

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

Section 701 Report

Docket No. PI2016-3

COMMENTS OF PITNEY BOWES INC.
(June 14, 2016)

Pitney Bowes Inc. (Pitney Bowes) respectfully submits these comments pursuant to Order No. 3238, which invited public comment on matters concerning the operation of the provisions of the Postal Accountability and Enhancement Act (PAEA) and ideas for legislative reform in connection with the Postal Regulatory Commission's (Commission) preparation of its upcoming "701 Report."¹ Section 701 of the PAEA directs the Commission to submit a report to the President and the Congress at least every five years regarding how well the PAEA is operating, and recommending measures the Commission or the Congress could undertake to improve the effectiveness and efficiency of postal system. These comments address: (1) the U.S. Postal Service's financial situation, (2) worksharing, (3) negotiated service agreements, (4) nonpostal services, and (5) market tests.

A. Postal Service Financial Situation

In its 2011 701 Report, when addressing the Postal Service's financial condition, the Commission recommended that Congress modify the prefunding level and payment schedule for the Postal Service Retiree Health Benefit Fund (PSRHBF). *See* 2011 Report at 21-23. The 2011 Report also recommended that any overstated Civil Service Retirement System (CSRS)

¹ *See* Pub. L. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

liabilities could be used as a potential remedy for the PSRHBF issues. *See id.*, at 24. Pitney Bowes continues to support those recommendations and respectfully requests the Commission include similar recommendations in its 2016 701 Report because restoring the financial integrity of the Postal Service is critical to the long-term vitality of an efficient and effective U.S. postal system.

The Postal Service continues to face financial challenges on and off its balance sheet. Changes in the law necessary to address these challenges have been proposed and are being considered by Congress. The Commission should recommend in its 2016 701 Report additional, complementary measures that would strengthen the Postal Service's financial position.

In written testimony submitted to the House Oversight and Government Reform Committee, Postmaster General Brennan identified several specific financial relief proposals, including: (1) "requir[ing] OPM to calculate FERS and CSRS liabilities using postal-specific salary growth and demographic assumptions," (2) "establish[ing] a proces by which any FERS surplus would be returned to the Postal Service," (3) "requir[ing] OPM to create separately rated postal plans within the FEHBP, . . . which would be fully intergrated with Medicare Parts A, B, and D," (4) "requir[ing] OPM to calculate the RHB actuarial liability on the basis of annuitant net claims cost, rather than premiums" and "requir[ing] the Postal Service to make actuarially-based RHB prefunding payments," and (5) "requir[ing] that a portion of the existing assets in the PSRHBF be invested in a manner designed to replicate the performance of the longest-term L Fund in the Thrift Savings Plan."²

The proposals described above are specific elements of a financial relief package that Pitney Bowes and other industry stakeholders, including the Postal Service, mailers, mail service

² *Reforming the Postal Service: Finding a Viable Solution*: May 11, 2016 Hearing Before the House Oversight and Government Reform Committee, 114th Cong. 2d Sess., (written testimony of Megan J. Brennan, Postmaster General and Chief Executive Officer, U.S. Postal Service, at 11-14).

providers, and postal labor, are supporting to help stabilize the Postal Service's financial condition. Pitney Bowes respectfully urges the Commission to recommend that Congress adopt these financial relief proposals in its 2016 Report.

B. Workshare Discounts

Order 3238 specifically invited comments on the "current operation of the provisions regarding workshare discounts, as well as insights on how the discounts and exceptions have functioned in practice." Order at 6. The workshare provisions have not worked well in practice. That the Postal Service has not set workshare discounts equal to the full value of the avoided costs has frustrated the efficiency goals of the PAEA and distorted upstream competitive mail processing markets.³ The Commission can and should revise its workshare regulations to fix this problem by requiring the Postal Service to set discounts equal (or as close as practicable) to the avoided costs.

The Commission should use the 701 Report to explain that even though Congress did not include language that specifically precluded the Postal Service from passing through less than the avoided costs, the Commission has the authority to adopt such a rule, and given its experience with the current workshare rules, a Commission rule requiring workshare discounts be set equal to avoided costs is necessary to give effect to the statutory objectives and factors and to ensure fair competition in competitive, upstream mail processing markets. *See* 39 U.S.C. §§ 3622(b) and 3622(c).

The PAEA included, for the first time, a statutory definition of workshare discount and required the Commission to establish rules and specific reporting requirements for workshare

³ *See* Docket No. ACR2015, Comments of Pitney Bowes Inc. (Feb. 2, 2016) at 3-4 (chart and narrative discussing how passthroughs that are persistently and increasingly inconsistent with efficient component pricing rule have frustrated the efficiency goals of the PAEA and distorted competitive upstream competitive markets for mail processing).

discounts as part of a modern system for regulating rates. *See* 39 U.S.C. § 3622(e)(1)(a) workshare discount, as defined in the PAEA is “provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission.”). Workshare discounts are one of the few areas where the PAEA requires cost-reflective prices. Section 3622(e)(2) states that “[t]he Postal Regulatory Commission shall ensure that such discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity,” unless specified exceptions are met. 39 U.S.C. § 3622(e)(2).

While the statute sets a ceiling for workshare discounts, it does not directly address whether the Commission should establish a presumptive floor for such discounts. Pitney Bowes respectfully submits that the Commission not only has the authority to require that the Postal Service set workshare discounts equal to, or as closely as practicable to, 100 percent of the costs avoided, but that a rule requiring that workshare discounts be set equal to, or as close as practicable to, 100 percent of the costs avoided is necessary to give effect to the objectives and factors of the PAEA as a whole.

The Commission has the authority to establish and, as necessary, revise by regulation the “modern system of regulating rates,” 39 U.S.C. § 3622(a). The Commission will have the opportunity to review its workshare rules as part of the mandatory review of the “modern rate system” required under 39 U.S.C. § 3622(d)(3).⁴ In doing so the Commission may require, by regulation, that the Postal Service set workshare discounts equal to avoided costs. Once issued through notice and comment rulemaking, those regulations would legally bind the Postal Service.

⁴ We need not address questions as to the potential scope of the ten year review at this time, i.e., whether the statutory requirements are subject to potential modification or replacement, because we are not advocating for the modification or replacement of section 3622(e)(2) or any other statutory requirement. *See* Docket. No. RM20167-9, Petition of the United States Postal Service for the Initiation of a Proceeding to Clarify the Scope of the Review of the System for Regulating Market-Dominant Rates and Classes (Apr. 7, 2016). Rather, we are advocating that the Commission exercise its authority to revise the workshare regulations that it established under section 3622(a) -- authority that the Commission indisputably has regardless of the scope of the ten year review.

See Batterton v. Francis, 432 U.S. 416, 425 (1977)(regulation adopted pursuant to delegated authority after notice and comment rulemaking has “legislative effect”).

The Commission has established analogous rules in other contexts. For example, section 3622(d)(1) specifies that rate increases for market-dominant products shall be limited to the rate of inflation. The PAEA specifies the use of the non-seasonally adjusted Consumer Price Index and addresses certain other details of the cap, but is silent as to other details, leaving implementation of the unaddressed matters to the Commission. The Commission established a rulemaking to develop the rules for implementing the price cap that are now found in 39 CFR Part 3010, which governs the means of calculating the aggregate percentage change in rates for each class, which requires weighting of the set of rates that comprise a class. The Commission, by rule, selected a backward-weighted index (Laspeyres) for purposes of pre-implementation review of proposed price adjustments, rather than a forward-weighted volume index (Paasche). Those rules are now legally binding on the Postal Service.

A rule that would presumptively set workshare discounts equal to avoided costs would similarly address a matter not expressly addressed in the statute, and falls well within the Commission’s rulemaking powers.

The establishment of a general rule that workshare discounts be set equal to, or as close as practicable to, avoided costs unless specified justifications are present is also a permissible construction of section 3622(e). The Commission may establish such rules unless the statute “unambiguously forecloses” it. *See, e.g., Northeast Hosp. Corp. v. Sebelius*, 657 F.3d 1, 4 (D.C. Cir. 2011) (quoting *Nat’l Cable & Telecomm. Ass’n v. FCC*, 567 F.3d 659, 663 (D.C. Cir. 2009) (deferring to an agency construction that was not “unambiguously foreclose[d]” by the statute)). *Accord, National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S.

967, 980-83 (2005) (agency’s course of action permissible unless the “statute unambiguously forecloses” it). As the Commission has previously recognized, the PAEA does not unambiguously foreclose such a rule. *See* Docket No. ACR2007, Annual Compliance Determination (Mar. 27, 2008) at 97 (“the requirements of the PAEA do not directly address workshare discounts that are below 100 percent of avoidable costs”).

The Commission is granted substantial deference to develop such rules provided that the rule is “based on a permissible construction of the statute.” *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843-44 (1984). Indeed, if the “agency’s construction is reasonable, *Chevron* requires a federal court to accept the agency’s construction of the statute, even if the agency’s reading differs from what the court believes is the best statutory interpretation.” *Brand X*, 545 U.S. at 980. *Accord*, *Van Hollen v. FEC*, 811 F.3d 486, 492 (D.C. Cir. 2016)(noting the “wide latitude [courts] afford agencies when interpreting statutes: we do not demand the *best* interpretation, only a reasonable one.”) (emphasis in original); *see also UC Health v. NLRB*, 803 F.3d 669, 675 (D.C. Cir. 2015) (requiring deference if an agency construction is “reasonable and consistent with the statute’s purpose”); *Kennecott Utah Copper Corp. v. United States Dept. of Interior*, 88 F.3d 1191, 1206 (D.C. Cir. 1996) (*Chevron* step two requires affirmance of the agency if it considered the matter in a detailed and reasoned fashion and its interpretation is arguably consistent with the underlying statutory scheme). *Chevron* also makes clear that consideration of the “wisdom of its policy on a continuing basis” is the business of the agency, not the courts. 467 U.S. at 863-64. *See id.* at 866 (“federal judges – who have no constituency – have a duty to respect legitimate policy choices made by those who do.”).

Nothing in the statute forecloses the Commission’s establishment of a general rule that

requires that workshare discounts be set equal to, or as close as practicable to, avoided costs. The statute only states that workshare discounts may not exceed avoided costs. When discounts exceed avoided costs, the mailer has price incentives to perform postal functions that the Postal Service can perform at a lower cost. In that instance, the discount can introduce inefficiencies and increase costs. The statutory ceiling explicitly requires the Commission to ensure that this does not occur unless a circumstance expressly stated in the statute is present. But neither this statutory ceiling nor its underlying rationale apply to a Commission determination that the statutory objectives and factors of the PAEA are best served by a rule requiring that workshare discounts be set equal to, or as close as possible to, avoided costs. To the contrary, such a rule would address the analogous inefficiencies caused by setting discounts below avoided costs which encourages the Postal Service to perform work that mailers and mail service providers could perform at a lower cost. The absence of an explicit requirement to establish a presumptive floor on workshare discounts does not relieve the Commission from its responsibility to design a modern rate system, because such a rule would best give effect to the objectives and factors of the PAEA.

Section 3622(b) requires the Commission to establish a modern rate system that is designed to “maximize incentives to reduce costs and increase efficiency.” 39 U.S.C. § 3622(b)(1). This is one of many statutory objectives and factors, but as applied to worksharing, this objective can be fully met *only* by requiring that workshare discounts be set equal to, or as close as practicable to, avoided costs.

Prior to the enactment of PAEA, the Commission generally required that workshare discounts be set equal to the costs avoided by the Postal Service.⁵ In regulatory economics this pricing principle is referred to as Efficient Component Pricing (ECP). As the name suggests, the idea is to develop access prices for the individual components of a service with the goal of promoting the most efficient use of each component. In the case of worksharing, each discount is effectively the price of a processing or transportation step in the Postal Service's network that is avoided. From the perspective of the Postal Service, ECP-based worksharing prices optimize the most efficient "make or buy" decisions in setting access prices to its network. Mailers or mail service providers will choose to perform a particular workshare activity *if and only if* the mailer's cost is less than the discount offered, making it profitable for the mailer to do the work. Mailers will choose to do the work themselves only when it is cheaper for them to do so, thus benefiting the overall economy and society at large by ensuring that postal products are utilized at the lowest possible cost. The savings can then be used to stimulate investment in new technology and new uses of the mail, increasing mail volume and maximizing productive efficiency. The efficiency enhancing benefits of ECP are well documented in the economic literature⁶ and in testimony before the Commission.⁷

⁵ See e.g., Docket No. R2006-1, Op. and Rec. Decision (Feb. 26, 2007), at ¶ 4005 ("Since [Docket No. MC95-1], broad support has grown for applying [efficient component pricing (ECP)] in the development of mail processing workshare rates. Indeed, in every subclass that has worksharing discount rates, both the Postal Service and the Commission strive to obtain an ECP outcome, i.e., a one-hundred percent passthrough of the avoidable cost savings."); Docket No. MC95-1, Op. and Rec. Decision (Jan. 26, 1996), at ¶ 4256 ("In order to send a signal to producers that will ensure that competitive components of postal services (worksharing discounts) are produced at the least cost to society, the efficient component pricing rule prescribes that their rates be set equal to the monopolist's marginal cost (or average incremental cost) for producing that component.").

⁶ R. Cohen, M. Robinson, J. Waller, and S. Xenakis (2006), "Worksharing: How Much Productive Efficiency, at What Cost and at What Price?" in *Progress Toward Liberalization of the Postal and Delivery Sector* (Springer), edited by M. Crew and P. Kleindorfer; J. Haldi and W. Olson (2003), "An Evaluation of USPS Worksharing: Postal Revenues and Costs From Workshared Activities," in *Competitive Transformation of the Postal and Delivery Sector*, (Kluwer) edited by M. Crew and P. Kleindorfer; R. Mitchell (1999), "Postal Worksharing: Technical Efficiency and Pareto Optimality," in *Emerging Competition In Postal and Delivery Services* (Kluwer), edited by M. Crew and P. Kleindorfer; and E. Pearsall (2005), "The Effects of Worksharing and Other Product Innovations on

The Commission has likewise consistently and vigorously endorsed efficient component pricing as a “guiding principle” in rate design to promote productive efficiency.⁸ *See, e.g.*, Docket No. RM2007-1, Order No. 43 (Oct. 29, 2007) at 41. The Commission has also noted that “passthroughs below 100 percent send inefficient price signals to mailers,” and has therefore “encourage[d] the Postal Service to adjust discounts to bring passthroughs closer to 100 percent.” Docket No. ACR2014, Annual Compliance Determination Report (Mar. 27, 2015) at 69. Indeed, the Commission has expressly recognized that workshare discounts that fail to pass through the full value of the avoided costs are inconsistent with section 3622(b)(1):

Although the requirements of the PAEA do not directly address workshare discounts that are below 100 percent of avoidable costs, the first objective in 39 U.S.C. § 3622(b) is “[t]o maximize incentives to reduce costs and increase efficiency.” Passthroughs below 100 percent typically indicate inefficiencies.

U.S. Postal Volumes and Revenues in Regulatory and Economic Challenges in the Postal and Delivery Sector (Kluwer), edited by M. Crew and P. Kleindorfer.

⁷ Dr. John Panzar has provided a detailed theoretical analysis of Efficient Component Pricing (“ECP”), the principle that work-sharing discounts should be set equal to the per unit avoided costs of the Postal Service on numerous occasions. *See, e.g., Docket No. R2006-1, Direct Testimony of John C. Panzar on behalf of Pitney Bowes Inc., PB-T-1 (Revised), (Oct. 31, 2006) at 16-24* (ECPR-based worksharing discounts in postal ratemaking should be set equal to the per unit avoided costs of the Postal Service); Docket No. RM2007-1, *Initial Comments of John C. Panzar on behalf of Pitney Bowes Inc. In Response to Advance Notice of Proposed Rulemaking on Regulations Establishing a System of Ratemaking* (Apr. 6, 2007) at 7-12 (setting workshare discounts equal to the per unit avoided costs of the Postal Service will minimize the total costs and increase the overall productive efficiency of the postal sector by inducing mailers and mail service providers to choose to perform workshare functions if and only if they can perform the work at a lower cost than the Postal Service; setting workshare discounts at less than the per unit avoided costs of the Postal Service will exclude some equally efficient or more efficient mailers or mail service providers from performing workshare functions.); Docket No. ACR2011, *Comments of John C. Panzar Submitted on behalf of Pitney Bowes*, at 1, 5 (Feb. 3, 2012)(“Worksharing discounts below avoided costs exclude efficient competitors in the upstream mail processing market from access to the monopoly delivery network of the Postal Service.” . . . “Deviating from [efficient component pricing] reduces productive efficiency and raises serious competition policy concerns.”).

⁸ Other reviews have reached similar conclusions. A General Accounting Office “Primer on Postal Worksharing,” (July 2003), noted the Commission’s guideline for recommending worksharing discounts that “the estimated reduction in USPS revenues will equal the estimated reduction in USPS costs,” resulting in a 100 percent pass through of the expected USPS savings to the mailer. Primer, at 33. The GAO further noted that “[w]orksharing discounts with 100 percent pass through create an incentive for the lowest-cost provider to do the work,” and cautioned that if the discounts are less than 100 percent “some lowest-cost providers may not have an incentive to workshare.” *Id.* *See also Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, Report of the President’s Commission on the United States Postal Service, (Jul. 31, 2003), at 87 (“The Postal Service should focus on its core competency - delivering the mail. Where private companies can deliver portions of the nation’s postal service or specific related functions better and at lower cost, those tasks should be outsourced.”).

The Postal Service should examine such potential inefficiencies and work to set rates which more fully reflect efficient component pricing.⁹

Several other PAEA rate setting objectives and factors also directly support the Commission adopting a rule requiring that workshare discounts be set equal to, or as close as practicable to, avoided costs.

The PAEA expressly requires the Commission to take account of “the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service.” 39 U.S.C. § 3622(c)(5). Again, the Commission has previously recognized that a rule requiring that workshare discounts be set equal to avoided costs would give effect to this statutory factor:

While the PAEA does not impose a minimum passthrough of avoided costs for workshare discounts, parts of the PAEA (including section 3622(b)(1) on incentives to increase efficiency and section 3622(c)(5) on reflecting the degree of mail preparation) do provide a rationale for promoting efficient mailing choices by mailers. Setting workshare discounts as close as feasible to 100 percent of avoided costs helps to promote these goals.¹⁰

The PAEA also requires that the Commission consider the “importance of pricing flexibility to encourage increased mail volume and operational efficiency,” *id.* § 3622(c)(7), and the “need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postage rates.” *Id.* § 3622(c)(12). A rule that encourages worksharing activities that increase operational efficiency and reduce costs would be consistent with these directives. And it would serve the objective of establishing a “just and reasonable schedule for rates and classifications,” *Id.* § 3622(b)(8), because setting workshare discounts below avoided costs has the effect of discouraging or excluding more efficient mailers or mail service providers from accessing competitive upstream components of

⁹ Docket No. ACR2007, *supra* at 97.

¹⁰ Docket No. ACR2009, Annual Compliance Determination (Mar. 29, 2010) at 73.

the postal service supply chain - mail processing, transportation, and the like.

Unfortunately, more recent statements have not sufficiently recognized the Commission's authority and responsibility under the PAEA to impose such a rule. For example, in the FY2014 Annual Compliance Determination, the Commission stated:

Although the Commission concurs that the Postal Service should set its workshare discounts at avoided costs, it is not unlawful to set discounts below avoided costs.

The worksharing requirements of Title 39 impose a ceiling but not a floor on passthroughs. See 39 U.S.C. § 3622(e)(2). The Commission notes that passthroughs below 100 percent send inefficient price signals to mailers. Therefore, it encourages the Postal Service to adjust discounts to bring passthroughs closer to 100 percent. The Commission, however, recognizes that the PAEA gives the Postal Service pricing flexibility and encourages it to balance its own needs with those of its customers.¹¹

While it is correct to state that setting workshare discounts below avoided costs is not “unlawful” in the absence of a Commission rule establishing such a requirement, that statement should not end the inquiry. Rather, it highlights why it is necessary for the Commission to establish a legal binding rule requiring the Postal Service to set workshare discounts equal to avoided costs. The same is true for the observation that setting discounts below avoided costs does not violate the limitations of section 3622(e)(2). Similarly, the fact that the statute imposes a ceiling but no floor does not answer the question of whether the Commission ought to establish a presumptive floor for such discounts. For the reasons cited above, such a rule is a permissible construction of the statute and is necessary to fulfil the intent of Congress and to give effect to the objectives and factors of the PAEA as a whole.

¹¹ Docket No. ACR2014, Annual Compliance Determination (Mar. 27, 2015) at 70, 76-77.

The Commission also reads far too much into section 3622(b)(4) by elevating this generalized notion of pricing flexibility as a paramount consideration that could outweigh the clear and frequently recognized benefits of a presumptive floor on workshare discounts. Section 3622(b)(4) requires the Commission to establish a modern rate system that is designed to “allow the Postal Service pricing flexibility.” 39 U.S.C. § 3622(b)(4). This objective is one of multiple objectives and factors, many of which strongly encourage operational efficiency, which in the context of workshare pricing can only be maximized by requiring that workshare discounts be set equal to, or as close as practicable to, avoided costs.¹² Pricing flexibility, alone, is insufficient to justify the Postal Service’s persistent practice of setting workshare discounts below avoided costs; a practice that affects the substantial majority of mail volumes and which the Commission has previously acknowledged is inconsistent with the other, competing objectives and factors of the modern rate system. While the statutory pricing flexibility objective may be appropriately realized as a general matter in a number of other procedural and substantive contexts, it is inappropriate in the context of workshare discounts to the extent “flexibility” leads to increased costs and decreased efficiency.

The general objective of pricing flexibility expressed in section 3622(b)(4) must be read in context with the more specific statutory pricing flexibility factor in section 3622(c)(7). Section 3622(c)(7) states that the Commission in establishing or revising the modern rate system must take account of “the importance of pricing flexibility to encourage increased mail volume and operational efficiency.” 39 U.S.C. § 3622(c)(7). This establishes that pricing flexibility is not a good in and of itself, but rather a good to the extent that it encourages increased mail

¹² See Docket No. RM2009-3, Order Adopting Analytical Principles Regarding Workshare Discount Methodology (Nov. 14, 2010) at 33-36 (noting that section 3622(b)(4) is one among many statutory objectives and factors; recognizing the tension is inherent between section 3622(b)(4) and sections 3622(b)(1) and 3622(c)(12); and dismissing “pricing flexibility” as paramount or overarching qualitative statutory objective).

volume and operational efficiency. Setting workshare discounts at less than 100 percent of the avoided costs, fails to promote (and, in fact, often cuts against) these two enunciated rationales of pricing flexibility. In general, passing through less than 100 percent of the avoided costs would only promote increased mail volume when, for example, the price elasticity of the non-workshare category is higher than the workshare category. But a few examples show that to be very likely the exception rather than the rule. In First-Class Mail Presort Letters, the price elasticity is estimated at the product level, not the rate category level. Thus, the elasticity of the non-workshare and workshare category for the vast majority of Presort Letters is estimated to be the same. In two instances for First-Class Mail Letters, the workshare category (Mixed AADC Automation Letters and Nonautomation Presort Letters) is in a different product than the nonworkshare category (Metered Letters) and thus has a different estimated price elasticity. In these instances, the price elasticity of the workshared categories is higher than for the nonworkshare category. *See* Econometric Demand Equation Tables for Market Dominant Products as of January 2016 (Jan. 20, 2016). Accordingly, a workshare discount set at less than 100 percent of the avoided costs would likely harm mail volume. Application of pricing flexibility that discourages mail volume and frustrates operational efficiency is directly inconsistent with the intent and purpose of the PAEA.

An alternative justification, that the Postal Service's persistent practice of setting discounts below avoided costs may be justified on the grounds that the PAEA encourages the Postal Service to "balance its own needs with those of its customers," is also unavailing. It is unclear which competing interests the Commission would be trying to balance and there is no statutory basis to support this position.

Setting discounts below avoided costs harms customers and fails to maximize social welfare because it fails to minimize total combined costs of mail, fails to maximize productive and allocative efficiency and, thus, is inconsistent with the PAEA. Setting workshare discounts below the avoided costs discourages or excludes mailers and mail service providers who could otherwise perform the work more efficiently than the Postal Service from doing so. This is bad for the Postal Service and bad for its customers. For example, the First-Class Mail Automation Letters 5-Digit discount is currently set at only 64 percent of the modeled avoided costs. It costs the Postal Service 3.6 cents to sort a First-Class Mail Automation Letter to 5-Digits from the approved 3-Digit / AADC benchmark, but it is currently only “paying” mailers and mail service providers 2.3 cents to perform the same work. If the discount were increased in the direction of a full passthrough, the Postal Service would save money on every additional piece sorted by a mailer or mail service provider, the total costs of postage would be reduced for the mailer, and it would encourage operational efficiency.

Setting discounts below avoided costs also raises competition policy concerns because it has the effect of excluding more efficient mailers and mail service providers from competitive upstream services (presorting, prebarcoding, handling, or transportation of mail). Setting workshare discounts below costs is thus anticompetitive and exclusionary. Because the Postal Service is statutorily immune from the antitrust laws with respect to market dominant products covered by the private express statutes, *see* 39 U.S.C. § 409(e), the Commission must play a more active role to ensure fair competition in these upstream markets. In failing to prescribe a presumptive floor on workshare discounts the Commission has not done so.

To the extent the Commission’s reference to the Postal Service’s balancing of its “own needs with those of its customers” is meant to suggest the Postal Service’s economic self-interest

may inform how it sets its workshare prices, the consideration is invalid. The U.S. Court of Appeals for the District of Columbia Circuit recently ruled that it was a violation of the Fifth Amendment’s Due Process Clause for an economically self-interested government entity to regulate or set the terms of competition for its competitors. *See Association of Am. Railroads v. DOT*, No. 12-5204, slip op. (D.C. Cir. Apr. 29, 2016). The syllogism applied by the court to Amtrak applies with equal or even greater force to the Postal Service: if giving an economically self-interested government entity regulatory authority over its competitors violates due process; and PAEA were interpreted to give an economically self-interested government entity (the Postal Service) regulatory authority over its competitors (by allowing workshare discounts, a form of access pricing, to be set at competitively harmful levels); then the PAEA would violate due process. *See id.*, at 11. The Commission can avoid this result only by assuring that workshare discounts reflect the efficiency goals of the PAEA and not the Postal Service’s self-interested “own needs.”

A Commission rule that required the Postal Service to set workshare discounts equal to, or as close as practicable to, 100 percent of the avoided costs could be qualified in two respects.

First, the Commission could fashion a rule that required the Postal Service to set workshare prices equal to avoided costs without unduly burdening the Postal Service flexibility to price in a manner that encourages mail volume and efficiency. This could be accomplished by imposing a regulatory requirement that implemented a “soft floor” (similar to the current ceiling). The rule would only affect workshare rates, it would not impair the Postal Service’s pricing flexibility with respect to the many other types of shape-based, non-workshare, and most cross-product rate differentials. Such a rule could also be structured to allow the Postal Service to phase in the adjustments over a set period of time if necessary to avoid rate shock.

Second, the Commission rule could allow certain exceptions to the new requirement that the Postal Service set workshare discounts equal to, or as close as practicable to, 100 percent of the avoided costs. The Commission's existing workshare rules require the Postal Service to justify workshare discounts set "substantially below" avoided costs. *See* 39 C.F.R. § 3010.14(b)(6). That rule is legally binding on the Postal Service but it has not been effectively enforced; the Postal Service offers only perfunctory justifications and the Commission has never required corrective action. The existence of the rule demonstrates that Commission was aware in 2007 that passthroughs below 100 percent are a problem; but more is required given the Postal Service's persistent practice of setting workshare discounts below avoided costs.

Because it is highly unlikely that requiring workshare discounts to be set equal to, or as close as practicable to, avoided costs would hurt mail volume or efficiency, any deviation from the presumptive floor should require a robust quantitative justification. For example, in general, workshare prices that comply with ECP will improve efficiency, but an exception similar to the statutory exception under section 3622(e)(2)(D) could be included for circumstances in which departures from ECP prices were shown to enhance efficiency. Similarly, there could be an exception to the presumptive floor based on a showing that ECP pricing would hurt mail volume; for example a quantitative showing based upon analysis of price elasticity or similar data. The exercise of these exceptions would likely be uncommon, but a provision for such exceptions would serve as an appropriate recognition of the competing statutory objective of efficiency and mail volume growth.

For all of the reasons stated above, the Commission should extend its regulatory history and practice and establish a rule that requires worksharing discounts to be set equal to avoided

costs wherever possible, with deviations permitted only with specified justifications consistent with the objectives and factors of the PAEA.

C. Nonpostal

Order No. 3238 specifically invites comments as to whether “the Postal Service should be permitted to offer [nonpostal services] . . . and, if so, whether and how the Commission should review new nonpostal services.” Notice at 9.

Pitney Bowes has been consistent in its position that the Postal Service should focus on its core competency, the delivery of physical mail and packages .¹³ Prior experience with commercial nonpostal services demonstrated that the Postal Service’s attempts to compete in adjacent, non-core markets were seldom profitable and often resulted in the distortion of private markets and the diversion of scarce resources and management attention from the Postal Service’s core responsibilities to provide “adequate and efficient postal services at fair and reasonable rates and fees.” 39 U.S.C. § 403(a). Accordingly, the Postal Service should not be permitted to offer commercial nonpostal services.

The Postal Service should be permitted to provide other governmental services to state, local and tribal governments subject to prior approval by the Commission. The Postal Service should be permitted to offer governmental services when it is in the public interest and where it is able to recover the costs of providing such services. Governmental services do not raise the same unfair competition concerns as commercial nonpostal services. Therefore, the Postal Service can permissibly be encouraged to leverage its ubiquitous retail network and the extensive knowledge base of its letter carrier workforce in providing governmental services to state, local and tribal governments. Permitting the Postal Service to offer expanded governmental services

¹³ See e.g., Docket No. MC2008-1, Initial Comments of Pitney Bowes Inc. (Sep. 10, 2008); Docket No. MT2011-2, Comments of Pitney Bowes Inc. (Feb. 4, 2011).

has broad support among industry stakeholders and within the Congress.

D. Market Tests

Section 3641 of the PAEA grants the Postal Service authority to conduct market tests of experimental products. Current law authorizes the Commission to approve and regulate Postal Service market tests, both to protect the public interest and to ensure that: (1) the product is significantly different than all products offered by the Postal Service within the prior two years; (2) the product will not create an unfair competitive advantage for the Postal Service or any mailer; and (3) the Postal Service identifies the product as either market dominant or competitive. *See* 39 U.S.C. § 3641(b).

The Postal Service has a long history of product innovation and experimentation, and Pitney Bowes supports the development of innovative, new *postal* products. Although the Commission has approved a variety of the new product offerings and market tests, none of these ventures have had a material effect on the Postal Service's financial condition. That is likely a function, in part, of the statutory limitations on the duration and anticipated revenues for market tests under the current law; market tests may not exceed 24 months in duration without an approved extension, and total anticipated revenues may not exceed \$10 million in any fiscal year, without an exemption. *See* 39 U.S.C. §§ 3641(d) and (e).

To the extent the Commission recommends that Congress modify the limitations on the duration or the anticipated revenue cap, Pitney Bowes respectfully urges that the Commission recommend a proportionate increase in the burden of proof that the Postal Service is required to meet to seek approval. For example, a more fully developed market assessment should be required to demonstrate that the "introduction or offering of the product will not create an unfair

or otherwise inappropriate competitive advantage for the Postal Service.” 39 U.S.C. § 3641(a)(2).

E. Negotiated Service Agreements

Section 3622(c)(10) requires the Commission to take into account the “desirability of Special classifications for both postal users and the Postal Service in accordance with the policies of title 39, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that (A) either improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or enhance the performance of mail preparation, processing, transportation, or other functions; and (B) do not cause unreasonable harm to the marketplace.” 39 U.S.C. § 3622(c)(10).

The experience with negotiated service agreements (NSAs) under the PAEA has been mixed. The Commission has reviewed and approved over 600 NSAs for competitive products since Fiscal Year 2008. *See* <http://www.prc.gov/sites/default/files/NSA%20Update%20November%202015.pdf>. Expedited procedures, clear standards, and robust confidentiality protections have allowed NSAs for competitive products to flourish, benefiting mailers and the Postal Service.

The experience with market dominant NSAs has not been as positive. Only four domestic market dominant NSAs have been approved since Fiscal Year 2008. *See id.* The regulatory approval process is expensive and uncertain and the standard adopted by the Commission for establishing net financial improvements under section 3622(c)(10)(A) has deterred the use and value of special pricing classifications for market dominant products. As a consequence, the Postal Service has not been able to take advantage of an important tool to grow

or stem the erosion of mail volumes for market dominant products.

The Commission should use the 701 Report to communicate its willingness to reassess how it evaluates risk for market dominant NSAs. A lower burden of proof or higher risk tolerance for market dominant NSAs designed improve the net financial position of the Postal Service is necessary to give effect to the language and intent of section 3622(c)(10). A lower burden of proof is also justified because the treatment of NSAs under the Commission's price cap rules protects other mailers and, thus, ensures there is no unreasonable harm to the marketplace. The Commission should also encourage the Postal Service to pursue market dominant NSAs that will improve the operational efficiency or enhance the performance of mail preparation, processing, transportation and other functions.

Pitney Bowes appreciates the Commission's consideration of these comments.

Respectfully submitted:

_____/s/_____
James Pierce Myers
Attorney at Law
320 South West Street, Suite 110
Alexandria, Virginia 22314
Telephone: (703) 627-5112
E-Mail: jpm@piercemyers.com

Michael F. Scanlon
K&L GATES LLP
1601 K Street, NW
Washington, DC 20006
Telephone: (202) 661-3764
E-Mail: michael.scanlon@klgates.com

Counsel to PITNEY BOWES INC.