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

SECTION 701 REPORT	Docket No. PI2016-3

UNITED STATES POSTAL SERVICE COMMENTS
IN RESPONSE TO ORDER 3238
(June 14, 2016)

Section 701 of the Postal Accountability and Enhancement Act of 2006 (PAEA) requires the Commission to issue a report to the President and Congress this year that (1) discusses "the operation of the amendments made by [the PAEA]"; and (2) makes "recommendations for any legislation or other measures necessary to improve the effectiveness or efficiency of the postal laws of the United States." The Postal Service's dire financial condition is well-recognized by the Commission, and legislative reform is critical to restoring solvency to the Postal Service and stability to the postal industry. Simply put, the PAEA does not enable the Postal Service to fulfill all of the obligations and to pay all of the bills imposed upon it, and if the status quo is maintained, it never will. The Section 701 report is the prime opportunity for the Commission to give Congress its views as to the shape of the statutory changes to the status quo that must be made to return the Postal Service to financial health.

These comments focus attention on the central issues to which the Commission's legislative recommendations to the President and Congress should be directed. Years of Congressional and stakeholder deliberation over comprehensive postal reform legislation have yielded no enacted bill so far. At this point, it is imperative to advance reforms that are capable of both enjoying broad consensus support and positioning the Postal Service to achieve the basic goal of postal policy: the provision of prompt, reliable, and efficient universal postal services in a financially self-sufficient manner. With those objectives in mind, the Commission should, at a minimum, recommend the enactment of the legislative proposal that the Postal Service has submitted to Congress, which addresses certain of the Postal Service's excessive post-retirement benefits costs and would also grant the Postal Service some ability to generate additional revenues.

While statutory reform is a critical step towards addressing the Postal Service's financial situation, it is not a sufficient step by itself. Also of critical importance is replacing the current price cap system that the PAEA established. However, the PAEA already provides a mechanism for the Commission to address the appropriateness of the current price cap, via the regulatory review that must begin in December of this year. Therefore, there is no need for the Commission to recommend in its Section 701 report any legislative changes regarding the regulatory system for market-dominant products, even though that system certainly needs to be replaced or substantially changed. Indeed, it would be inconsistent with the Commission's recent order concerning its authority to resolve issues implicated by that review, if the Commission were to prejudge in this proceeding matters that will be the subject of litigation in the review. Focusing the Section 701 report on statutory reforms, rather than matters implicated in the ten-year review, will ensure that all stakeholders have a full opportunity to present their views, and to respond to the views presented by others, in the course of that review.

I. THE COMMISSION MUST CONTINUE TO ALERT THE PRESIDENT AND CONGRESS TO THE POSTAL SERVICE'S DIRE FINANCIAL CONDITION

The Commission is well aware of the Postal Service's dire financial condition. Most recently, the Commission devoted much of its FY2015 financial analysis report to the subject,[1] and the Commission's Acting Chairman used his testimony to the House Committee on Oversight and Government Reform as another opportunity to sound the alarm.[2] Because the Postal Service's financial condition negatively affects its ability to continue fulfilling its basic universal service mission and other legal obligations, it should be the central topic of discussion when answering the first question posed by Section 701: the effectiveness of the PAEA. Plainly stated, the PAEA has not been effective in certain material respects.

In short, the Postal Service has had a net loss in every year since the PAEA was enacted in 2006. Overall, the Postal Service has incurred cumulative net losses of $56.8 billion from FY2007 to FY2015, and it has exhausted its borrowing authority. The chart below illustrates this situation.

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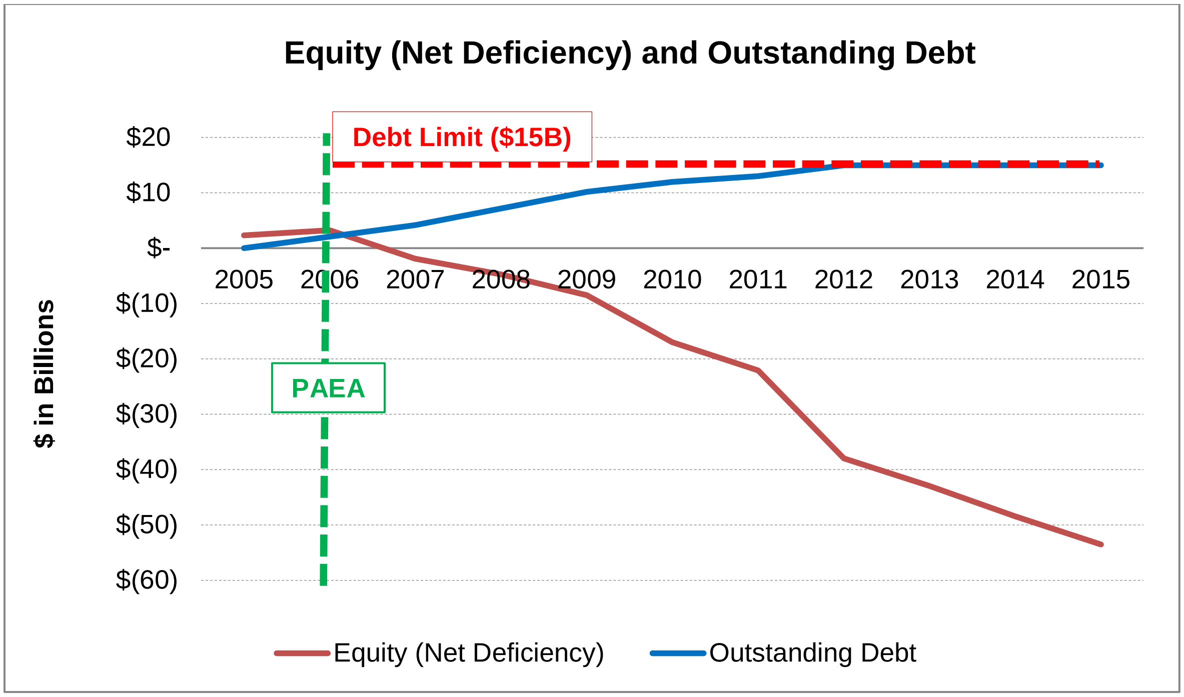
[1] *See generally* Postal Regulatory Commission, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2015 (Mar. 29, 2015) [hereinafter "FY2015 Financial Analysis Report"].

[2] *Reforming the Postal Service: Finding a Viable Solution: Hearing Before the House Oversight & Gov't Reform Comm.*, 114th Cong. (May 11, 2016) (statement of Robert G. Taub, Acting Chairman, Postal Regulatory Commission), https://oversight.house.gov/wp-content/uploads/2016/05/Taub-PRC-Statement-5-11-Postal-Reform.pdf [hereinafter "Taub Testimony"], at 3-20; *see also* House Comm. for Oversight & Gov't Reform, *Reforming the Postal Service: Finding a Viable Solution* (May 11, 2016), https://www.youtube.com/watch?v=FVqXeRGfUh4 (2:08:14-2:10:41) (oral testimony of Acting Chairman Taub) ("The most important thing is the financial balance sheet mess of the Postal Service; that's the house that's on fire that has to be dealt with.").



As discussed in section II.A below, these losses are the result of the confluence of several factors, including the PAEA's unique and onerous requirement that the Postal Service prefund an excessively large retiree health benefits (RHB) liability on an accelerated schedule. However, the Postal Service is in poor financial shape even disregarding those RHB payments, which the Postal Service has not been able to pay since FY2010. Not counting those payments and certain other expenses (the non-cash workers' compensation liability adjustments and, more recently, the amortization payment calculated by the Office of Personnel Management under the Federal Employees Retirement System (FERS)), the Postal Service still had net losses every year between FY2009 and FY2013, and it would have continued to do so in FY2014 and FY2015 but for an exigent surcharge that has since expired.[3]

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[3] *E.g.*, FY2015 Financial Analysis at 1-2 (listing FY2015 net operating income as $1.2 billion and exigent surcharge revenue as $2.1 billion).

The end result of this decade of losses is that the Postal Service has dangerously low liquidity with which to meet its financial needs. It has exhausted its line of credit with the U.S. Treasury. As the Commission has reported, the Postal Service's available cash is insufficient to meet current legal obligations, much less invest adequately in long-deferred but necessary capital investments.[4] The lack of capital to invest "is significant to the entire postal system," as "[i]nsufficient capital investment could impair the Postal Service's ability to meet the delivery requirements of the USO, service performance could be impacted, and access to postal services could be substantially impacted."[5] Nor is the available cash adequate as a financial buffer against adverse circumstances. In his recent testimony, Acting Chairman Taub extensively discussed the Postal Service's insufficient and declining liquidity, cautioning that "[i]f a downturn in the economy or other circumstance should further stress the Postal Service's cash flow, it risks not being able to pay some of its bills and could, in a worst case scenario, run out of cash."[6]

At the same time that the Postal Service has an inadequate level of liquidity, there is a pressing need to make significant additional capital investments in order to

[4] Postal Regulatory Commission, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2014 (Apr. 1, 2015) [hereinafter "FY2014 Financial Analysis Report"], at 2, 22 ("Postal Service liquidity is insufficient to significantly improve operational efficiency. Liquid assets (current assets) are insufficient to meet the payment of current liabilities. . . . All current activity is financed with internally generated cash, which severely limits the Postal Service's capability to invest in productive assets. The initial capital contributions, coupled with small surpluses in the years prior to FY 2006, are not sufficient to fund all the Postal Service's current obligations."); *id.* at 65 ("[The fact that the Postal Service's FY2014 debt ratio is approximately double the historic ten-year average] indicates that the Postal Service does not possess sufficient capital (equity) and cannot raise investment funds beyond basic earnings or borrowing. . . . To reduce its debt ratio to historic averages, the Postal Service would have to increase its current cash position or investments in capital assets and reduce its obligation to the [RHB Fund] and workers' compensation.").

[5] FY2013 Financial Analysis Report at 17.

[6] Taub Testimony at 8. The Postal Service has already been in a position where it cannot "pay some of its bills": it has defaulted on $28.1 billion of mandated RHB prefunding payments. FY2015 Financial Analysis at 32, 76-77.

improve productivity and continue providing prompt, reliable, and efficient universal service. Over the past several years, the Postal Service has been forced to defer all but essential capital investments in order to maintain liquidity: the cumulative amount of deferred or reduced investment since FY2009 amounts to over $8.5 billion. Although this was a necessary short-term response to the Postal Service's financial crisis, the continued deferral of investment cannot be maintained if the Postal Service is to be able to continue providing appropriate levels of service. The Commission has previously recognized these facts, noting both that capital investments are essential to providing universal service, and that capital spending must be increased from current levels.[7] Overall, investments are needed to sustain, modernize, and improve the Postal Service's information technology infrastructure, its facilities and processing infrastructure, and its delivery infrastructure, particularly its aging fleet of delivery vehicles.

Furthermore, the Postal Service has been and will continue to be obligated to make substantial payments to finance the post-retirement benefits that it is statutorily required to provide. Regarding pensions, the Postal Service is obligated to make annual payments to cover normal costs in its FERS account (approximately $3.4 billion,

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[7] FY2014 Financial Analysis Report at 24 ("Capital investments in physical resources are necessary to increase and maintain productivity. For the Postal Service to effectively compete in the e-commerce market, it will need to make capital investments in suitable delivery vehicles. It also needs to replace its existing aging vehicles to accommodate the shift in mail mix toward a larger share of packages relative to letter- and flat-shaped pieces of mail. The Postal Service must also invest in new and efficient mail processing technologies and equipment. However, its ability to make these investments is diminished by the lack of available working capital."); Order No. 1926, Order Granting Exigent Price Increase, PRC Docket No. R2013-11 (Dec. 24, 2013), at 119-122; *see also* United States Postal Service Office of the Inspector General, RARC-WP-16-009, Peeling the Onion: The Real Cost of Mail (Apr. 18. 2016) [hereinafter "OIG, Peeling the Onion"], at 2, 4-5, 14-16 (finding that 2015 capital expenditures were one-half of 2006-2007 levels, well below UPS and FedEx's inflation-adjusted capital expenditures, and lagging behind depreciation and amortization of the Postal Service's assets). The deferred investment in fleet replacement has begun to drag on TFP growth, and the deferred investment in parcel sorting equipment may be hindering growth and efficiency in parcel delivery. FY2015 Financial Analysis Report at 19, 28.

or more, per year through FY2020), and it will soon be subject to a new requirement to amortize the unfunded liability in the Civil Service Retirement System (CSRS) (approximately $1.5 billion per year). In addition, the Office of Personnel Management (OPM) has determined that the Postal Service's FERS account is now underfunded, and that an amortization payment of approximately $0.2 billion is owed (although the Postal Service has appealed that determination). Regarding RHB, while the fixed payment schedule ends this year, the Postal Service will thereafter be required to make annual payments to cover normal costs and amortize the unfunded RHB liability, for a total annual cost (approximately $6.3 billion per year on average through FY2020) that will exceed the fixed payments. Therefore, while the Postal Service will benefit from the fact that the Postal Service Retiree Health Benefits Fund (RHB Fund) will pay annuitant premiums beginning in October of this year, the total average annual normal cost and amortization payments required for post-retirement benefits will be very large, amounting to approximately $11.4 billion, or more, per year through 2020. This is in addition to the approximately $1.4 billion that the Postal Service must pay the Department of Labor each year to cover workers' compensation expenses.

As noted above, the Postal Service has been able to maintain sufficient liquidity to achieve its universal service mission (which requires paying employees and suppliers) only by defaulting on the legally mandated RHB payments. Absent fundamental reforms, the Postal Service faces the prospect of having to continue to default on its obligations moving forward. One possibility would be to default on certain of its RHB and pension obligations. However, simply defaulting on these obligations is not a solution, as it would ultimately deplete the funds set aside to finance the promised benefits. For instance, a long-term series of defaults on actuarially-based RHB payments could exhaust the RHB Fund in just over a decade.[8] The obligation to pay premiums would then revert to the Postal Service, at a time when the Postal Service will have less volume and therefore less ability to cover annuitant premiums. Over the long term, default simply increases the risk that taxpayers may ultimately be called on to fund these benefits, in contravention of a fundamental principle of postal policy: that the Postal Service be financially self-sufficient.

II. THE COMMISSION MUST ACKNOWLEDGE THAT THE POSTAL SERVICE LACKS THE TOOLS TO SOLVE ITS FINANCIAL PROBLEMS ON ITS OWN

A. There Is a Fundamental Mismatch Between the Postal Service's Revenues and Expenses

The Postal Service's financial situation arises from the confluence of four factors.

First, there has been a significant decline in total mail volumes, coupled with changes in the mail mix. Total mail volume has declined by approximately 28 percent since its peak in FY2006, while First-Class Mail, which provides the highest contribution toward the Postal Service's institutional costs, has declined by approximately 36 percent. As a network organization with significant economies of scale and density and revenue generated almost entirely by senders of mail pieces, the Postal Service is highly vulnerable to volume declines, particularly in high-contribution First-Class Mail. The end result of declining total volumes and an increased proportion of lower-margin products is less contribution to cover the Postal Service's institutional costs.[9] While the

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[8] This prognosis reflects reasonable assumptions concerning annuitant premium growth and investment returns.

[9] *See* Postal Regulatory Commission, Analysis of United States Postal Service Financial Results and 10-K Statement for Fiscal Year 2013 (Apr. 10, 2014) [hereinafter "FY2013 Financial Analysis Report"], at ii ("In addition, the change in mail mix, particularly the growth of Standard Mail as a percent of total mail, jeopardizes the Postal Service's ability to cover total costs. This is because Standard Mail generates

decline in mail volume has slowed in recent years, the post-PAEA level shift in volume will not reverse. In fact, these trends of lower total mail volumes, and lower First-Class Mail volumes in particular, are expected to continue as customers increasingly use electronic substitutes to the mail.

Second, the PAEA imposed a strict price cap on market-dominant products, which accounted for 97 percent of total mail volume and 76 percent of total revenue in FY2015. Since average prices generally cannot be raised above the Consumer Price Index for All Urban Consumers (CPI), the Postal Service has been unable to increase prices enough so that the remaining volume generates sufficient contribution to cover the Postal Service's costs.[10] Indeed, as the Commission has noted previously, "[t]he combination of the price cap and the continuing decline of First-Class Mail prevents the Postal Service from generating sufficient funds from mail users to cover its institutional costs."[11]

Third, the Postal Service must maintain a certain infrastructure in order to process, transport, and deliver mail to 155 million delivery points six days per week.

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much lower net revenue per piece than First-Class Mail, and as a result, contributes less towards the Postal Service's overhead costs."); Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2012 (Jan. 3, 2013) [hereinafter "FY2012 PRC Annual Report"], at 29 ("If volume had remained at 2006 levels the combined $7.5 billion in contribution to institutional cost would have been enough to pay the $5.6 billion due to the [RHB Fund] at the end of FY 2012 [on which the Postal Service defaulted] and would have offset most of the $3.5 billion operating loss incurred in FY 2012.").

[10] *See* United States Postal Service Office of the Inspector General, RARC-WP-13-007, Revisiting the CPI-Only Price Cap Formula (Apr. 12, 2013) [hereinafter "OIG Price Cap Report"], at iii ("The present price cap formula was not designed for an environment of falling mail volumes. An unstated assumption under a traditional price cap is that volume will remain stable or preferably grow.").

[11] Postal Regulatory Commission, Annual Compliance Determination, Fiscal Year 2011 (Mar. 28, 2012), at 5; *see also* Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2013 (Jan. 9, 2014) [hereinafter "FY2013 PRC Annual Report"], at 21 (noting that the Postal Service would have needed a 9.6-percent average increase in revenue per piece to cover funding obligations and break even in FY2013, yet the price cap limited the actual average price increase to only 2.57 percent); FY2012 PRC Annual Report at 28 (noting that a 24-percent average increase in revenue per piece would have been necessary to break even in FY2012, but the CPI-based price cap only allowed a 2.133-percent actual average price increase).

The significant costs of that infrastructure are relatively inflexible, due to the inexorable growth in delivery points and other expenses outside of the Postal Service's control.[12] However, despite the fixed or growing costs to maintain the necessary infrastructure regardless of volume, the declining volumes and less profitable mail mix described above means that there is less and less revenue to pay for those network costs.

Fourth, the PAEA provided no new flexibility concerning the Postal Service's cost structure. As the Office of the Inspector General aptly summarized, "legal hurdles to adjusting the size, configuration, compensation, and deployment of the workforce, and stakeholder opposition to changes in the processing, delivery, and retail networks" "have blunted any efficiency-promoting qualities of the [PAEA's] price cap. . . . The result was intensive pressure to economize, but limited ability to do so."[13]

For instance, although the Postal Service is a highly labor-intensive organization, the PAEA gave it no new authority to reduce labor costs, contrary to the advice of the President's Commission on the United States Postal Service. Indeed, the PAEA expressly disclaims any such effect.[14] The Postal Service participates in the federal worker's compensation, pension, and health benefits systems, which are more costly than offered by private sector employers and result in excessive funding obligations, as discussed further in section III.A below. Furthermore, the interest arbitration process inherently constrains the Postal Service's ability to achieve labor cost reductions. In fact, even as it gave the Postal Service no new tools to cut costs, the PAEA saddled the

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[12] OIG Price Cap Report at iv, 4 ("With fewer pieces of mail and more delivery points, each piece of mail has to cover a greater share of the institutional costs of the delivery network. The additional pressure on a product to finance the network as mail volume declines is separate from, and in addition to, increases in inflation.")

[13] *Id.* at ii.

[14] Pub. L. No. 109-435, § 505(b), 120 Stat. at 3236.

Postal Service with significant new expenses in the form of the RHB prefunding schedule.

B. The Postal Service Has Achieved Substantial Cost Reductions Despite These Constraints, But Its Future Potential Is Limited

Within these constraints, the Postal Service has been very successful in reducing its operating costs in order to respond to volume trends. Since the enactment of the PAEA in particular, the Postal Service has rationalized its retail, processing, transportation, and delivery networks, reduced employee complement, and achieved new flexibilities and labor cost reductions through the interest arbitration process.[15] Overall, these efforts have reduced the Postal Service's cost base by approximately $15 billion annually.

The Postal Service has ample and inherent incentive to improve efficiency and reduce costs, considering the pressures of volume declines and the critical importance of mail volume to the Postal Service's financial stability. On multiple occasions in recent years, the Commission has commended the Postal Service for taking reasonable steps within its power to cut costs, increase efficiency, and grow volume; most recently, the Commission praised the Postal Service's "significant efforts to reduce operating expenses and improve efficiency to ensure that expenses are better aligned with mail volumes."[16] As one example of these efforts, the Postal Service has grown total factor

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[15] These cost reductions have built off efforts undertaken prior to the PAEA, when the Postal Service implemented cost reduction initiatives and improved productivity to respond to the divergence between First-Class Mail and the economy due to electronic diversion. *See* FY2013 Financial Analysis Report at 9 ("From FY 2000 until FY 2007, the Postal Service aggressively reduced workhours and its employee complement and TFP grew at an average annual rate of 1.5 percent.").

[16] FY2015 Financial Analysis Report at 1; *see also* FY2014 Financial Analysis Report at 3. This acknowledgment is particularly noteworthy in a year when operating expenses began to tick upward due to growth in parcel-delivery-related work-hours and career employee complement. *See* FY2015 Financial Analysis Report at 2.

productivity (TFP) in each of the past six years, despite declining mail volume.[17] The Postal Service's efficiency measures have helped it to sustain ongoing operations, but they not been – and will not be – enough to restore the Postal Service to financial health in light of its current legal obligations.

The Postal Service will continue to maintain a sharp focus on achieving any possible operational savings, to the extent consistent with providing appropriate levels of service and adhering to the other constraints of law. However, the Postal Service's remaining opportunities are simply not sufficient to scale the wall of costs that looms before it, particularly given the Postal Service's mandated prefunding expenses. In particular, the Postal Service is nearing the limits of its ability to take major cost-cutting initiatives, in light of legal and universal service constraints.[18] To the extent that the Postal Service might achieve further cost reductions from its service network, its ability to do so is subject to the ongoing need to provide levels of universal service adapted to the current needs of the United States. Beyond the legal constraints of the USO, customer expectations ultimately determine the bounds of universal service and limit the Postal Service's ability to reap significant efficiencies at the expense of access, service quality, or geographic reach. The Postal Service has availed itself of most of the feasible opportunities for service-related cost reductions within existing conceptions of

[17] *Id.* at 18. In fact, except for the two years during the Great Recession in which workload declined so dramatically that the Postal Service could not reduce expenses fast enough to maintain positive productivity, the Postal Service has experienced productivity growth every year since 2000. *Id.*

[18] *See* Order No. 1926 at 131, 134-35 ("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. . . . Although converting from door delivery might reduce costs, 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.").

appropriate levels of service.[19] For example, the fixed costs that universal service requirements impose, combined with the growth in delivery points, mean that, by 2012, the Postal Service was "beginning to reach the limits of the [delivery cost] reductions that can be accomplished within the existing network structure and standards."[20] The fixity of delivery costs is largely responsible for the fact that "[t]he cost reduction [of 2.6 percent per year in labor expenses] is not proportional to the [annual] volume decline of 3.5 percent on average since 2006."[21]

The Postal Service will continue doing what it can to improve efficiency by seeking operational savings where possible and pressing for favorable outcomes in collective bargaining and interest arbitration. However, this alone will not avert the need for fundamental changes to the Postal Service's cost structure and revenue-generation capacity. Whatever arguable margin for efficiency improvements might remain under the current structure, it is far from enough to both keep pace with declining volume and cover billions of dollars in legal mandates.

C. Competitive Products Should Be Allowed to Continue Providing Much-Needed Contribution, But They Likewise Cannot Bridge the Gap

As the Commission is well aware, competitive products have been a bright spot in the Postal Service's finances in recent years. In FY2015, competitive product volumes grew 16.3 percent, added $1.3 billion in revenue, and contributed a much-

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[19] Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059, PRC Docket No. R2013-11 (Sept. 26, 2013), at 22-27; Reply Comments of the United States Postal Service, PRC Docket No. R2013-11 (Dec. 6, 2013), at 93-94, 100-105.

[20] OIG, Peeling the Onion at 12.

[21] *Id.* at 9.

needed \$4.5 billion to institutional costs.[22] Competitive products have covered an increasing share of the Postal Service's institutional costs over the last several years, above and beyond their minimum contribution requirement.[23] They have been an important tool for the Postal Service to help pay for the network costs that are necessary to process, transport, and deliver mail to 155 million delivery points six days per week.

As vital as this success has been, however, competitive products cannot be the Postal Service's saving grace. Competitive products have a much lower rate of contribution to the Postal Service's institutional costs: it takes \$1.64 in competitive product revenue to generate as much contribution as \$1.00 in market-dominant revenue.[24] Moreover, for all their growth, competitive products still comprise only a minor portion of the Postal Service's overall portfolio: 2.6 percent of total volume and 24.1 percent of total revenue.[25] The vigorous competition from unregulated, and thus more nimble, private actors in the package and express delivery markets inherently tempers the Postal Service's ability to grow competitive volumes and revenues. Whatever gains the Postal Service can continue to make with competitive products, they will not be enough to avert the need for substantial legislative and regulatory reform to balance the Postal Service's books.

[22] FY2015 Financial Analysis Report at 39.

[23] *Id.* at 42.

[24] *See id.* at 36, 39 ((\$16,423 million in competitive product revenue / \$4,523 million in competitive product contribution) / (\$51,674 million in market-dominant product revenue / \$23,364 million in market-dominant contribution) = 1.64). *See also* FY2014 Financial Analysis Report at 2 ("However, Competitive products constitute only 2 percent of total volumes and generate a lower markup than First-Class Mail. Although operating net income improved and Standard Mail volume increased in 3 of the last 5 years, the steady decline in volume from First-Class Mail – the Postal Service's most profitable product – continues to affect overall revenue and jeopardizes the Postal Service's ability to cover total costs.").

[25] FY2015 Financial Analysis Report at 36, 39.

While competitive products are not a panacea, they are critically important to the Postal Service's financial sustainability. As such, the Commission must avoid recommending changes that would undercut the Postal Service's ability to compete fully and fairly in the competitive marketplace and raise contribution toward the infrastructure costs necessary to provide universal service. The Commission is currently considering proposals that, in the view of the Postal Service and several other commenters, would jettison well-established principles of causation-based cost attribution in service to a competitor's parochial (and consumer-harming) interest in artificially raising market prices.[26] Those principles have served the Commission, the Postal Service, competitors, and consumers well in ensuring that costs are attributed to products in a rational manner. The history of postal costing shows that a shift away from causation-based cost attribution would plunge postal costing back into the sort of arbitrary methodologies that Congress specifically sought to leave behind. The Commission should reject any call to recommend changes to the cost attribution standards in 39 U.S.C. §§ 3622(c)(2) and 3631(b).

The Commission should also decline to heed any baseless concerns that commenters may voice about "cross-subsidization" and "unfair competition." Competitive product prices have increased far faster than those for market-dominant products.[27] The Postal Service has clearly been trying to enhance contribution from competitive products, as shown by competitive products' consistent outperformance of

[26] *E.g.*, Initial Comments of the United States Postal Service on Proposals One and Two, PRC Docket No. RM2016-2 (Jan. 25, 2016), at 1-34; Comments of Amazon Fulfillment Services, Inc., PRC Docket No. RM2016-2 (Jan. 25, 2016), at 9-114.

[27] *E.g.*, Initial Comments of the United States Postal Service on Proposals One and Two, PRC Docket No. RM2016-2, at 35-36; Comments of Amazon Fulfillment Services, Inc., PRC Docket No. RM2016-2, at 13, 70-72.

the 5.5-percent “appropriate share” level of minimum required contribution.[28] If anything, the playing field is tilted against the Postal Service: the Federal Trade Commission (FTC) reported in 2008 that the Postal Service’s legal status places it, on balance, at an overwhelming competitive disadvantage and artificially heightens the prices of its competitive products.[29] The FTC’s evaluation did not even account for other staggering burdens under which the Postal Service must labor, such as the federal workers’ compensation program and the requirement to prefund retiree health benefits without integrating with Medicare Parts A, B, and D.[30] In light of these circumstances, it would be irrational to recommend changes that would further tilt the playing field against the Postal Service, reduce consumer welfare, and diminish competitive products’ contribution toward paying for the infrastructure and the network that is necessary to provide universal service.

III. MEANINGFUL SOLUTIONS WILL NEED TO COME FROM CONGRESS AND THE COMMISSION

In light of the circumstances that have prevailed since the PAEA’s enactment, “legislation or other measures” are clearly “necessary to improve the effectiveness or efficiency of the postal laws of the United States,” and so the Commission is charged

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[28] *See* FY2015 Financial Analysis Report at 42.

[29] FTC Report at 8-9, 55-64. The situation is unlikely to have changed significantly in the intervening years. If anything, the value of various “subsidies” like the Postal Service’s exemption from property taxes probably decreased in the wake of the Great Recession. Meanwhile, Congress has loosened only one of the burdens that the FTC enumerated, leaving in place the burdens that account for fully 99 percent of the FTC’s cost estimate. *See* Pub. L. No. 110-405, 122 Stat. 4287 (2008) (deregulating the Postal Service’s purchase of air transportation for international mail); FTC Report at 56 (estimating the burden from the then-extant regulation of international air transportation rates at $98 million, out of a total burden of $7,584 million). While at least one competitor-funded report has attempted to stand the FTC’s finding of a net burden on its head, that report is riddled with discrediting errors. *See* Initial Comments of the United States Postal Service on Proposals One and Two, PRC Docket No. RM2016-2, at 48-50.

[30] For a fuller treatment of these additional burdens, see United States Postal Service Reply Comments, PRC Docket No. PI2014-1, at 6-7; Library Reference PRC-LR-PI2014-1/1, Postal Service Analysis of Additional Postal Service Activities That Could Qualify for Reporting Under 39 U.S.C. § 3651(b)(1)(C), at 4-10, 12-14.

with recommending how Congress should tackle the problem.[31] The Postal Service has already developed and presented Congress with a set of common-sense reforms that would "put the Postal Service on a more stable financial footing, allowing for further innovation, investments, and growth for the Postal Service, and the mailing industry as a whole."[32] The Postal Service's proposal aligns with proposals advanced by a coalition of postal employee organizations and mailing industry stakeholders.[33] The proposal offers a sound foundation for the legislative recommendations that the Commission is responsible for providing to Congress.

The Postal Service cannot bring itself back to solvency with the limited tools available to it under current law. Therefore, the only way to restore solvency and ensure the future of universal postal service is to change the legal framework. Meaningful reform of the statutes under which the Postal Service operates must, above all, result in the Postal Service's post-retirement benefits costs being made more rational and affordable. Furthermore, the Postal Service must have more flexibility to raise revenue.

The Postal Service's legislative proposal addresses these issues. The key reforms in the proposal reflect numerous discussions with stakeholders, including the postal labor unions and a cross-section of the mailing industry, and are therefore

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[31] Pub. L. No. 109-435, § 701(a)(2), 120 Stat. 3198, 3242 (2006).

[32] *Reforming the Postal Service: Finding a Viable Solution: Hearing Before the House Oversight & Gov't Reform Comm.*, 114th Cong. (May 11, 2016) (statement of Megan J. Brennan, Postmaster General and Chief Executive Officer, U.S. Postal Service), https://oversight.house.gov/wp-content/uploads/2016/05/Brennan-USPS-Statement-5-11-Postal-Reform.pdf [hereinafter "Brennan Testimony"], at 16.

[33] *See* Letter from the American Postal Workers Union, et al., to Jason Chaffetz, Chairman, and Elijah Cummings, Ranking Member, House Oversight & Government Reform Committee (May 11, 2016), *available at* https://www.nalc.org/government-affairs/body/5-3-Draft-JLP-Supporting-Organizations-Statement-for-5-11-OGR-Hearing-.pdf.

capable of achieving broad support. At the same time, enactment of the proposal would constitute significant progress towards financial sustainability of the Postal Service. Universal postal service must ultimately be made financially sustainable, and it is in the interest of the Commission and all other stakeholders to urge Congress to enact the sensible reforms proposed by the Postal Service. Indeed, the sooner Congress enacts reforms to the Postal Service's business model, the smaller the financial gap that will have to be reckoned with in the ten-year review of the market-dominant rate regulation system. While the Postal Service believes that replacement of the current price cap with an appropriate regulatory structure is ultimately necessary in any event, Congressional action on the Postal Service's proposal would minimize the size of the price increases needed to cover its costs.

A. Retiree Benefits Must Be Funded, But Congress Should Be Urged to Rationalize Funding Policies

Pensions and retiree health benefits are real obligations. During their years of service, employees earn the right to these benefits after they retire. The employer cannot merely pretend that the liability does not exist in order to make its balance sheet look better, and neither can regulators. An employer may defer payments in the short run, but sooner or later, there must be a reckoning, or else there will be no money to pay for retirees' promised benefits.

Federal post-retirement benefits laws artificially and unnecessarily inflate the Postal Service's liabilities. The Commission should recommend legislative reforms that would rationalize these liabilities, lessen the burden on ratepayers, and help to ensure the financial future of universal postal service.

1. Retiree health benefits

For budget scoring purposes, Congress included in the PAEA (as amended) a requirement that the Postal Service pay $51.8 billion into the RHB Fund over ten years, with any remaining liability to be amortized over 40 years thereafter. The Postal Service did not have the available liquidity to make the required annual payments after FY2010, although they have continued to be included as expenses in the Postal Service's financial reports. Retiree health benefits were 47.8 percent funded as of the end of FY2015. Assuming (as is expected) that the Postal Service is unable to make any further contributions in the meantime, the remaining liability will be amortized. In FY2017, the RHB Fund will assume responsibility for paying current annuitants' premiums, but the Postal Service will need to replenish the fund through normal cost and amortization payments. Those payments, together, are estimated to total approximately $6.3 billion per year on average. Deferring one or more payments in order to ensure short-term liquidity will increase the amount of later years' amortization payments. If the Postal Service is unable to meet these payment obligations altogether, the fund could run out of money in a little over a decade.[34] The obligation to pay annuitant premiums would then revert to the Postal Service. If the Postal Service is unable to finance those premiums, either the taxpaying public will need to pick up the tab, or else retirees could be left without the health benefits that they were promised as a condition of their employment.

Because RHB ultimately must be paid for, it is essential that the RHB program be designed and managed appropriately so that the Postal Service can more easily pay for

[34] This prognosis reflects reasonable assumptions, including returns on fund assets of 3 percent per year.

it. In this regard, the RHB program in which the Postal Service is required to participate is woefully deficient. Other employers' best practices demonstrate a number of sensible reforms that enjoy consensus support among a wide range of postal stakeholders. These reforms would dramatically reduce the Postal Service's RHB liability and, consequently, the size of any necessary prefunding payments. The Commission should endorse these reforms as well.

- **Full and fair Medicare integration.** The Federal Employees Health Benefits Program (FEHBP) is unique in that it does not require Medicare-eligible participants to enroll in Medicare Parts A and B and does not access prescription drug subsidies through Medicare Part D. As a result, 9 percent of eligible annuitants and dependents do not take advantage of Medicare Part A benefits, and 27 percent do not participate in Medicare Part B.[35] No rational self-funding employer would pay Medicare taxes, yet continue to pay the full cost of health benefits that could be covered by Medicare in the first instance. Indeed, full Medicare integration is a universal practice among private-sector and state and local government employers that offer retiree health benefits, as well as the Department of Defense's RHB program. Creating a separately-rated Postal Service plan within FEHBP, appropriately assigning claims costs to Medicare, and establishing an Employer Group Waiver Plan for Medicare Part D prescription drug benefits would create savings for the Postal Service

[35] Brennan Testimony at 14.

and participants. It would eliminate 94 percent ($54 billion) of the current unfunded RHB liability.[36]

- **Sound actuarial practice in calculating the RHB liability.** Currently, the Office of Personnel Management (OPM) calculates the actuarial RHB liability on the basis of premium costs. Doing so is inconsistent with normal actuarial practice and results in the actuarial liability being overstated. Instead, the Postal Service has proposed that actuarial liability be calculated according to annuitant net claims costs, in accordance with actuarial standards.
- **Prudent investment of fund assets.** Post-retirement benefits funds for private-sector employees, as well as for many public-sector employees, invest assets in order to use market forces to grow those assets, thereby lowering the unfunded liability that employers must cover out of pocket. For example, 30 percent of Pension Benefit Guaranty Corporation (PBGC) assets are invested in equity, 47 percent in corporate bonds, and only 24 percent in federal bonds; this allocation yielded average returns of 7 percent between 2006 and 2014.[37] By contrast, 100 percent of the Postal Service's RHB Fund assets are invested solely in low-yield Treasury securities, which yielded

[36] *Id.* at 14. At the same time, these changes would add less than half a day's claims cost to Medicare, or one-tenth of one percent of total annual Medicare payments. *Id.* It should be noted that these comments present only direct cost savings from each proposed measure; actual savings would be higher, due to reduced interest from lower borrowing. *See id.* at 16 (estimating $2.6 billion in five-year interest savings if the Postal Service's entire legislative proposal were enacted).

[37] Lazard, Selected Federal and State Fund Allocations and Returns (Aug. 2015), at 2, 4, *appended to Reforming the Postal Service: Finding a Viable Solution: Hearing Before the House Oversight & Gov't Reform Comm.*, 114th Cong. (May 11, 2016) (statement of Fredric V. Rolando, President, National Association of Letter Carriers), https://oversight.house.gov/wp-content/uploads/2016/05/Rolando-NALC-Statement-5-11-Postal-Reform.pdf [hereinafter "Rolando Testimony"].

average returns of only 4 percent over the same period.[38] Any short-term risks associated with a more diversified allocation can be mitigated by investing according to a portfolio designed for both yield and resiliency over the long term. If RHB Fund assets had been allocated according to the Thrift Savings Plan's (TSP's) L 2040 portfolio, for example, the unfunded liability would have been 18.4 percent ($10.1 billion) lower in FY2015.[39] The Postal Service has proposed that 50 percent, and possibly up to 75 percent, be invested in a manner consistent with the TSP's longest-term lifecycle fund.

- **A more realistic funding target.** The PAEA requires the Postal Service to prefund 100 percent of its RHB liability. By contrast, of the 38 percent of Fortune 1000 companies that prefund RHB at all, the median funding level ranged from 23 to 37 percent between 2001 and 2010.[40] State governments prefunded 30 percent of their RHB liabilities in FY2009, and the Department of Defense prefunded 28.1 percent of its liability in FY2015.[41] It should be noted that these employers prefund at such low levels even after the liability has been reduced through the other measures described above, such as Medicare integration. The Postal Service has proposed that its RHB funding obligation be similarly reduced, albeit to a more conservative target of 80

[38] *Id.*

[39] Rolando Testimony at 9-10. For a fuller discussion of this proposal, see *id.* at 8-13. *See also* Brennan Testimony at 14, 16.

[40] Brennan Testimony at 13 (citing United States Postal Service Office of the Inspector General, FT-MA-12-002, Pension and Retiree Health Care Funding Levels (June 18, 2012) [hereinafter "OIG Retiree Benefits Report"], at 4 fn.13). Almost two-thirds of Fortune 1000 companies either do not provide RHB at all or, if they do, do not prefund the liability. *Id.*

[41] *Id.* (citing OIG Retiree Benefits Report at 4 and Financial Report of the United States Government - 2015).

> percent, in determining whether any amortization payment should be required.[42] In addition, normal cost payments would not be required to the extent that they would cause the RHB actuarial liability to be more than 100 percent funded.[43]

Taken together, these reforms are estimated to save the Postal Service $38 billion over the next ten years.[44] In essence, they would eliminate virtually all of the Postal Service's remaining RHB prefunding obligations.

2. Pensions

The story is similar with respect to Postal Service pensions. The Postal Service is required to fund 100 percent of its total pension liabilities and has achieved 92.2 percent funding as of FY2015, far more than private-sector and state and local government employers and four times more than the rest of the federal government.[45] Like the RHB Fund, assets are invested solely in low-yield Treasury securities, rather than higher-yielding diversified portfolios. Moreover, OPM calculates pension liabilities not on the basis of demographic and salary-growth assumptions relevant to postal employees, but on the basis of assumptions concerning the entire federal workforce. Finally, there is no provision to return overpayments in FERS to the Postal Service. Needless to say, no rational self-funded employer that still provides a defined-benefit pension plan would design such a funding scheme.

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[42] *Id.* at 14. In 2012, the Senate passed a postal reform bill that would have enacted just such a lower RHB funding target, although the House did not take up the bill. S. 1789, 112th Cong. § 103(b)(1)(A) (2012).

[43] *Id.* at 13-14.

[44] Brennan Testimony at 16.

[45] *Id.* at 12.

The paradoxical result is that, despite having funded far more of its pension liabilities than other employers, those liabilities continue to inflict heavy costs on the Postal Service each year. The Postal Service is required to prefund its pensions, including an amortization of any unfunded liability. The Postal Service is expected to face annual $1.5 billion amortization payments for its unfunded CSRS liability, beginning in FY2017, in addition to $3.4 billion (or more) in annual normal cost payments and, possibly, $0.2 billion in annual amortization payments to its FERS account (depending on the outcome of its current appeal).[46]

These payment amounts could even increase, depending on changes to actuarial assumptions. For example, in FY2011, OPM's Board of Actuaries agreed on a 50-basis-point reduction in the discount rate (the assumed rate of interest) used to determine the CSRS actuarial liability. This change transformed a $1.6 billion surplus in the Postal Service's CSRS account into a $17.8 billion shortfall, single-handedly creating the unfunded liability to be amortized. A similar assumption change in the future could significantly increase the unfunded liability that the Postal Service would need to cover.

As with RHB prefunding, these obligations cannot simply be ignored. Any short-term deferral of a given payment will only increase the amount of later years' amortization payments. If the pension funds are not replenished, they will eventually run out of money that postal annuitants and their dependents were promised.

The Postal Service, with the support of a wide swath of labor and mailer stakeholders, has proposed reasonable reforms to mitigate at least some of its pension

[46] *See id.* at 3.

burdens. Congress should require OPM to calculate the Postal Service's pension liabilities according to postal-specific assumptions. It is only sensible to determine the Postal Service's pension obligations based upon the characteristics of its own beneficiary population, rather than that of another employer. Further, any immediate surplus in FERS would be used to pay down the Postal Service's debt to the Treasury; future surpluses could be applied against pension liabilities, RHB liability, or Postal Service debt.[47] The amortization period for CSRS should also be lengthened to accord with the period for amortizing RHB. These refunds, together with the reduction in CSRS amortization payments, would lower Postal Service expenses by $3.2 billion over five years.[48] The Commission should recommend that Congress adopt this proposal.

B. The Postal Service Must Have Additional Ability to Generate Revenue

Although RHB and pension reforms would afford significant relief, they would not, by themselves, be enough to ensure a sustainable future for universal service. There must also be more flexibility in terms of revenue generation.

1. Price cap on market-dominant products

In light of the other policies that Congress enacted or kept in place, the PAEA's rigid price cap for market-dominant products has utterly failed to ensure financial stability in the face of declining volume, an ever-expanding delivery network, and the Postal Service's other expenses. Ultimately, an honest appraisal of the price cap demands serious attention to whether the cap has met such statutory objectives as "assur[ing] adequate revenues, including retained earnings, to maintain financial stability" and "establish[ing] and maintain[ing] a just and reasonable schedule for rates

[47] *Id.* at 11-12.

[48] *Id.* at 16.

and classifications,"[49] given the financial constraints imposed by other statutory policies. There is simply no basis to conclude that the price cap has been effective in allowing the Postal Service to raise the revenue needed to fulfill statutory polices and ensure the financial sustainability of universal service.[50]

Although it certainly needs to be replaced or modified substantially, further discussion of the price cap is premature in this proceeding, because current law already charges the Commission with evaluating the price cap as part of the upcoming ten-year review. The plain language of the PAEA shows that Congress cast the price cap as a mandatory requirement only of the initial market-dominant rate-regulation "system" that is subject to the ten-year review,[51] and legislative history bears out this reading of the statute's plain language.[52] Although the Commission recently decided to defer opining

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[49] 39 U.S.C. § 3622(b)(5), (8); *see also* Taub Testimony at 25 (highlighting the "adequate revenues" objective); Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2015 (Jan. 6, 2016) [hereinafter "FY2015 PRC Annual Report"], at 22 (characterizing the price cap's restrictions as at "tension" with "the objective that the Postal Service must be self-sufficient and maintain financial stability"). "Just and reasonable" rate regulation is a term of art that connotes a balance between, on the one hand, guarding against excessive rates and, on the other hand, ensuring that a utility will have sufficient revenue to meet its financial needs. *E.g.*, *Verizon Communs., Inc. v. FCC*, 535 U.S. 467, 481 (2002) ("The traditional regulatory notion of the 'just and reasonable' rate was aimed at navigating the straits between gouging utility customers and confiscating utility property." (citations omitted)); *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1172 (D.C. Cir. 1987) ("It is axiomatic that the end result of Commission rate orders must be 'just and reasonable' to both consumers and investors, and that, in achieving this balance, the Commission must consider the impact of its rate orders on the financial integrity of the utility.").

[50] *See* FY2013 PRC Annual Report at 21-22 (noting the gap between the revenue increase allowed under the price cap and the revenue needed to meet all obligations and break even, and noting that the Postal Service's exercise of its limited pricing flexibility within the price cap would not generate "enough revenue or contribution to recover the losses from volume declines"); FY2012 PRC Annual Report at 27 ("The Postal Service's current financial challenges demonstrate that it is at risk of failing to meet the objectives of section 3622(b)(5), which include assuring adequate revenues, including retained earnings, to ensure financial stability. . . . Despite the Postal Service's efforts to significantly reduce costs, the revenue generated from [CPI-based price] increases has not been enough to cover the [RHB] funding requirements and operating expenses." (footnote omitted)).

[51] 39 U.S.C. § 3622(a), (d)(1), (d)(3).

[52] 152 Cong. Rec. S11,675 (daily ed. Dec. 8, 2006) (statement of Sen. Collins) (explaining that the PAEA reflects a compromise among its framers, in that it establishes a ten-year CPI-based price cap followed by the Commission's "review [of] the rate cap").

on this basic statutory-interpretation question until an unspecified later date (and possibly not until after the ten-year review is well underway),[53] the existence of the review makes it unnecessary to propose any legislative changes to the market-dominant regulatory system at this time, despite the need for change. Therefore, the Postal Service has not included modification or replacement of the price cap in its legislative proposals, although it has proposed restoration of the relatively modest exigent price increase as an interim stabilizing measure.

2. Exigent Surcharge

Regarding that proposal, the Commission itself affirmed that above-CPI price increases were necessary, notwithstanding the Postal Service's exercise of honest, efficient, and economical management, when it approved the exigent price increase in FY2013.[54] To be sure, the Commission decided that the price increase would be only temporary, based on its interpretation of the applicable standard under the PAEA (in particular, the Commission's determination of how much revenue loss was proven to be "due to" the Great Recession). While the Postal Service does not agree with that decision, and it is the subject of a pending appeal, it is nevertheless true that such an application of the current statutory provision does not affect the Commission's recognition that more revenue is necessary as a policy matter. Existing law may

[53] *See generally* Order No. 3237, Order Holding Petition in Abeyance, PRC Docket No. RM2016-9 (Apr. 12, 2016). The Postal Service disagrees with the Commission as to whether resolving this threshold interpretative question (i.e., whether the CPI price cap will be under review at all) would necessarily "prejudge" the substance of the review itself (i.e., whether the price cap is effective and, if not, ought to be modified or replaced). *Compare* 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, PRC Docket No. RM2016-9 (Apr. 7, 2016), at 3, *with* Order No. 3237 at 3 & Supp. Views of Commissioner Hammond. Either way, it would clearly be inconsistent with the Commission's recent order for the Commission to actually opine on the cap's effectiveness in the truncated proceeding concerning the Section 701 report, in advance of the more focused notice-and-comment process of the ten-year review.

[54] Order No. 1926 at 131-36.

arguably confine the regulator's discretion in applying that law (at least in the view of the Commission), but policy is the sole determinant of whether the law should be changed. On that score, a majority of then-sitting Commissioners recognized that, notwithstanding their disagreement on whether it comported with existing law, an indefinite exigent price increase at least made sense as a policy matter.[55]

The Postal Service has proposed that Congress reinstate the 4.3-percent exigent surcharge and make it part of the rate base, at least pending the resolution of the ten-year review.[56] Doing so would recognize that, whatever its justification under current law, rolling back a price increase worth $2 billion in annual revenue makes no business or policy sense at a time when the Postal Service continues to face severe cash shortages, looming capital investment needs, a lack of available borrowing authority, and an inability to make legally mandated payments. As the Commission has already observed, only the exigent surcharge has been able to raise enough revenue to offset (albeit not reverse) the effect of volume declines in the relevant years.[57]

[55] *Id.*, Separate Views of Commissioner Acton at 2-4 ("If I was a member of the Governors, and charged with approving management approaches within my control in an effort to move the Postal Service forward, I may well have voted for this exigent proposal, to request piercing of the price cap by over four percent into perpetuity as a prophylactic remedy. . . . I am aware too that it would in some sense be a convenient choice to allow the Postal Service to recover billions in additional revenues from mailers from now into eternity to offset a portion of the expense of existing structural constraints within the Postal Service's business model. The Postal Service proposes a perpetual recovery arrangement that may be revisited as part of the Commission's mandated 2017 review of the system of ratemaking."); *id.*, Dissenting Op. of Vice Chairman Taub (opining that the Postal Service should be legally entitled to a much longer exigent price increase, due to the continuing financial harm from volume losses caused by the Great Recession).

[56] Brennan Testimony at 15.

[57] FY2014 Financial Analysis Report at 9 ("As shown in Figure II-1, the average revenue per piece in FY 2014 grew significantly and covered the loss in revenue due to declines in mail volume. In the 5 years previous to FY 2014, the change in revenue per piece was not sufficient to offset the loss of revenue due to volume declines. . . . The exigent rate surcharge accounted for almost $1.3 billion of the [$2 billion] increase [in revenue due to the rise in revenue per piece]." (footnote omitted)); *see also* Taub Testimony at 4, 8 ("The exigent surcharge added $2.1 billion in revenue, which was enough to offset the loss of revenue due to declining volumes. . . . The exigent surcharge, effective for the full fiscal year, increased

The Commission should endorse this legislative recommendation. Doing so would not undermine the Commission's interpretation of the bounds of the current exigency provision. The recommendation would simply acknowledge that, as a policy matter, the additional revenue is needed in order to sustain universal service and meet other legal obligations, and that Congress could change the law to accommodate that need. Indeed, a moderate short-term price increase would help to mitigate the Postal Service's financial condition going into the ten-year review. Endorsing a reinstatement and extension of the surcharge on policy grounds would not bear on the proper interpretation of the current exigency provision, but it would reflect the fact that the Postal Service needs additional revenue and liquidity in the short term.

3. Workshare Discounts

We anticipate that at least some mailing industry stakeholders may urge the Commission to recommend that Congress mandate efficient-component pricing regulation of workshare discounts, such that any discounts must pass through 100 percent, not just <u>up to</u> 100 percent, of avoided costs. Although certain mailers have argued that this change would benefit all stakeholders, imposing such a requirement would not improve Postal Service revenue and contribution. It would, however, dramatically reduce the Postal Service's pricing flexibility. Therefore, the Commission should not make any recommendations on that issue in its report.

4. Increased Product Flexibility

Finally, the Commission should lend its voice to the consensus in favor of allowing the Postal Service to offer a somewhat expanded range of non-postal services.

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revenue by an estimated $2.1 billion, offsetting all of the revenue loss from the declining Market Dominant volume.").

Current law confines the Postal Service to postal services, grandfathered non-postal services, and other revenue-generating activities specifically authorized by law, such as those according to agreements with other federal entities.[58] There is broad agreement among the Postal Service, employee organizations, mailers, and even key Congressional stakeholders[59] that the Postal Service should be given additional product flexibility, within reasonable limits.

For example, the Postal Service could be permitted to enter agreements to provide services to state, local, and tribal governments, just as it is authorized to do today with other federal government entities. The Postal Service could be allowed to carry beer, wine, and distilled spirits, subject to conditions about complying with applicable local laws and verifying recipients' age. The Commission could also be allowed to approve other new non-postal services that are consistent with the public interest, do not cause unfair competition, do not unreasonably interfere with the value of postal services, comply with all applicable federal laws and regulations, and are reasonably expected to improve the Postal Service's net financial condition. This measure could provide needed additional revenue. The Commission should include this sensible proposal in its Section 701 report.

IV. CONCLUSION

The Postal Service's problems are dire but solvable. Congress is looking to the Commission for guidance about how to restore the Postal Service's solvency. The Commission should fulfill that expectation. Indeed, the more that stakeholders,

[58] 39 U.S.C. §§ 404(e), 411.

[59] *See, e.g.*, S. 2051, 114th Cong. §§ 303-304 (as introduced 2015); S. 1789, 112th Cong. §§ 210, 404-405 (2012).

including the Commission, can spur Congress to pass meaningful and timely reforms that reduce the Postal Service's cost structure and enable a modest increase in revenues, the better off the Postal Service will be heading into the ten-year review.

Respectfully submitted,
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