the 2008-2012 period by 96.0 billion pieces, and other factors that *reduced* volume by 279.5 billion pieces.[58] Therefore, the above estimate of loss caused by the Great Recession actually constitutes only about *38 percent* of the loss caused by all factors reducing volume over the relevant five years.

As important as what the above volume loss estimates include, however, are the volume losses that are not included. First and foremost, they exclude the 39.1 billion pieces already reflected in Table Two of the Thress Statement as cumulatively lost due to ongoing electronic diversion. Thus, for example, the above estimate of 13.5 billion pieces of First-Class Mail lost due to the Great Recession over the FY2008-FY2012 period is well *under one-half* of the 35.7 billion pieces of First-Class Mail that Mr. Thress specifically identified as lost due to ongoing electronic diversion over that period. Regardless of the merits of the criticism that earlier Postal Service estimates

[57] *Alliance of Non-Profit Mailers*, slip op. at 3, 15, 18-19.

[58] *See* Thress Statement, Table Two at 10.

overattributed to the Great Recession and underattributed to electronic diversion, that criticism is plainly inapplicable to the above set of estimates.[59]

Those circumstances, moreover, relate directly to what else is excluded from the above estimates. As reflected in his Table Two, Mr. Thress' models allocate 87.1 billion

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[59] The notion that the Postal Service's earlier exigent analysis failed to sufficiently account for the long-anticipated effects of electronic diversion is premised on the broad pre-recession consensus that increasing electronic alternatives to mail would continue to produce declining mail volumes. That consensus is reflected, for example, in the analysis presented by the President's Commission Report in 2003. But page iv of the President's Commission Report shows two sets of mail-volume projections, with the more pessimistic projection – *i.e.*, the projection reflecting a *greater* impact of electronic diversion – being as follows:

A Costly Status Quo: Projected Mail Volumes & Fiscal Health *(in millions)*

Year	2002	2003	2007	2012	2017
Mail Volume	202,822	202,200	208,900	201,500	181,700

"Two Scenarios for Future Mail Volumes, 2003-2017," Greg Schmid, Institute for the Future, May 2003 (prepared for the President's Commission), available on the Commission website as Library Reference NALC-LR-N2010-1/4 (Docket No. N2010-4, Aug.3, 2010) at 8.

But by 2012, even that pessimistic forecast turned out to be grossly *optimistic*. At 159.9 billion pieces, actual volume in 2012 declined well below the forecasted level for 2012 of 201.5 billion pieces, and was already well below the forecasted level for *2017*. Clearly, notwithstanding the President's Commission's views of increased electronic diversion, it did not expect volume to plunge as it did in the five years following 2007 -- the peak years of the Great Recession – because its forecast assumed that "real GDP would increase by between 2.5% and 3.0% per year over the next 10-15 years," that advertising and communications spending (which had "been growing faster than overall GDP growth over the last two decades") would "continue to grow slightly faster than GDP," and that "the trend for the number of [financial] accounts to grow faster than the number of households would continue." "Two Scenarios for Future Mail Volumes, 2003-2017," *supra*, at 6. The Great Recession totally confounded those economic assumptions, as the data presented by Mr. Thress showed, *see* POIR 3, Q 1; POIR 6, Q 5, Q8, Q19; POIR 9, Q 2, which explains why the drop in mail volume dramatically exceeded the projection. The President's Commission, like everyone else, expected and accounted for electronic diversion, but did not foresee the Great Recession.

Just as the President's Commission report did not project that electronic diversion would produce a rapid decline in mail volume that occurred primarily in 2008 and 2009, neither did the contemporaneous projections of the Commission or the Postal Service. In April 2007, following an omnibus rate proceeding that featured a significant debate about electronic diversion, the Commission forecasted that total domestic volume would be 210.8 billion pieces in FY2007, 210.7 billion pieces in FY2008, and 213.2 billion pieces in FY2009. *See* http://www.prc.gov/Docs/56/56406/vf_ar06PRCLR23.xls (filed April 27, 2007) ("Attachment A" tab. FY2007 forecast can be seen at Column AO, Row 116; FY2008 is at Column AV, Row 116; and FY2009 is at Column BC, Row 116). The Commission's FY2007 forecast proved to be slightly pessimistic, while its FY2008 and FY2009 forecasts proved to be wildly optimistic (and, in fact, are consistent with Mr. Thress' findings of what volume would have been in FY2008 and FY2009 absent the effects of the Great Recession, as illustrated most vividly in his response to POIR 6, Q.1).

The only unforeseen event postdating these forecasts was the hammer blow of the Great Recession. The approach outlined above by the Postal Service, which still results in substantially more of the FY2008-FY2012 First-Class Mail volume loss being explicitly attributed to electronic diversion than to the Great Recession, could plausibly be criticized as implicitly attributing relatively too much to "long-expected" diversion and relatively too little to the Great Recession, but not vice-versa.

pieces of lost mail volume across the FY2008-FY2012 period to the effects of linear intervention variables (55.8 billion in First-Class Mail and 31.3 billion in Standard Mail). Mr. Thress interprets these variables as reflecting unanticipated changes in mail volume in response to the Great Recession, as distinguished from the “macro” variables which reflect anticipated changes in response to Great Recession “macro” conditions (i.e., *if* mailers had reacted to them in a manner consistent with how mailers had previously reacted to changes in “macro” conditions).[60] Mr. Thress thus attributed these lost volumes to the effects of the Great Recession, whereas the Commission in Order No. 1926 declined to accept that interpretation of the nonlinear intervention variables. Consequently, those 87.1 billion pieces are totally excluded from the above estimates.

It should also be noted that Order No. 1926 acknowledges that some portion of the volume loss captured by the linear variables may have been due to the effects of the Great Recession,[61] but the Commission chose not to explore the matter further. Therefore, regardless of the actual cause of that lost volume, it is not included in the above estimate of 105.7 billion pieces lost due to the Great Recession.

One further issue that may be raised regarding the reasonableness of the above set of estimates is one articulated clearly by the Commission for the first time only in its attempt to defend to the court its reliance on the “count once” rule. The Commission raised the concern that, of a given number of pieces that are identified as lost due to the macro-economic effects of the Great Recession in one year, some portion of those pieces may be ones that, even in the absence of the Great Recession, would have been lost to electronic diversion in a subsequent year anyway. At that point in time, those

[60] Thress Statement at 7; POIR No. 3, Question 5.

[61] Order No. 1926, at 77.

pieces can fairly be said to be lost for two reasons (the Great Recession *and* electronic diversion), so if the object of the exercise is to identify pieces lost *exclusively* to the Great Recession, it could be argued that the portion representing overlap should be omitted from the count of Great Recession losses in those later years.

Regardless of whatever superficial merit that concern may have in theory, there is no valid basis in practice, considering the context of the above set of estimates, to fear that the proposed estimates are overstated. Recall, for example, that the total cumulative estimate of lost First-Class Mail due to accepted Great Recession factors shown above is only 13.5 billion pieces. Even if it is assumed for purposes of discussion that some small fraction of the 13.5 billion pieces identified as lost due to the Great Recession fell into the overlap category, it must also be remembered (as discussed above) that there are an additional 55.8 billion lost pieces of First-Class Mail which are accounted for only in the accepted models by the linear intervention variable. The Commission in Order No. 1926 refused to accept the analysis of Mr. Thress that all 55.8 billion of those pieces were lost due to the Great Recession. Yet, as even the Commission appears to concede on page 77 of Order No. 1926, there is plainly some portion of those 55.8 billion pieces which, in fact, were lost due to the Great Recession. If, for example, only a quarter of the 55.8 billion pieces (or 13.9 billion pieces) were actually Great Recession pieces, that amount would exceed the *entire* amount of the 13.5 billon pieces directly identified by the Employment variable and incorporated into the above estimate. In reality, therefore, any theoretical concern that an estimate based exclusively on the macro variables might overstate the loss because of some small fraction of overlap is utterly swamped by the vastly greater probability that the estimate is understated because of the complete exclusion of pieces lost due to unanticipated changes beyond those directly encapsulated in the macro-economic variables.[62]

In summary, the above estimates of 105.7 billion pieces of mail and $11.4 billion of contribution lost due to the Great Recession reflect the most reasonable approach to "counting" the volume losses identified by the Commission in its spreadsheets.

C. <u>Counting Continuing Standard Mail Losses in FY2010</u>.

As discussed in section III.B.3 above, if the Commission is not inclined, as it should, to count continuing losses until FY2013 for all mail classes, it should at least harmonize the cutoffs for First-Class Mail and Standard Mail. Doing so (coupled with counting continuing losses until the Order No. 1926 cutoffs, per section IV.A, but keeping all other variables and methodologies consistent with Order No. 1926) yields a figure of *56.010 billion* pieces lost due to the Great Recession.

PRC Estimates: (Eliminate Count Once, Carry Standard Mail Over Through FY2010)									
(Market-Dominant mail, millions of pieces)									
	FY2008	FY2009	FY2009	FY2010	FY2010	FY2011	FY2011	FY2012	**2008 -12**
	First Time	First Time	Annual	First Time	Annual	First Time	Annual	Annual	
First-Class Mail	(582.7)	(1,863.9)	(2,446.7)	(1,043.3)	(3,490.0)	0.0	0.0	0.0	**(6,519.4)**
Standard Mail	(5,350.0)	(15,572.0)	(20,922.0)	0.0	(20,922.0)	0.0	0.0	0.0	**(47,193.9)**
Periodicals Mail	(110.3)	(377.2)	(487.4)	(352.3)	(839.7)	(15.8)	(855.5)	0.0	**(2,292.9)**
Package Serv.	0.0	(3.4)	(3.4)	0.0	0.0	0.0	0.0	0.0	**(3.4)**
TOTAL	**(6,043.0)**	**(17,816.5)**	**(23,859.5)**	**(1,395.6)**	**(25,251.7)**	**(15.8)**	**(855.5)**	**0.0**	**(56,009.6)**

As the table below shows, this volume loss translates into a contribution loss of *$5.847 billion*.

[62] An alternative way to put this in perspective is to note that in each of the First-Class Mail rows of the FY2008 Annual, FY2009 Annual, and FY2010 Annual columns shown above, the Single Piece component of the accepted annual recession-related loss (i.e., Employment) is less than 19 percent of the corresponding actual Single-Piece volume loss, measured against the F2007 benchmark volume. An estimate that fewer than one out of each five pieces of Single Piece mail missing in those three core recession years was lost due to the Great Recession is hardly likely to be overstating the harm from the exigent circumstances.

	FY08-FY12 Lost Vol	Unit Cont	Total Lost Cont
First-Class Mail	(6,519.4)		$ (1,730.3)
Single-Piece Letters	(3,753.6)	$0.2430	($912.2)
Single-Piece Cards	(208.8)	$0.1137	($23.7)
Presort Letters	(2,104.0)	$0.2770	($582.9)
Presort Cards	(140.1)	$0.1831	($25.7)
Flats	(325.7)	$0.5789	($188.5)
International Mail	12.8	$0.2064	$2.6
Standard Mail	(47,193.9)		$ (4,256.5)
High-Density & Saturation Letters	(1,690.6)	$0.0916	($154.8)
H-D & Saturation Flats & Parcels	(4,427.4)	$0.1033	($457.4)
Carrier-Route	(3,973.9)	$0.0886	($352.3)
Letters	(31,423.7)	$0.1096	($3,443.6)
Flats	(5,565.8)	($0.0271)	$150.6
Non-Flat Machineables & Parcels	(112.4)	($0.0081)	$0.9
Periodicals Mail	(2,292.9)	($0.0611)	$140.0
Package Services	(3.4)		$ (0.1)
Bound Printed Matter Flats	(0.8)	$0.2742	($0.2)
Bound Printed Matter Parcels	(0.7)	$0.2415	($0.2)
Media and Library Rate Mail	(1.8)	($0.1405)	$0.3
TOTAL MARKET-DOMINANT MAIL	**(56,009.6)**		**$ (5,847.0)**

This contribution loss is $3.081 billion more than the $2.766 billion estimate in Order No. 1926. Assuming, again, a constant annual contribution rate of $1.809 billion from the exigent surcharge, this approach would extend the approximate surcharge period from Order No. 1926's 1.53 years to a corrected estimate of 3.23 years.

As explained above, the most reasonable option readily available at this time to count up the volume losses identified in the Commission spreadsheets as lost to the Great Recession is to continue counting through FY2012, up to the year (FY2013) that the Commission has elsewhere acknowledged the Postal Service was finally able to show improvements in its controllable operating results from the cost-cutting initiatives begun earlier in response to the plunge in volume. As also explained above, the resulting quantification of harm (in the form of lost contribution to the recovery of institutional costs) is nonetheless an extremely conservative one, quite likely understating actual harm by a significant margin. Necessarily, therefore, an even more conservative estimate that (beyond eliminating the effects of the “count once” rule) only harmonizes the counting process by ending both Standard Mail and First-Class Mail at the end of FY2010 is even *more* likely to understate actual harm by far greater amounts. All of the elements discussed above that are excluded from the broader lost volume estimate (105.7 billion pieces) and lost contribution estimate ($11.4 billion) are likewise excluded from the more narrow estimates shown above of 56 billion pieces and $5.8 billion. Additional exclusions (beyond the 39 billion pieces explicitly lost to electronic diversion, and the 87 billion missing pieces accounted for the linear intervention variables, and beyond the losses in the years before 2008 and after 2012), are the 7 billion pieces of First-Class Mail and 42 billion pieces of Standard Mail that even the Commission agrees were first lost due to the Great Recession, but are now *not* being recognized as carryover losses in FY2011 and FY2012. As with all of the other excluded pieces, refusing to count those pieces does not alter the fact that, in reality, they are still missing, and the models account for them in no other way.

Under this more conservative view, only *20 percent* of the volume loss caused by all factors reducing volume by 279.5 billion pieces over the five-year period beginning in FY2008 would be attributed to the Great Recession, with 80 percent of the loss being attributed to some other cause.[63]

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[63] Another noteworthy feature of this scenario is the implication, directly carried over from Order No. 1926, that the only volume losses from the Great Recession that extended into FY2011 were those experienced in Periodicals, which, because Periodicals as a class is underwater, is tantamount to the dubious claim that the only effects of the Great Recession on the Postal Service’s finances in FY2011 were *beneficial*.

V. EXTENDING THE EXIGENT SURCHARGE IS REASONABLE AND EQUITABLE AND NECESSARY, AND IS OTHERWISE CONSISTENT WITH THE POLICIES UNDERLYING THE CURRENT PRICE CAP

The Postal Service has demonstrated that the amount of contribution lost "due to" the Great Recession should be increased from what the Commission determined in Order No. 1926, thereby extending the exigent surcharge for an additional, but still-defined, period of time. In this section, the Postal Service discusses how extending the surcharge also conforms to the requirement that the surcharge be "reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." As demonstrated below, the reasoning employed by the Commission in Order No. 1926, finding that the existing exigent surcharge meets these standards, compels a conclusion that extending the surcharge as proposed by the Postal Service is "reasonable and equitable and necessary."

While the Commission found that the exigent surcharge met the "reasonable and equitable and necessary" standards, it raised other concerns that the Postal Service's original exigent request in this docket, which did not propose a definite end-point to the surcharge, was inconsistent with the policies of the current pricing system set forth in Section 3622(d).[64] As discussed above, the Postal Service does not propose an indefinite surcharge in these comments. Rather, the Postal Service proposes that the

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If, to avoid this anomalous result, the cut-off date of FY2011 solely for Periodicals were instead harmonized in this scenario with the FY2010 cut-off date for First-Class Mail and Standard Mail, that would reduce the overall Periodicals volume loss by the 855.5 million pieces (as shown in the table above), and thereby increase the net contribution loss by $52 million (as shown on page 106 of Order No. 1926).

[64] *See* Order No. 1926 at 174-75.

surcharge be extended until it generates $11.4 billion in contribution in total from when it was first instituted in January 2014.[65] This fact fundamentally distinguishes the Postal Service's current proposal from its earlier proposal, and addresses the concerns raised by the Commission in Order No. 1926 concerning whether the earlier proposal was consistent with the policies underlying the price cap.

A. Extending the Surcharge is "Necessary".

In Order No. 1926, the Commission noted that the question under the "necessary" clause is whether an "exigent rate increase would be necessary to maintain and continue the development of needed postal services, even if the Postal Service uses best practices of honest, efficient, and economical management."[66] In answering this question, the Commission recognized that the Postal Service's ability to maintain an adequate level of liquidity is "necessary" to ensure that the Postal Service can "both maintain the Nation's needed postal services and continue the development of those services."[67] In particular, the Commission noted that the Postal Service must have sufficient liquidity to cover current and anticipated operating expenses, make necessary capital investments, and have some cushion to absorb "sudden, unforeseen declines in

[65] This would mean that the surcharge would extend for approximately another four years beyond the date by which it would be eliminated solely by correcting the "count once" error (for a total of six years). Extending the surcharge so that it extends for approximately 6 years (until early-to-mid 2020) would, as a practical matter, mean that the surcharge would extend through the Commission's 10-year review of the market-dominant ratemaking system. 39 U.S.C. § 3622(d)(3). In that review, the Commission is tasked with fundamentally re-examining the regulatory structure, and designing a system that best achieves the "objectives" of Section 3622(b). At that point in time, any continuation of the rate levels which include the surcharge past that review would not be because of the continuing statutory force of the current exigency provision, but because the Commission has concluded that continuing those rate levels is needed to achieve the objectives.

[66] Order No. 1926 at 125.

[67] *Id.* at 119.

volumes or increases in costs" in order to "maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States."[68]

The same considerations demonstrate that continuation of the exigent surcharge as proposed by the Postal Service above is clearly "necessary." The Postal Service's liquidity situation remains precarious: as of the end of the second quarter of FY2015, the Postal Service had liquidity of $6.1 billion, or only approximately 22 days of operating expenses, of which $2.5 billion was attributable to the collection of the exigent surcharge. The Postal Service also remains at the debt limit of $15 billion, meaning it is wholly dependent on generating revenue from operations in order to continue functioning; as witness Nickerson has previously noted, the Postal Service lacks any foreseeable means of paying off this debt.[69] While the Postal Service's liquidity situation has improved somewhat from prior years, $6.1 billion of liquidity remains wholly inadequate for an organization of the size of the Postal Service, and is certainly not indicative of anything approaching "a significant change in financial health" that would render the continuation of the surcharge unnecessary.[70]

Furthermore, the Postal Service's recent improvement in liquidity has occurred in large part *because of* the exigent surcharge, as the Commission has recognized.[71] Of

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[68] *Id.* at 116, 119-122.

[69] *Id.* at 108.

[70] *Id.* at 117-118 (rejecting argument that improvements in the Postal Service's liquidity prior to implementation of the exigent surcharge meant that the surcharge was not "necessary").

[71] *See* FY2014 Financial Analysis at 9 ("The exigent rate surcharge significantly increased revenue over FY2013. Table II-3 (next page) shows a total of $2 billion in additional revenue generated from increases in average revenue per piece. The exigent rate surcharge accounted for almost $1.3 billion of the increase."). *See also id.* at 25 ("As a result of the increased revenues generated by the exigent surcharge on Market Dominant products, the cash and cash equivalents balance is at its highest level in 4 years."); *id.* at 28 ("Total Market Dominant revenue increased in FY 2014 despite a decline of more than 3 billion pieces in total Market Dominant volume. As noted in Chapter 2, all of the increase in revenue was driven by the exigent rate surcharge implemented in January of 2014.").

course, the additional revenue and contribution provided by the surcharge will no longer be generated when the surcharge is removed. Thus, to even maintain liquidity at its current precarious level, the Postal Service would need to find some way to replace the lost contribution from removing the surcharge. However, the Postal Service faces the very same upward cost pressures that the Commission recognized in Order No. 1926 would make it difficult to keep costs at existing levels, much less capture significant additional cost savings.[72] It is also continuing to lose significant amounts of contribution each year due to the continued declines in First-Class Mail, even as the number of delivery points increase each year. Furthermore, it is unrealistic to expect that the lost contribution could be provided entirely through increases in competitive product revenues.[73] Therefore, eliminating the additional contribution from the exigent surcharge will simply exacerbate the Postal Service's already-precarious liquidity position, threatening its ability to maintain efficient and effective postal services.

The revenues generated from the exigent surcharge are particularly needed in order to ensure that the Postal Service has the ability to fund necessary capital expenditures. As the Commission noted in Order No. 1926, the Postal Service cannot make capital investments without adequate liquidity, and capital investments are essential to ensuring the continued provision of postal services adapted to the needs of the United States.[74] Therefore, while the deferral of capital spending has been a

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[72] Order No. 1926 at 118.

[73] In FY2014, the contribution provided by competitive products increased by $450 million from the prior year, a 10 percent increase. FY2014 Financial Analysis at 39. There would have to be an approximately 40 percent increase in the contribution provided by competitive products – which are by definition subject to intense competition – to cover the lost contribution from removing the exigent surcharge.

[74] Order No. 1926 at 119-121. *See also* FY2014 Financial Analysis at 20, 22 (noting that "[b]ecause the Postal Service exhausted its statutory borrowing limit in FY 2012, it now relies on revenues to fund capital

necessary short-term response to the financial difficulties facing the Postal Service, "capital outlays *must be increased* in order for the Postal Service to maintain and continue to develop the Nation's needed postal services."[75] The Commission thus approved the exigent surcharge in order to enhance the Postal Service's "ability to make the investments necessary to maintain universal service and continue the development of the Nation's needed level of postal services."[76] An extension of the surcharge is also needed to achieve this goal, considering the Postal Service's still-precarious liquidity position and the significant capital expenditures that it must begin making in areas such as new delivery vehicles and facilities maintenance.[77]

At the same time that the Postal Service faces increasing cost pressures and the need to increase its capital investments, the Postal Service's ability to achieve significant savings along the lines of what it has been able to accomplish in prior years is inherently limited, as the Commission has recognized. As discussed previously in this proceeding, the Postal Service has been able to achieve significant cost reductions consistent with the exercise of "honest, efficient, and economical management," efforts

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expenditures," and that "[a]ll current activity is financed with internally generated cash, which severely limits the Postal Service's capability to invest in productive assets.").

[75] Order No. 1926 at 120 (emphasis in original). *See also id.* at 121 ("The consequences of continued low levels of liquidity and related low levels of capital investment are significant to the entire postal system. If the Postal Service is unable to repair, maintain, and replace its fleet of delivery vehicles, it could very quickly lose its ability to meet the delivery requirements of the USO [i.e., universal service obligation]. Similarly, if important pieces of machinery are unable to be repaired and replaced, service performance and the Nation's 'ready access' to postal services will be substantially impacted"); FY2014 Financial Analysis at 23-24 (noting how "limited capital investments…has hindered growth and productivity enhancements in key infrastructure assets required for primary postal operations"). Similarly, the General Accountability Office has recognized the importance of capital spending to the Postal Service's achievement of its mission to provide prompt and reliable postal services, as well as the Postal Service's need to increase capital spending going forward. GAO, *U.S. Postal Service: Actions Needed to Strengthen the Capital Investment Process*, GAO-14-155 at 2 (2014).

[76] Order No. 1926 at 121.

[77] As the Postal Service noted in its most recent Form 10-Q, needed capital expenditures may be "as much as an additional $8.0 billion for the period of 2016 through 2020." Quarter II, 2015 Report on Form 10-Q at 27.

that the Commission has described as "commendable."[78] These efforts have continued since Order No. 1926 was enacted: for instance, in FY2014, the Postal Service completed the Phase I closures and consolidations of mail processing facilities, reduced mail processing workhours and the productive hourly wage rate, and increased TFP.[79]

However, many of the benefits of the Postal Service's cost-reduction initiatives have been fully realized, and the opportunity for significant *additional* savings are inherently limited by the need to provide effective service (i.e., "postal services of the kind and quality adapted to the needs of the United States").[80] The Commission has explicitly recognized this, noting that "additional savings" from processing and delivery operations "cannot be achieved without a further reduction in service or mailing service standards."[81] The Commission also noted that the Postal Service's public-service mandate requires it to strike a "balance [between] financial responsibility and the need to provide postal services of the kind and quality adapted to the needs of the United States."[82] For example, the biggest source of cost savings for the Postal Service has

[78] Order No. 1926 at 131-136; Order No. 547 at 61 n.48, 80-86. *See also* Postal Service Reply Comments at 91-108; Postal Service Renewed Exigent Request at 22-35. The Postal Service has reduced the costs of its mail processing, retail, and delivery networks, through initiatives such as Phase I of Network Optimization, POStPlan, and delivery route optimization. Reductions in labor costs have also been achieved through the continued reduction in the number of employees, as well as savings enabled by the last round of collective bargaining and interest arbitration (including the increased use of non-career employees). Since 2006, the Postal Service has eliminated over 350 million workhours, while reducing the number of career employees by over 200,000, all while continuing to deliver the mail to an ever-expanding number of delivery points.

[79] FY2014 Financial Analysis at 13-17.

[80] Order No. 1926 at 118.

[81] *Id.*

[82] *Id.* at 127-28 & n.119. *See also id.* at 131 ("Unlike a private enterprise, the Postal Service must consider the impact of its cost-cutting activities on its ability to continue to provide postal services consistent with the policies of title 39, United States Code.").

been in the reduction of workhours, but the opportunity for additional workhour savings under existing conceptions of appropriate service is constrained.[83]

The need to continue providing adequate service also inherently constrains the Postal Service's ability to continue reducing the total number of employees, and future savings in wages and benefits costs for those employees can be achieved only through the collective bargaining and binding interest arbitration process. While the Postal Service has been working, and will continue to work, towards additional savings in the new round of collective bargaining, the outcome of that process is uncertain.

As the Commission has noted, the essential question for purposes of the "honest, efficient, and economical management" inquiry is whether the exigent surcharge is rendered "less necessary or unnecessary" because of the Postal Service's management practices, considered in light of the "unique framework within which the Postal Service must operate."[84] The Commission rejected arguments that various Postal Service management practices rendered the exigent surcharge unnecessary or less necessary, such as Valpak's claim that the Postal Service should move immediately to replace door delivery with centralized delivery.[85] As detailed above, nothing has changed since that date that would render that conclusion less valid today. Indeed, when it comes to door delivery, the benefits of the careful, deliberative approach described by the Postal Service in its earlier Reply Comments continue to fully accord with the views of the Commission that the Postal Service "must consider the

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[83] In FY2014, workhours in delivery increased, as they did in FY2013. This is reflective, among other things, of the general fact that "reducing delivery costs in response to declining volumes is challenging, because '[c]osts associated with the time it takes carriers to walk or drive their route will not change noticeably if mail volumes decline.'" *Id.* at 133 (citing Order No. 547 at 84-85).

[84] Order No. 1926 at 124-128.

[85] *Id.* at 131-138.

impact of its cost-cutting activities on its ability to continue to provide postal services consistent with policies of title 39, United States Code," and that it had not been shown that eliminating door delivery "would also allow the Postal Service to maintain and continue to develop postal services of the kind and quality adapted to the needs of the United States."[86]

The Postal Service will continue to act in accordance with "honest, efficient, and economical management," by responsibly providing postal services consistent with the Nation's postal needs in an efficient manner.[87] In particular, the Postal Service will continue to pursue all available means of enhancing efficiency in its retail, processing and delivery networks while maintaining levels of services adapted to the needs of the United States, and of addressing wages and benefits costs through collective bargaining and interest arbitration.[88] But, even with the continuation of prudent management consistent with the standard of "honest, efficient, and economical management," the Postal Service's financial situation is currently precarious, and will remain so going forward, meaning the continuation of the exigent surcharge is clearly "necessary."

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[86] *Id.* at 131, 134-35.

[87] The Postal Service anticipates that some commenters may point to the recent delay in the full implementation of Phase II as evidence that the Postal Service is not acting in accordance with "honest, efficient, and economical management." The decision to delay full implementation was made to ensure that the Postal Service continues to provide reliable service consistent with existing service standards, and thus accords with the Commission's direction that the Postal Service balance cost savings against ensuring continued service. *Id.* at 127. Furthermore, the delay is irrelevant to whether to extend the exigent surcharge, considering both that the Postal Service will resume further closures and consolidations in 2016, and that the continuation of the surcharge remains "necessary" even if Phase II were still being implemented at this time.

[88] As previously discussed, labor costs are outside the scope of the "honest, efficient, and economical" standard, due to section 505(b) of the PAEA. *See, e.g.*, Renewed Exigent Request at 20-21.

B. <u>Extending the Surcharge is Reasonable</u>.

The Commission noted that the "reasonable" standard is "evaluated from the perspective of the overall percentage increase in rates requested by the Postal Service as well as the amount of contribution the Postal Service is forecasted to generate."[89] Considerations involved in this inquiry include the potential for rate shock, "whether mail elasticities might adversely affect the potential exigent rate recovery by reducing demand more than is expected," and the statutory objectives and factors.[90] Based on these factors, the Commission found that a 4.3 percent increase would generate approximately $1.8 billion a year in contribution, which it determined was "reasonable."

Extending the existing 4.3 percent surcharge is "reasonable" for the same reasons. Despite dire predictions by numerous commenters that implementation of the exigent surcharge would exacerbate the Postal Service's financial problems,[91] the Commission rejected such arguments, and in fact the surcharge has significantly benefited the Postal Service.[92] There is no basis for the Commission to draw a different conclusion here than it drew in Order No. 1926.

In addition, continuation of the surcharge would not cause rate shock any more than did the implementation of the surcharge in the first place. The Commission found that raising prices by 4.3 percent would not cause rate shock, considering "increases well above 4.3 percent for particular products and rate categories are commonplace," and there was "no indication that these increases resulted in serious financial harm to

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[89] Order No. 1926 at 155.

[90] *Id.* at 36.

[91] *Id.* at 148-155.

[92] *See* FY2014 Financial Analysis at 9, 25, 28.

mailers."[93] Here, continuation of the exigent surcharge would not even constitute an increase in the rates that mailers are paying today, but would simply keep prices at existing levels.

Extending the exigent surcharge would also be consistent with the relevant objectives and factors of Section 3622. In Order No. 1926, the Commission first noted that implementing the increase would be consistent with the objectives and factors because it would enhance the Postal Service's liquidity, which was substantially diminished due to the losses from the Great Recession, and therefore would improve its ability to provide high quality service, make needed capital investments, and "absorb financial adversity."[94] As discussed above, the same is true with respect to extending the surcharge. Furthermore, the Commission found that the Postal Service had acted consistent with factor (c)(3) "by proposing a moderate overall increase and aligning the increase to what mailers could more easily bear."[95] Clearly, this conclusion also applies to a temporary extension of the surcharge, particularly considering the Postal Service's current proposal incorporates a specific end-date, whereas its earlier proposal did not.

C. Extending the Surcharge is Equitable.

The Commission noted that the "equitable" clause considers rate design issues, and concluded that an across-the-board surcharge met that standard because "the particular circumstances surrounding the Great Recession do not necessitate differentiated price increases for various classes of mail."[96] In particular, the

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[93] Order No. 1926 at 157.

[94] *Id.* at 158.

[95] *Id.*

[96] Order at 166.

Commission noted that it is appropriate to consider rate design issues not through a temporary exigent surcharge, but through CPI increases.[97] The Postal Service and the Commission recently successfully completed, in Docket No. R2015-4, the first general CPI increases since the implementation of the exigent surcharge.[98] In that docket, price design changes and price differentiation were achieved without disturbing the across-the-board nature of the exigent surcharges.

The same considerations apply to extending the surcharge as proposed by the Postal Service. While the time period of the surcharge would be extended, it would still be a "limited-term increase," meaning there is no basis to conclude that it should be jettisoned and replaced by an exigent surcharge with differentiated prices. The Postal Service has, and will continue to, address any rate design issues through the normal price-increase processes.

D. <u>Extending the Surcharge is Consistent with the Policies Underlying the Current Price Cap</u>.

Extending the temporary surcharge as proposed by the Postal Service cannot rationally be viewed as obviating the incentives underlying the current price cap. In Order No. 1926, the Commission stated that an exigent increase resulting from the Great Recession could not be imposed indefinitely, because the Postal Service has a continuing obligation "to respond to revenue losses by reducing costs or improving efficiency," particularly by "downsizing its network to align it with much lower volumes."[99]

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[97] *Id.* at 167.

[98] *See* Order No. 2472 (May 7, 2015).

[99] Order No. 1926 at 3, 175-78.

Approval of the Postal Service's requested approach here is fully consistent with these principles.

First, the Postal Service does not propose an indefinite increase, but an increase that is tied to the recovery of a discrete amount of contribution that was clearly lost "due to" the Great Recession. Second, there is simply no rational way to conclude that the approving the continuation of the surcharge would "suspend or eliminate" the Postal Service's obligation to be efficient. To the contrary, the Postal Service is asking the Commission merely to recognize the actual point at which its efforts to enhance efficiency and to adjust to the volume losses due to the Great Recession actually allowed the Postal Service to achieve some measure of stability after the upheaval of the Great Recession. Therefore, there is no basis to conclude that allowing this increase would subvert the purposes of the current price cap or be inconsistent with the principle that the exigency clause is a narrow exception to the cap.

The Postal Service's obligation to respond to revenue losses through greater efficiency is of course true as a general principle. However, as a guide to rational decision-making that principle must be applied not simply through superficial recitation, but by considering the actual circumstances facing the Postal Service, including the statutory and operational realities under which it operates.[100] As noted above, the Postal Service's efforts to improve its efficiency through downsizing have been well-documented in this docket. Furthermore, the Commission has explicitly recognized that the Postal Service operates under a "unique framework" that requires it to ensure that it

[100] As the Commission has noted when discussing the proof required under the "due to" clause, "[v]ague generalizations and unsupported conclusory statements are not sufficient." Order No. 864 at 49. The same is equally true with respect to assertions that extending the surcharge in accordance with a rational application of the "new normal" standard would vitiate the Postal Service's incentives to be efficient.

provides service consistent with the policies of title 39, that efforts to reduce costs must take into account those policies, and that "additional savings" in processing and delivery operations "cannot be achieved without a further reduction in service or mailing service standards."[101] Based on these practical considerations, the Commission has rejected arguments that the exigent increase should be denied because the Postal Service has failed to adhere to "honest, efficient, and economical management."[102]

Therefore, when considering the factors that the Commission has already recognized underlie the "honest, efficient, and economical management" standard, and the Postal Service's adherence to that standard, it would be fundamentally irrational to refuse to extend the exigent surcharge based on a claim that such a refusal is necessary to ensure that the Postal Service continues to act efficiently. Considering the economic conditions facing the Postal Service, including First-Class Mail volume that is continuing to decline, the need to increase revenue and contribution through package growth in a highly competitive marketplace, the need to increase capital spending, and its precarious liquidity position, the Postal Service certainly does not lack for incentives to be efficient. These incentives will not change simply because the Postal Service is allowed to generate approximately $1.8 billion in additional contribution each year for several more years. Extending the surcharge would, on the other hand, provide an important source of additional contribution to ensure that the Postal Service can continue providing postal services adapted to the needs of the United States.

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[101] Order No. 1926 at 118, 123-131.

[102] *Id.* at 131-138. Indeed, in the face of the only instance in which a commenter actually made a specific proposal for how the Postal Service should further downsize the network—Valpak's proposal that the Postal Service eliminate door delivery—the Commission found that "Valpak has not shown that converting from door delivery would also allow the Postal Service to maintain and continue to develop postal services of the kind and quality adapted to the needs of the United States." *Id.* at 134-35.

Finally, the Commission cannot permissibly decline to extend the exigent surcharge for several more years based on a concern that doing so would address issues with regard to the Postal Service's business model that should more properly be resolved by Congress through postal reform legislation. For two reasons, it is not enough simply to say that a revenue increase will enable the Postal Service to cover costs that could potentially be reduced through the enactment of postal reform legislation. First, it is Congress's prerogative to dictate the conditions under which the Postal Service operates, and, as the Commission has previously recognized, its role in applying the exigent provision is not to incentivize Congress to make different policy choices.[103] As such, the Commission cannot permissibly narrow the duration of the exigent surcharge based not on the rational application of the exigent provision, but on a view that the Postal Service should instead seek to reduce costs through the enactment of postal reform legislation implementing reforms that the Commission considers appropriate (though other stakeholders may not). This is especially true when considering issues relating to labor costs, in view of Section 505(b) of the PAEA. Second, when considering an exigent circumstance that manifests itself in a loss of revenue, it will *always* be possible to make the claim that allowing the Postal Service to recover those losses is an attempt to address other factors that implicate the Postal Service's costs, since a loss of volume, and hence revenue, is problematic in that it affects the Postal Service's ability to continue covering its institutional costs. The only costs that are relevant in rejecting or narrowing an exigent increase are those that reflect the Postal Service's failure to follow "honest, efficient, and economical

[103] Order No. 896 at 42.

management." By definition, costs that are outside the Postal Service's control do not violate that standard. In any event, even if these concerns could have had some validity with respect to the Postal Service's original request in this docket, which did not specify a definitive end-date for the increase, they do not apply to the temporary extension of the surcharge requested here.

VI. CONCLUSION

For the reasons discussed above, the Commission should recalculate the amount of mail volume and contribution lost "due to" the Great Recession. First, it must correct the "count once" error identified by the court. Second, it should reconcile its conflicting statements concerning when the Postal Service could reasonably have been expected to "adjust" to the reduced level of mail volume produced by the Great Recession, and should find that such point was at the beginning of FY2013. Alternatively, it should harmonize the differing treatment of Standard Mail and First-Class Mail concerning the Postal Service's ability to adjust.

Respectfully submitted,

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