Postal Regulatory Commission
Submitted 6/15/2016 11:54:52 AM
Filing ID: 96274
Accepted 6/15/2016

Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Section 701 Report — Docket No. PI2016-3

PUBLIC REPRESENTATIVE COMMENTS

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June 15, 2016

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PUBLIC REPRESENTATIVE COMMENTS

(June 15, 2016)

On April 14, 2016, the Commission established this docket to obtain public comments on the report required by section 701 of the Postal Accountability and Enhancement Act of 2008 (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006) (PAEA), section 701.[1] Pursuant to Order No. 3238, the Public Representative hereby files his comments.[2]

I. SUMMARY OF RECOMMENDATIONS

Postal Service Financial Situation:

- Cancel Defaulted PSRHBF Payments
- Recalculate and Apply CSRS Balances to the PSRHBF
- Increase the Postal Service's Debt Limit
- Require the Postal Service to File a True-Up Rate Case

Market Dominant Rate System

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[1] Notice and Order Seeking Comments on Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, April 14, 2016 (Order No. 3238). For convenience, the report required by PAEA section 701 will be referred to throughout these comments as the Section 701 Report.

[2] Assisting the Public Representative are Kenneth R. Richardson, from the Office of General Counsel, and Kenneth R. Moeller and Natalie R. Ward, from the Office of Accountability and Compliance.

- Adjust the Price Cap to Account for Declining Mail Volumes and Increasing Delivery Points
- Require Annual Adjustment of Workshare Discounts to Reflect the Most Recent Avoided Cost Estimates

Negotiated Service Agreements

- No Recommended Changes Regarding Competitive NSAs
- No Recommended Changes Regarding Market Dominant NSAs and Special Classifications

Post Office Closings/Consolidations

- Establish Deadlines for Initiating Discontinuance Studies for Leases That Are Terminated or Not Extended
- Establish Deadlines for Initiating Discontinuance Studies for Post Offices Whose Operations Are Suspended
- Establish Deadlines for Completing Discontinuance Studies
- Require Reports on Retail Network and Clarify Scope of Commission's Appellate Authority

Advisory Opinion Process

- Do Not Disturb “Hearing on the Record” Requirement
- Require Postal Service Responses to Advisory Opinions, Postal Service Consideration of Advisory Opinion Recommendations, and Submission to Congress of Advisory Opinions and Responses

Market Tests

- No Recommended Changes

Public Representative Requirement

- No Recommended Changes

II. BACKGROUND

The Section 701 Report that is the subject of this proceeding will be the second such report issued by the Commission. The first Section 701 Report was issued during 2011.[3] Section 701 reports are not issued in a vacuum. They are an integral part of the comprehensive regulatory framework established by Congress. Individually, and collectively, they afford opportunities periodically to assess the effectiveness of the PAEA’s statutory and regulatory regime. In addition to periodic reports, the Commission, the Postal Service, and its Board of Governors have been required to produce a variety of one-time reports that also

[3] Postal Regulatory Commission, Section 701 Report, Analysis of the Postal Accountability and Enhancement Act of 2006, September 22, 2011 (2011 Section 701 Report).

evaluate postal services and the mechanisms of postal regulation.[4] Finally, the Commission, from time-to-time, engages outside experts to assist it in responding to requests from the Postal Service or Congress for Commission opinions on specific issues.[5] Together, all of these reports help inform the Commission's analyses in the Section 701 Reports.

The Commission's Annual Reports. Among the reports the Commission is required to produce annually are its annual report to the President and Congress (39 U.S.C. section 3651); and its annual compliance determination report, including its analysis of Postal Service financial results (39 U.S.C. §3653(b)); and its review of the Postal Service's performance report and performance plan (39 U.S.C. section 3653(d)).[6]

The focus of each of these annual reports is different. The Commission's annual report to the President and Congress prepared under 39 U.S.C. section 3651 focuses on "the operations of the Commission under … title [39], including the extent to which regulations are achieving the objectives under sections 3622 and 3633, respectively." As such, this report

[4] Periodic reports by the Postal Service and its Board of Governors include the Postal Service's annual compliance report (39 U.S.C. § 3652); selected Postal Service financial reports as otherwise required by the Securities and Exchange Commission (39 U.S.C. § 3654); the Postal Service's annual comprehensive statement (39 U.S.C. § 2401(e)); the Board of Governors' annual report (39 U.S.C. § 2402); the Postal Service's tri-annual strategic plan (39 U.S.C. § 2802); the Postal Service's annual performance plan (39 U.S.C. § 2803); and the Postal Service's annual program performance report (39 U.S.C. § 2804). These reports provide the Commission with information used in the reports that it issues.

Other reports include the Commission's *Report on Universal Service and the Postal Monopoly,* December 19, 2008 (USO Report); and the *Periodicals Mail Study, Joint Report of the United States Postal Service and Postal Regulatory Commission*, September, 2011 (Joint PRC/USPS Periodicals Study).

[5] *See, e.g.,* The Segal Company, *Civil Service Retirement System Cost and Benefit Allocation Principles,* June 29, 2010 (Segal Report).

[6] Prior to fiscal year (FY) 2013, the Commission's annual compliance determination included a financial analysis and a report on the Postal Service's annual performance report and forward-looking performance plan submitted pursuant to 39 U.S.C. §§ 2803 and 2804. *See* Docket No. ACR2012, *Annual Compliance Determination (Revised)*, May 7, 2013. Beginning in FY 2013, the Commission issued an annual compliance determination, a separate and expanded financial report, and a separate report on the Postal Service's sections 2803 and 2804 performance reports. *See* Docket No. ACR2013, *Annual Compliance Determination Report*, March 27, 2014; Docket No. ACR2013, *Analysis of Postal Service Financial Results and 10-K Statement for FY 2013*, April 10, 2014; and Docket No. ACR2013, *Review of Postal Service FY 2013 Performance Report and FY 2014 Performance Plan*, July 7, 2014.

provides a Commission self-assessment of how well its regulations are functioning to achieve statutory objectives for both market dominant products, 39 U.S.C. § 3622, and competitive products, 39 U.S.C. §3633. These annual reports typically discuss whether and how particular regulations, or Commission actions pursuant to its regulations, further a statutory objective.

Although the focus of the Commission's section 3651 annual report to the President and Congress is on how well the Commission's regulations are achieving statutory objectives, the possibility exists that a regulation's ability to achieve a statutory objective could be impaired by a deficiency in the underlying statutory scheme. This latter possibility is, on occasion, suggested by the Commission in its annual reports.[7] Instances of shortcomings in the statutory scheme identified in section 3651 annual reports can also be relevant to Commission evaluations in its Section 701 Reports.

The Commission's Annual Compliance Determinations. Unlike the Commission's section 3651 annual reports to the President and Congress, which focus on the efficacy of Commission regulations, the Commission's annual compliance determinations under 39 U.S.C. section 3653 focus on the Postal Service's performance under applicable statutory and regulatory requirements.

- Subsection 3653(b)(1) requires the Commission to determine whether or not Postal Service rates or fees in effect during the year under review were in compliance with applicable provisions of chapter 36 of title 39 and with Commission regulations adopted under those statutory provisions.

[7] *Annual Report to the President and Congress for FY 2011*, at 15 (noting difficulty faced by Commission rules in assuring adequate revenues to maintain Postal Service's financial stability due to prefunding requirements for Postal Service Retiree Health Benefit Fund).

- Subsection 3653(b)(2) requires the Commission to determine whether or not the Postal Service has met its service standards that were in effect during the year under review.

- Subsection 3653(d) requires the Commission to evaluate whether the Postal Service has met its goals established pursuant to 39 U.S.C. sections 2803 and 2804.

Determinations in the Commission's compliance reports issued under section 3653 can, like the conclusions reached in the Commission's § 3651 annual reports inform Commission analyses in its Section 701 Reports.

The Commission's Section 701 Reports. Section 701 Reports must be issued at least every five years and are to focus on the operation of the 2006 PAEA amendments:

> (a) In General.—The Postal Regulatory Commission shall, at least every five years, submit a report to the President and Congress concerning—
>
> (1) the operation of the amendments made by this Act [the PAEA]; and
>
> (2) recommendations for any legislation or other measures necessary to improve the effectiveness or efficiency of the postal laws of the United States.

See 39 U.S.C. § 501 note (2006) (Assessments of Ratemaking, Classification, and Other Provisions). Section 701 Reports can include recommendations to the President and Congress for "any legislation or other measures necessary to improve the effectiveness or efficiency of the postal laws of the United States." *Id.* The Commission is further authorized and directed to include in its Section 701 Reports any recommended changes to universal postal service and the postal monopoly that the Commission considers appropriate, including changes that can be made under current law and changes that require statutory modifications. *Id.*

The Commission's 10-Year Review of Market Dominant Product Regulation. The Commission's annual section 3651 reports, annual compliance determinations, and Section 701 Reports will, in turn, each provide the context and the foundation for the Commission's upcoming review of the system for regulating rates and classes for market dominant products that the Commission established under 39 U.S.C. § 3622. Subsection (d)(3) of section 3622 requires the review of the market dominant regulatory system to be begin 10 years after enactment of the PAEA—*i.e.,* during December, 2016. While the scope of the Commission's review may yet need to be determined,[8] it is clear from the language of section 3622(d)(3) that Congress expects the focus of the 10-year review, if the Commission first determines the system is not achieving the objectives, taking into account the factors, to be on the system for regulating rates and classes for market dominant products that was established under section 3622.[9] Although the 10-year review may not authorize Commission review of the price cap or the provision permitting rate adjustments in extraordinary or exceptional circumstances, such review may be undertaken in its Section 701 Report.

[8] *See* Docket No. RM2016-9, Order Holding Petition in Abeyance, April 12, 2016 (Order No. 3237). (responding to a Postal Service request for clarification of the Commission's view on the scope of the 10-year review).

[9] Although the focus of the 10-year review is narrower than the focus of either the Commission's annual reports or its Section 701 Reports, the potential for some overlap exists. For example, the Commission's consideration in its Section 701 Report of the PAEA's amendments and the desirability of "any legislation or other measures necessary to improve the effectiveness or efficiency of the postal laws" could impact the Commission's consideration in the 10-year review of the need for modification of the Commission's current system for regulating market dominant products.

The various reports required from the Commission, as well as the Postal Service and others, are interrelated and provide complementary analyses that aid in the assessment of the postal regulation regime. In the comments that follow, the Public Representative will draw upon these reports, as well as other relevant sources of information, in addressing areas of interest identified in Order No. 3238.

III. THE 2011 SECTION 701 REPORT AND OTHER REPORTS

A. The 2011 Section 701 Report

The centerpiece of the Commission's 2011 Section 701 Report was Chapter IV, which was comprised of four main subsections containing the following: (1) a brief overview of the Commission's statutory roles in the wake of the PAEA amendments; 2011 Section 701 Report at 7-12; (2) a discussion of financial and transparency issues, *id.* at 13-27; (3) an analysis of rate and service matters, *id.* at 28-70; and (4) a discussion of possible enhancements to Commission processes, *id.* at 71-85.

The subsection dealing with the Commission's statutory roles provided a brief discussion of the new regulatory environment created by the PAEA, a statement of how the Commission implemented its responsibilities under the PAEA, and highlights of the Commission's experience regulating the Postal Service under the PAEA. *Id.* at 7-12.

The subsection that addressed financial and transparency issues, discussed the following areas: (1) Retirement Funds and Compliance with the Sarbanes-Oxley Act; (2) The Market Dominant Price Cap; (3) Market Dominant Classes of Mail; (4) Nonpostal Services; (5) NSAs and Special Classifications; (6) Service Performance Measurements and Customer Satisfaction; and (7) Market Tests and Experimental Products. The Commission concluded its discussion of each of these areas by making a finding or presenting a recommendation.

The final subsection of Chapter IV in the 2011 Section 701 Report addressed potential enhancements to Commission procedures in the following two areas: (1) Post Office Closing Procedures; and (2) The Advisory Opinion Process. The Commission concluded its discussion of each of these areas by presenting recommendations.

B. Other Reports

Since issuing its 2011 Section 701 Report, the Commission has issued five annual reports under Section 3651; five annual compliance determination reports under Section 3653,[10] including three separate reports analyzing the Postal Service's financial situation[11] and, to date, two separate annual reviews of Postal Service performance goals under Sections 3653(b) and (d).[12] Together, these Commission reports address the eight areas discussed in the 2011 Section 701 Report. These reports, issued by the Commission for FY 2011 through FY 2015, provide important information bearing on the operation of the PAEA's amendments and questions regarding the need for legislative or other changes to improve the effectiveness or efficiency of United States postal laws.

[10] Docket No. ACR2011, *Annual Compliance Determination,* March 28, 2012 (FY 2011 ACD); Docket No. ACR2012, *Annual Compliance Determination (Revised),* May 7, 2014 (FY 2012 ACD); Docket No. ACR2013, *Annual Compliance Determination,* March 27, 2014 (FY 2013 ACD); Docket No. ACR2014, *Annual Compliance Determination,* March 27, 2015 (FY 2014 ACD); and Docket No. ACR2015, *Annual Compliance Determination,* March 28, 2016 (FY 2015 ACD).

[11] Docket No. ACR2013, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement (Revised),* April 10, 2014 (FY 2013 Financial Report); Docket No. ACR2014, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement,* April 1, 2015 (FY 2014 Financial Report); and Docket No. ACR2015, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement,* March 29, 2016 (FY 2015 Financial Report).

[12] Docket No. ACR2013, *Analysis of the Postal Service's FY 2013 Program Performance Report and FY 2014 Performance Plan,* July 7, 2014; and Docket No. ACR2014, *Analysis of the Postal Service's FY 2014 Program Performance Report and FY 2015 Performance Plan,* July 7, 2015.

IV. COMMENTS

In its notice and order instituting proceedings in the instant docket, the Commission identified 13 areas of interest on which comments were invited. The 13 areas of interest include the areas addressed by the 2011 Section 701 Report identified above, as well as five additional areas.[13] Each of these 13 areas is addressed in the comments that follow.

A. Postal Service Financial Situation

Prior to the enactment of the PAEA, the Postal Service's share of retiree health benefit premiums were paid on a "pay-as-you-go" basis. 2011 Section 701 Report at 14. By contrast, the Postal Service funded CSRS benefits by means of annual installments calculated by the Office of Personnel Management (OPM) and payable over relatively long periods of time (30 to 40 years). *Id.* at 14-15. Surpluses that had been generated by the Postal Service's CSRS payments were used to reduce the Postal Service's accumulated long-term debt and to delay rate increases through 2005. *Id.* at 16. CSRS surpluses after FY 2005 were placed in escrow for use as later determined by Congress. *Id.*

The PAEA completely revamped the mechanism for funding retiree health benefits. First, the PAEA established September 30, 2016, as the end-date for the pay-as-you-go system under which the Postal Service paid current retiree health benefit premiums. *See* PAEA section 803(a)(1)(A).

Second, the PAEA established the Postal Service Retiree Health Benefits Fund (PSRHBF) within the Department of the Treasury. *See* PAEA section 803(a)(1)B).

[13] The five additional areas of interest identified by the Commission are: (1) the Competitive Rate System; (2) the Postal Service Fund and Postal Service Competitive Products Fund; (3) the Universal Service Obligation and Postal Monopoly; (4) the Requirement of a Public Representative; and (5) the Requirement of a Commission Inspector General.

Third, the PAEA provided initial funding to the PSRHBF by directing that CSRS funds that remained in escrow after FY 2005 be transferred to the PSRHBF. *See* PAEA section 804(b). Additional initial funding was provided by directing OPM to determine whether a surplus existed as of September 30, 2006 in the Postal Service portion of the CSRS Fund and, if so, to transfer such surplus to the PSRHBF by June 30, 2007. *See* PAEA section 802(a)(2).

Fourth, it established a payment schedule under which the Postal Service was to fund the PSRHBF with the following annual payments from FY 2007 to FY 2016:

Table 1
PAEA Schedule of Payments into the Retiree Health Benefits Fund

FY	PAEA Payment Schedules ($ billion)
2007	5.4
2008	5.6
2009	5.4
2010	5.5
2011	5.5
2012	5.6
2013	5.6
2014	5.7
2015	5.7
2016	5.8

Source: PAEA, section 803.

Fifth, the PAEA provided that beginning in FY 2017 all retiree health benefit premiums were to be paid first from the PSRHBF, with any shortfall to be paid by the Postal Service. *See* PAEA section 803(a)(1)(A).

Sixth, the PAEA required OPM to redetermine the surplus or supplemental liability of the Postal Service portion of the CSRS Fund at the close of each fiscal year from FY 2008 through FY 2038 and to either (1) pay any surpluses into the PSRHBF at the close of fiscal years 2015, 2025, 2035, and 2039; or (2) establish an amortization schedule that would eliminate the supplemental liability by September 30, 2043. *See* PAEA section 802(a)(2).

Successful funding of the PSRHBF depended heavily on the Postal Service's ability to generate adequate revenues under the new regulatory rate regime. Under that regime, market dominant products were, of course, subject to a price cap that could escalate in response to changes to the consumer price index for urban areas (CPI-U). The prices of competitive products were to be disciplined by competition in the marketplace.

Under this new regime, the Postal Service would no longer be expected to merely break-even. Rather, by responding to the discipline of the price cap and the pressures of the competitive market, the Postal Service was expected to become more efficient and thereby generate revenues that would exceed costs. Such excess, retained earnings, would not only be able to fund the PSRHBF, but would, among other things, be available to pay down debt, make capital investments, and weather economic downturns by offsetting losses in years when revenues might fall below costs. 39 U.S.C. § 3622(b)(5).

Before implementing the new regulatory regime, the Postal Service was given one final opportunity to propose rate increases under the break-even rate regulation policies of the Postal Reorganization Act (PRA). *See* PAEA section 201 (enacting 39 U.S.C. § 3622(f)). Had it done so, the resulting rates for market dominant products would have been the rates to which the new PAEA price-cap would have applied. However, the Postal Service declined to file such a final PRA rate proposal, possibly because of projected volume and revenue growth.

Aside from its own revenues and the relatively small amount of subsidies for such things as mail for the blind and the military, the only other source of funds for the Postal Service was its borrowing authority. That authority was, however, subject to a $15 billion limit. 39 U.S.C. § 2005(a)(2)(C).

Even before the 2011 Section 701 Report was issued, it was becoming apparent that the PAEA's schedule for prefunding the PSRHBF was overly aggressive. In the first year following passage of the PAEA, the Postal Service operations generated a $1.6 billion profit, but experienced an overall net loss of $5.1 billion due primarily to the required $5.4 billion lump sum PSRHBF payment.[14] The Postal Service responded by borrowing $2.1 billion.

In FY 2008, the economic downturn, now referred to as the Great Recession, began. Notwithstanding the decline in mail volumes, the Postal Service again posted a profit.[15] As in FY 2007, however, that profit was turned into a loss by a $5.6 billion lump sum PSRHBF payment. *Id.* at 1. Once again, the Postal Service resorted to its borrowing authority to borrow a further $3 billion.

As the Great Recession deepened in FY 2009, the Postal Service began incurring losses.[16] Mail volume continued to decline. *Id.* The burden of the PSRHBF prepayments became so severe that on the last day of FY 2009, it became necessary for Congress to reduce the Postal Service's FY 2009 PSRHBF prefunding payment to $1.4 billion by deferring the payment of $4 billion. 2009 ACD at 5 (citing Continuing Appropriations Resolutions, 2010, Pub. L. 111-68, § 164, 123 Stat. 2023, 2053 (2009)). Notwithstanding the temporary relief provided by this deferral, the Postal Service still found it necessary to borrow an additional $3 billion.

During July, 2010, the Postal Service filed its first Exigent Rate request.[17] That request was, however, denied on September 30, 2010.[18] In FY 2010, the Postal Service

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[14] Docket No. ACR2007, *Annual Compliance Determination,* March 27, 2008, at 1, 25 (FY 2007 ACD).

[15] Docket No. ACR2008, *Annual Compliance Determination,* March 30, 2009, at 3 (FY 2008 ACD).

[16] Docket No. ACR2009, *Annual Compliance Determination,* March 29, 2010, at 5 (FY 2009 ACD).

[17] Docket No. R2010-4, Exigent Request of the United States Postal Service, July 6,2010.

[18] Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010, at 2 (Order No. 547).

again posted a loss even before making its scheduled PSRHB lump sum payment.[19] It nevertheless made that payment of $5.5 billion, based, in part, on additional borrowing of $1.8 billion. *Id.*

Over the period FY 2007 through FY 2010, the Postal Service made PSRHBF prefunding payments of $17.9 billion. *See* Table 2. These payments contributed significantly to net losses of over $20.2 billion. *Id.* Not surprisingly, the Postal Service was compelled, over this period, to increase its outstanding debt by $9.9 billion. *Id.*

[19] Docket No. ACR2010, *Annual Compliance Determination,* March 29, 2011, at 5 (FY 2010 ACD).

Table 2

Effect of PSRHBF Prefunding Payments on Net Income and Additions to Debt FY2007 through FY2010 ($ millions)

	Net Income (Loss) w/ RHBF[1]	RHBF Payment[2]	Net Income (Loss) w/o RHBF	Additional Debt Incurred[1]
FY 2007	(5,142)	(5,400)	258	2,100
FY 2008	(2,806)	(5,600)	2,794	3,000
FY 2009	(3,794)	(1,400)	(2,394)	3,000
FY 2010	(8,505)	(5,500)	(3,005)	1,800
Total	(20,247)	(17,900)	(2,347)	9,900

Note 1: FY 2015 Financial Report, Table II-20
Note 2: FY 2015 Financial Report, Table II-19

In its September 30, 2010 Order addressing the Postal Service's first exigent rate request under 39 U.S.C. 3622(d)(1)(E), the Commission found that the PSRHBF prefunding schedule was the principal cause of the Postal Service's then-impending liquidity crisis. Order No. 547 at 68. As the Commission explained, "Postal Service liquidity is the combination of cash on hand and borrowing authority that it can use to finance its operations." *Id.* at 69. Congress expected cash-on-hand to be generated by earnings that would be retained by the Postal Service for various uses. *Id.* at 70 (citing H.R. Rep. No. 109-66 at 43-44). Such retained earnings would have provided the Postal Service with a cushion to compensate for reduced earnings during slow business cycles or to make investments to grow the enterprise. *Id.* at 70. However, because of the PAEA's PSRHBF funding requirements, the Postal Service had been unable to generate retained earnings and therefore lacked liquidity resulting in its request for an exigent rate increase.[20] *Id.* at 71.

The impact of the PSRHBF prepayments on the Postal Service's retained earnings was dramatic, as demonstrated by the following table which is based upon Table 3 of Order No. 547:

[20] At the time the Postal Service made its exigent rate request, it had already borrowed $10.2 billion of its statutorily authorized $15 billion and anticipated borrowing an additional $3 billion in FY 2010. Order No. 547 at 69-70. Resort to its borrowing authority as a source of liquidity was becoming less feasible.

Table 3
Statement of Changes in Net Capital (Deficiency)
($ millions)
With and Without Retiree Health Benefits Pre-Funding[21]
Years ended September 30, 2007 through Estimated September 30, 2010

	Retained Earnings (Deficit) w/o RHBF[1]	Retained Earnings (Deficit) w/RHBF[2]
Balance, September 30, 2006	3,242	3,242
Net Income (Loss) FY 2007	3,216	(5,142)
Balance, September 30, 2007	6,458	(1,900)
Net Income (Loss) FY 2008	2,794	(2,806)
Balance, September 30, 2008	9,252	(4,706)
Net Income (Loss) FY 2009	(2,394)	(3,794)[3]
Balance, September 30, 2009	6,858	(8,500)
Net Income (Loss) FY 2010	(505)[4]	(6,005)
Balance, September 30, 2010	6,353	(14,505)

[1] USPS Form 10-K, FY 2009 at 52; Net Incomes (Losses) from PRC Library Reference 1, R2010-4; Cash Flows PRC Estimates R2010-4.XLS, tab *No RHB*.
[2] USPS Form 10-K, FY 2009 at 52; Net Incomes (Losses) from PRC Library Reference 1, R2010-4, Cash Flows PRC Estimates R2010-4.XLS, tab USPS Forecast.
[3] Reflects $4.0 billion Congressional deferral.
[4] 2010 ACD at 22, Table IV-1.

The Commission concluded further that Congress' deferral of the FY 2009 $4 billion PSRHBF payment had not solved the Postal Service's liquidity problems and that those

[21] For column (a) of Table 3, this analysis assumes that all other financial decisions remained the same.

problems, which had precipitated the Postal Service's exigent rate increase proposal, would continue arise as further PSRHBF prepayments were required.[22] *Id.* at 74-75.

Shortly before issuing its order denying the Postal Service's initial exigent rate request, the Commission prepared an analysis of alternative methodologies for calculating the PSRHBF.[23] The analysis made several recommendations which would have reduced the Postal Service's fixed annual PSRHBF payments to \$3.4 billion from the approximate \$5.5 billion produced by OPM's methodology. Commission PSRHBF Report at 3. Some, but not all, of these recommendations were adopted by OPM. *See* FY 2010 ACD at 25-26.

In a related development, the Postal Service requested the Commission to provide an opinion on the OPM methodology for allocating responsibility to the Postal Service for making payments to Civil Service Retirement System (CSRS) pension fund.[24] The request was prompted by a report issued by the Postal Service's Inspector General concluding that the Postal Service had overpaid \$75 billion into the CSRS fund.[25] In a report dated June 29, 2010, a consulting firm engaged by the Commission estimated that past allocations had understated the Postal Service's share of CSRS assets by as much as \$50 to \$55 billion.[26] It was the Segal Report that the Commission relied upon in the 2011 Section 701 Report to recommend that a \$50 billion to \$55 billion transfer be made to the PSFHBF from the CSRS

[22] Better than expected operating results subsequently enabled the Postal Service to limit its additional borrowing in FY 2010 to \$1.8 billion (thereby increasing total borrowing at the end of FY 2010 to \$12.0 billion). FY 2010 ACD at 22-23. The improved operating results also permitted the Postal Service to make its scheduled FY 2010 \$5.5 billion payment into the PSRHBF. *Id.* Nevertheless, financial challenges were expected to continue into FY 2011. *Id.* at 24.

[23] Postal Regulatory Commission Review of Retiree Health Benefit Fund Liability as Calculated by Office of Personnel Management and U.S. Postal Service Office of Inspector General, July 30, 2009 (Commission PSRHBF Report). The analysis was prepared at the request of the Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, Committee on Oversight and Government Reform, U.S. House of Representatives.

[24] The request was made pursuant to PAEA section 802(c).

[25] USPS-OIG Report Number RARC-WP-10-001, January 20, 2010.

[26] The Segal Report at 13, *supra,* note 5.

fund to compensate the Postal Service for its overpayment. 2011 Section 701 Report at 24-25. OPM has never accepted the Commission's recommendation.[27]

1. Prior Commission Recommendations Regarding Financial and Transparency Issues

In its 2011 Section 701 Report, the Commission recommended "that Congress adjust the current PSRHBF [Postal Service Retiree Health Benefit Fund] payment schedule." 2011 Section 701 Report at 21. It based its recommendation on its conclusion that the then-current prefunding schedule was "the principle cause of the Postal Service's current financial challenges…." *Id.* at 13. The Commission also recommended that Congress consider using the $50 to $55 billion of estimated excess payments that had been paid by ratepayers to satisfy overstated CSRS liability to reduce the unfunded liability of the PSRHBF fund. *Id.* at 24-25.

Experience over the five years since the 2011 Section 701 Report was issued provides further evidence that confirms the need for legislation. Without legislation, the adverse impact of the PAEA's prefunding schedule of the PSRHBF will be perpetuated when, in 2017, the prefunding mechanism is again revised. To correct the prefunding mechanism, Congress needs to take the remedial steps discussed below to balance the goals of ensuring both the adequacy of the PSRHBF and the financial viability of the Postal Service to ensure a vital and efficient universal mailing system.

2. Developments Since the 2011 Section 701 Report

From FY 2011 through FY 2015 and into FY 2016, the Postal Service continued to struggle with declining mail volumes and revenues. That struggle resulted from the

[27] Because of its refusal to accept an alternative methodology for calculating the Postal Service's allocation of CSRS responsibility, OPM calculates that the Postal Service has an unfunded CSRS liability, not a

continued effect of the Great Recession when mail volumes continued to decline in FY 2011 beyond the recession's end during June of 2009.[28] Since FY 2010, the Postal Service has sought to reduce expenses by focusing on several areas, including workhour reductions, consolidation of its mail processing network, and a restructuring of retail facility operations.[29] During this period, the Postal Service also continued to borrow needed funds until it reached its $15 billion borrowing limit. Congress attempted to aid the Postal Service by deferring the Postal Service's PSRHBF lump-sum payment. Ultimately, however, the Postal Service began defaulting on those payments. With the Commission's approval of an exigent rate surcharge during FY 2014, the Postal Service was able to post operating profits in both FY 2014 and FY 2015. However, with the elimination of the exigent surcharge in FY 2016,[30] the Postal Service faces the prospect of a resumption of operational losses.

Following are some of the significant financial highlights of the Postal Service's fiscal years since FY 2010 that demonstrate a recurring pattern:

CSRS surplus. *See infra,* note 27 and accompanying text.

[28] Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013 at 100 (the point in time at which "new normal" mail volumes arrived was different for each class of mail) (Order No. 1926).

[29] Because employee compensation and benefits constitute the largest portion of operating expenses, the Postal Service devoted significant efforts, in particular, to reducing career employee headcounts and workhours. *See, e.g.,* FY 2013 USPS 10-k at 28-29 (compensation and benefits expenses represented 68 percent, 59 percent, and 65 percent of total operating expenses in 2011, 2012, and 2013, respectively).

[30] Docket No. R2013-11, Order on Remand of Exigent Surcharge and Related Changes to Mail Classification Schedule, March 29, 2016 (Order No. 1926).

FY 2011:

- The Postal Service reduced workhours by 34 million hours (USPS Form 10-K, FY 2011 at 21) and compensation and benefits expenses by $599 million (*id*. at 22);
- Total mail volumes declined by approximately 2.9 billion pieces (FY 2011 ACD at 25, Table IV-2);
- Operating revenues continued to decline from $67,051 million to $65,711 million (FY 2011 ACD at 25, Table IV-3);
- The Postal Service made a $2.4 billion pay-as-you-go payment from operating revenues for retiree health care benefits (USPS Form 10-K, FY 2011 at 28);
- The Postal Service showed a loss from operations of $2.8 billion (FY 2011 ACD at 22, Table IV-1);
- The Postal Service found it necessary to borrow $1.0 billion (FY 2015 Financial Report at 33, Table II-20); and
- The Postal Service's precarious financial situation prompted Congress to defer the scheduled FY 2011 $5.5 billion PSRHBF payment to FY 2012 (FY 2011 ACD at 25).

FY 2012:

- The Postal Service reduced workhours by 27 million hours, its career employee headcount by 27,000 employees, and (USPS 10-K, FY 2012 at 24, 33) and compensation and benefits expenses by $621 million (*id.* at 25 and 33);

- Total mail volumes declined further by approximately 8.1 billion pieces (FY 2012 ACD at 29);

- Operating revenues continued to decline from $65,711 million to $65,223 million (FY 2012 ACD at 31, Table IV-1);

- The Postal Service made a $2.6 billion pay-as-you-go payment from operating revenues for retiree health care benefits (USPS 10-K, FY 2012 at 31);

- The Postal Service showed a loss from operations of approximately $2.5 billion (FY 2012 ACD at 32);

- The Postal Service borrowed $2.0 billion thereby reaching its statutory borrowing limit of $15 billion (FY 2015 Financial Report at 33, Table II-20); and

- The Postal Service defaulted on $11.1 of scheduled PSRHBF payments for FY 2011 and FY 2012 (FY 2012 ACD at 27).

FY 2013:

- The Postal Service reduced workhours by 12 million hours, its career employee headcount by 37,000, and its compensation and benefits expenses by $640 million (USPS 10-K, FY 2013 at 28, 29, and 44);
- Total mail volumes declined by approximately 1.5 billion pieces (USPS 10-K, FY 2013 at 23);
- Operating revenues rose from $65,223 million to $66,002 million (USPS 10-K, FY 2013 at 23);
- The Postal Service made a $2.9 billion pay-as-you-go payment from operating revenues for retiree health care benefits (USPS Form 10-K, FY 2015 at 55);
- The Postal Service showed a loss from operations of approximately $1.0 billion (FY 2013 Financial Report at 3, Table 1);
- The Postal Service could no longer borrow because it had reached its statutory borrowing limit of $15 billion; and
- The Postal Service defaulted on its scheduled $5.6 billion FY 2013 PSRHBF payment (FY 2015 Financial Report at 32, Table II-19).

FY 2014

- The Postal Service reduced workhours by 3 million hours, its career employee headcount by 40,000, its compensation and benefits expenses by $708 million (USPS 10-K, FY 2014 at 20-21);
- Total mail volumes declined in FY 2014 by approximately 2.9 billion pieces (*cf.* FY 2013 Financial Report, Appendix A (158,302.4 million pieces) with FY 2014 Financial Report, Appendix A (155,374.8 million pieces));
- The Commission approved the collection of an exigent surcharge (Order No. 1926);
- Operating revenues rose from $66,002 million to $67,831 million (FY 2014 Financial Report at 7, Table II-1);
- The Postal Service showed a profit from operations of approximately $1.375 billion (FY 2014 Financial Report at 7, Table II-1);
- The Postal Service made a $2.9 billion pay-as-you-go payment from operating revenues for retiree health care benefits (USPS Form 10-K at 26);
- Notwithstanding its posting of a profit, the Postal Service defaulted on its scheduled $5.7 billion FY 2014 RHBF payment (FY 2015 Financial Report at 32, Table II-19).

FY 2015:

- Postal Service workhours increased by 21 million hours and career employee headcount increased by 35,000 in order to support growth in shipping and package business and growth in delivery network; the increase in career employees was accomplished by converting non-career to career employees offset attrition-although more costly than non-career employees, the new career employees were cheaper than the career employees they replaced); and compensation and benefits expenses were up by $1.519 million (USPS 10-K, FY 2015 at 19);

- Total mail volumes declined in FY 2015 by approximately 1.2 billion pieces (*cf.* FY 2014 Financial Report, Appendix A (155,374.9 million pieces) with FY 2015 Financial Report, Appendix A (154,157.0 million pieces));

- The exigent surcharge remained in effect throughout FY 2015 (Order No. 3186);

- Operating revenues rose from $67,831 million to $68,928 million (FY 2015 Financial Report at 6, Table II-1);

- The Postal Service showed a profit from operations of approximately $1.188 billion (FY 2015 Financial Report at 6, Table II-1);

- The Postal Service made a $3.1 billion pay-as-you-go payment from operating revenues for retiree health care benefits (USPS Form 10-K at 26); and
- Notwithstanding its posting of a profit, the Postal Service defaulted on its scheduled $5.7 billion FY 2015 PSRHBF payment (FY 2015 Financial Report at 32, Table II-19).

FY 2016:

- The exigent surcharge was eliminated during April, 2016 (Order No. 3186);
- The elimination of the Exigent Surcharge is projected to reduce revenues during FY 2016 by at least $2.0 billion. (FY 2015 Financial Report at 3);
- The Postal Service is expected to make a $3.3 billion pay-as-you-go payment from operating revenues for retiree health care benefits (*see* USPS Quarter II, 2016 Report on Form 10-Q at 23); and
- The Postal Service is expected to default on its scheduled $5.8 billion FY 2016 PSRHBF payment (FY 2015 Financial Report at 3).

The picture that emerges from developments over the past five years is one of the Postal Service continuing to struggle to remain financially viable. Over that period, revenues declined as mail volume declined. In the face of those declines, the Postal Service attempted to reduce its expenses in order to meet its ongoing operational expenses, as well as the statutorily fixed schedule of PSRHBF payments. When its revenues fell short, it resorted to borrowing (as well as the deferral of necessary investments). When its borrowing authority was exhausted, its initial exigent rate request was denied, and Congress failed to terminate or further defer annual lump-sum PSRHBF payments, the Postal Service began defaulting on the PSRHBF payments. When the Postal Service eventually succeeded in obtaining authority to collect an exigent rate surcharge, that surcharge, in part, permitted it to post modest income for two fiscal years.

The following table summarizes Postal Service revenues; net operational expenses; net income/losses from operations; net income/losses including PSRHBF and other statutory accruals; and borrowing over the period from FY 2011 through FY 2015:

Table 4
Postal Service Operating Revenues/Expenses/Income/Losses
FY 2011 through FY 2015

	FY 2011 ($ in millions)	FY 2012 ($ in millions)	FY 2013 ($ in millions)	FY 2014 ($ in millions)	FY 2015 ($ in millions)
Operating Revenues	65,711[1]	65,223[3]	66,002[4]	67,831[6]	68,928[7]
Net Operating Expenses[A]	68,392[2]	67,523[4]	66,839[4]	66,296[6]	67,579[7]
Net Income/(Loss) from Operations	(2,825)[2]	(2,465)[4]	(1,004)[4]	1,375[6]	1,188[7]
Net Income/(Loss)[B]	(5,067)[2]	(15,906)[5]	(4,977)[4]	(5,507)[6]	(5,060)[7]
Long-Term Borrowing	1,000[8]	2,000[8]	-	-	-

[A] Expenses without RHBF accruals, supplemental FERS contributions, and non-cash Workers' Compensation Liability
[B] After statutory accruals into RHBF, supplemental FERS contributions, and non-cash Workers'' Liability
[1] FY 2011 ACD at 25, Table IV-3
[2] FY 2011 Postal Service 10-k at 16
[3] FY 2012 ACD at 31, Table IV-1
[4] FY 2013 Financial Report at 3, Table I
[5] FY 2012 ACD at 32, Table IV-3
[6] FY 2014 Financial Report at 7, Table II-1
[7] FY 2015 Financial Report at 6, Table II-1
[8] FY 2015 Financial Report at 33, Table II-20

Looking ahead, it appears that without the exigent surcharge, the Postal Service will again face the prospect of inadequate operational revenues, defaults on lump-sum PSRHBF payments, and a limited ability to make necessary investments.

3. The Postal Service's FY 2016 Year-End Financial Situation and the Potential Consequences of Legislative Inaction

a. The Postal Service's Financial Situation as of September 30, 2016

At the close of FY 2016 on September 30, 2016, the Postal Service's financial situation will be influenced by the following significant factors:

Unfunded Retiree Health Benefit Liability. Fiscal year 2016 will end on September 30, 2016. As of the end of FY 2015 on September 30, 2015, the amount of PSRHBF unfunded retiree health benefit liability was $54.8 billion.[31] Since the unfunded liability of the PSRHFB has increased every year since FY 2011, it should not be surprising for the unfunded liability to be at least $54.8 billion, and possibly more, on September 30, 2016.[32]

Pay-As-You-Go System for Current Retiree Health Benefit Premiums. The pay-as-you-go system for paying current retiree health benefit premiums from operating revenues will end on September 30, 2016. The termination of the pay-as-you-go system will reduce operating expenses by approximately $3.4 billion.

Total Lump-Sum PSRHBF Defaults. Since the Postal Service has already indicated that it expects to default on the last lump-sum PSRHBF payment, $5.8 billion, as specified by the PAEA, the total amount of defaults as to September 30, 2016, is expected to be approximately $34 billion. *See* FY 2015 Financial Report at 32.

Outstanding Postal Service Debt. As of September 30, 2016, the Postal Service will have borrowed the maximum $15 billion authorized by law.

[31] Postal Service Form 10-K at 55 as reported in the Commission's FY 2015 Financial Report at 32, Table II-19. This unfunded liability is calculated annually by OPM.

[32] *See* FY 2015 Financial Report at 32, Table II-19.

Effect on Revenues of Exigent Surcharge Termination. As of September 30, 2016, the Postal Service will no longer be collecting the exigent rate surcharge. Collection of the surcharge terminated during April, 2016. Termination of the surcharge will reduce annual Postal Service revenues by approximately $2 billion.

b. The Potential Consequences of Legislative Inaction

Assuming no changes in current law, the following factors can be expected to have a significant impact on the Postal Service's financial situation beginning in FY 2017:

Payment of Current Retiree Health Benefit Premiums. Beginning in FY 2017, the Postal Service will no longer make retiree health benefit payments from operating revenues on a pay-as-you-go basis. Instead, those payments will be made from the PSRHBF. Payment from the PSRHB will permit a reduction in Postal Service operating expenses of $3.4 billion. This is a potentially positive development, because, by itself, it creates the potential for improvement in the Postal Service's financial condition. In FY 2017, the anticipated amount of retiree health benefit payments will be approximately $3.5 billion.[33]

Payment of "Normal Costs" into the PSRHBF. Beginning in FY 2017, the Postal Service must pay so-called "normal costs" into the PSRHBF. Normal costs represent the change, calculated annually by OPM, of the present value of future benefits for all current (at the time of the annual calculation) employees of the Postal Service. For FY 2017, Normal Costs payable by the Postal Service to the PSRHBF are estimated to be $3.3 billion.[34] The Postal Service will need adequate operating revenues in order to be able to pay these costs.

[33] Assuming a 5.9 percent increase in FY 2016 payments (estimated to be $3.3 billion, *see, supra,* Section IV. A. 2. (*FY2016*)), those annual payments from the PSRHBF will be approximately $3.5 billion.

[34] "Reforming the Postal Service: Finding a Viable Solution: Hearing Before the House Oversight and Government Reform Committee, 114th Cong. (May 11, 2016) (written statement of Megan J. Brennan, Postmaster General and Chief Executive Officer).

Amortization of Unfunded Retiree Health Benefit Premiums. As noted in the preceding section, the PSRHBF unfunded retiree health benefit liability can be expected to be at least $54.8 billion, and possibly more, by the end of FY 2016. It appears that the $34 billion of PSRHBF lump-sum payment defaults will be subsumed within the $54.8 billion (or more) of unfunded liability. It is the unfunded liability that OPM will calculate by June 30, 2017, and use to determine the amount to be amortized over the next 40 years. The annual payment amount needed to amortize $54.8 billion over 40 years is approximately $3.4 billion. By reducing the lump-sum payment requirements for amortizing unfunded liability, this change also has the potential for improving the Postal Service's financial condition. However, the Postal Service will need adequate operating revenues to avoid a repeat of the pattern of previous PSRHBF lump-sum payment defaults that occurred from FY 2012 through FY 2016.

Termination of the Exigent Surcharge. Termination of the exigent surcharge can be expected to reduce Postal Service operating revenues by approximately $2 billion per year. The Postal Service must, through some combination of revenue increases and cost reductions, compensate for the loss of these revenues or risk being unable to meet its expenses.

The loss of $2 billion of annual exigent surcharge revenues severely reduces the net effect that would otherwise be produced by the $2.5 billion net positive effect that will otherwise be produced by two net payment reductions. Those net reductions are, first, the elimination of the $3.5 billion pay-as-you-go payment of retiree health premiums from operating revenues with payments from the PSRHBF and , instead, the payment into the PSRHBF of the $3.3 billion of Normal Costs for a net reduction of $0.2 billion. The second net payment reduction results from the reduction of lump-sum payments into the PSRHB from $5.8 billion, as required in FY 2016, to an anticipated payment of approximately $3.5 billion, to be calculated by OPM in FY 2017 for a net reduction of $2.3 billion. The total net effect of these two changes would be an increase in Postal income of approximately $2.5 billion, as shown in the following table:

Table 5
Estimated Annual Effects on Operating Revenues
From Changes in RHB Payment Mechanism
Without Exigent Surcharge

Activity	Amount (billions)
Removal of Pay-As-You-Go Premiums From Operating Revenues	($3.5)
Begin Payment of Normal Costs from Operating Revenues into PSRHBF	$3.3
Average FY 2007- FY2016 Scheduled PSRHBF Prepayments	($5.8)
FY 2017 OPM Calculated Lump-Sum Payments into PSRHBF from Operating Revenues	$3.5
Effect on Operating Revenues	$2.5
Loss of Exigent Rate Surcharge	($2.0)
Effect on Operating Revenues From Loss of Exigent Rate Surcharge	$0.5

The effect of losing $2 billion in annual exigent surcharge revenues could reduce the net effect of the positive increase in operating revenues due to changes in the PSRHB payments down to only approximately $500 million.

The potential impact of the foregoing changes on the Postal Service's net income would be to either marginally reduce or marginally increase overall losses. This can be demonstrated by adjusting the Postal Service's net loss in FY 2015 (the most recent year available) as shown on Table 4, column 6, by the estimated annual effects of the changes in the PSRBHF funding mechanism and the loss of the exigent surcharge as shown on Table 5, above:

Table 6
FY2015 Postal Service Loss
Adjusted for Changes in PSRHBF
Funding Mechanism and Termination
Of Exigent Surcharge

Postal Service Operating Revenues/Expenses/Income/Losses

	FY 2015 ($ in millions)	FY 2015 as Adjusted ($ in millions)
Operating Revenues	68,928	68,928
Net Operating Expenses	67,579	67,579
Net Income/(Loss) from Operations	1,118	1,118
Net Income/(Loss)	(5,060)	(5,060)
Adjustment	n/a	500
Adjusted Net Income/Loss	(5,060)	(4,560)

Sources: *See* Table 4, column 6, and Table 5, column 2, line 7.

Together, the changes in the PSRBHF funding mechanism and the loss of the exigent surcharge can be expected to have only a marginal net effect on the Postal Service's *substantial and continuing* losses.

Outstanding Postal Service Debt. Finally, since the Postal Service has reached its $15 billion borrowing limit, it will enter FY 2017 without any further borrowing authority. This will continue to hinder the Postal Service's ability to respond to fluctuations in income and severely limit its ability to make necessary investments.

The Current Price Cap Mechanism. Without legislation, the Postal Service price increases will continue to be limited to changes in the CPI-U index. The existing price cap mechanism will force the Postal Service to continue living "hand-to-mouth" with a severely limited opportunity to generate profits or retained earnings.

4. Recommendations of the Public Representative

Without changes to existing law, the Postal Service will continue to face very serious financial challenges. Without increased operating income, it will continue to struggle and will likely be unable to make the payments determined by OPM to be necessary to eliminate its unfunded retiree health benefits liability. It will be unable to make necessary capital investments. It will be unable to reduce the balance of its outstanding debt. And it will struggle to meet operating expenses.

To give the Postal Service a reasonable opportunity to meet these challenges, the Public Representative recommends some combination of the following changes in existing law:

a. Cancel Defaulted PSRHBF Payments

As of the end of FY 2016, the Postal Service has defaulted on the payment of $28.1 billion of PSRHBF lump-sum payments. The effect of those defaults was to increase the end-of-year net unfunded actuarial liabilities of the PSRHBF. *See* 2015 Financial Report at 32, Table I-29. When OPM computes a schedule of annual payments to liquidate unfunded liabilities, as required by 5. U.S.C. § 8909a(d)(2)(B), the $28.1 billion of defaults will be retired. The Public Representative therefore submits that cancellation of the Postal Service's defaulted PSRHBF payments would be appropriate.

b. Recalculate and Apply CSRS Balances to the PSRHBF

While the anticipated lump-sum payments that OPM is required to calculate in FY 2017 are expected to be significantly lower than the payments prescribed by the PAEA from FY 2007 through FY 2016, the amount of those payments, approximately $3.5 to $4.0 billion per year is still substantial. The Public Representative supports the recommendation made by the Commission in its 2011 Section 701 Report that the CSRS balances be recalculated in the manner suggested by the PAEA section 802(c) report prepared for the Commission by the Segal Company and that the recalculated balances be applied to satisfy the unfunded PSRHBF liability.[35] At the time the Commission issued the 2011 Section 701 Report, the CSRS balance had the potential for completely satisfying the unfunded PSRHBF liability. Were the same result to be produced today, the Postal Service could have as much as $3.5 billion to $4.0 billion of additional revenues. Not enough to wipe out its annual losses, which, all things remaining equal, would continue to be several billion dollars, but enough to greatly improve the Postal Service's financial position.

c. Increase the Postal Service's Debt Limit

Since FY 2006, the Postal Service has used all of its borrowing authority. Most, if not all, of that borrowing is directly due to the annual lump-sum PSRHBF payments the PAEA required the Postal Service to make. The consequence is that the Postal Service is now without an important source of funds for much needed investment. While it would be preferable for investment funds to come out of retained earnings, the prospect of an immediate improvement in earnings is not likely. Even if one or more of the Public Representative's other recommendations were adopted, it might take some time for those recommendations to be approved and implemented and for the Postal Service to generate adequate additional revenues for needed investments. Rejection of all of the Public Representative's recommendation would make additional borrowing authority even more critical.

In his comments in the FY 2009 ACD proceeding, the Public Representative proposed an increase in the Postal Service's statutory borrowing limits.[36] He based that suggestion on

[35] 2011 Section 701 Report at 24-25 (citing the Segal Report).

[36] Docket No. ACR2009, Public Representative Comments on Annual Compliance Report, February 2, 2010, at 29-30.

the fact that the Postal Service's statutory borrowing limits had not been changed since they were established, which, at that time, was almost 20 years earlier. *Id.* at 29. The Public Representative proposed that the statutory limits be adjusted for inflation. Had that adjustment been made, the annual borrowing limit would have been raised to $4.9 billion and the total borrowing limit would have been raised to $22.9 billion.

An additional six years have passed and the Postal Service is still operating under the original statutory borrowing limits. In light of the demonstrated need for additional financial flexibility, including the need to make capital investments, the Public Representative renews the recommendation that the Postal Service's borrowing limits be increased to account for inflation.

d. Require the Postal Service to File a True-Up Rate Case to Reset Rates at Break-even as Contemplated in Section 3622(f) as Adopted by the PAEA

➢ *A Fundamental Principle of Economic Regulation is Long-Run Recovery of All Prudently Incurred Costs*

A fundamental principle of rate regulation is that all costs associated with an ongoing enterprise must be recovered in the long run or the ability to continue operations at the desired level of efficiency and service will deteriorate, ultimately forcing a termination of operations. This principle is particularly important in the case of a regulated entity that must rely upon regulators and applicable legislation to ensure that all costs can be recovered.

This fundamental principle underlies the theory of ratemaking as often expressed in the literature of regulation. One of the most notable of commentators is Bonbright who described reasonable rates as "rates adequate to yield revenues that will cover all legitimate operating expenses plus a return on investment sufficient to maintain sound corporate credit and to attract required amount of new capital. Rates below this level are deemed deficient because, at least in the long run, they will not enable the company to live up to its obligations to serve the community."[37] Bonbright at 50.

Bonbright elaborates further on the cost of service, "Nevertheless, one standard of reasonable rates can fairly be said to outrank all others in the importance attached to it by experts and by public opinion alike—the standard of cost of service, often qualified by the stipulation that the relevant cost is *necessary* cost or cost reasonably or prudently incurred." *Id*. at 67. Further, "in the rate-making practices of publicly owned plants, the determination of general rate levels…the most directly pertinent costs are the total cost, including the overhead costs. In other words, the cost principle is taken to mean that rates as a whole should cover cost as a whole." *Id*. at 74.

Other commentators, Garfield and Lovejoy expressed the principle as follows: "it is a fundamental truism that the public utility under regulation should be authorized to collect, if possible, total revenues equal to its cost of service."[38]

Another author, Phillips, states most directly, "As to rate level, public utilities are entitled to cover all allowable operating costs and to have the opportunity to earn a "fair" rate of return. Collectively, these items comprise a company's total revenue requirements."[39] Phillips notes that Bonbright lists as one of eight criteria of a sound or desirable rate structure is, "Effectiveness in yielding *total* revenue requirements under the fair-return standard." (Emphasis supplied.) *Id*. at 434.

This principle that regulated entities must recover all costs underlies the financial provisions in title 39 and other related laws, discussed above, that are implicitly and

[37] James C. Bonbright, Principles of Public Utility Rates, Columbia University Press, New York, 1969 at 50.

[38] Paul J. Garfield, Wallace F. Lovejoy, Public Utility Economics, Prentice-Hall, Inc. Englewood Cliffs, N.J., 1964 at 44.

sometimes explicitly designed to insure that all costs of retiree annuity benefits and retiree health benefits can be paid, when due, from retirement and health benefit funds. Other provisions of title 39 related to recovery of other Postal Service costs do not require recovery of its total costs.

➢ *The PAEA Effectively Precludes Recovery of Legitimate Postal Service Costs*

The PAEA regulatory regime did not merely change the method of calculating the amount of revenue that rates were to recover. The previous method had been based on estimates of costs. Under the PAEA, costs were taken out of the equation for determining the overall allowable revenues. With rates at the starting point assumed to be at or near breakeven, revenue changes since have been based on the percentage increase in consumer prices: Consumer Price Index for All Urban Consumers (CPI-U) unadjusted for seasonal variation. 39 U.S.C. § 3622(d)(1). The change in consumer prices is, at best, only remotely related to Postal Service operations cost changes. They bear little or no measurable relationship to funding requirements established for retirees by the PAEA.

Although the PAEA assumed that at the starting point in 2007 the Postal Service's rates were covering costs, it permitted the Postal Service to file one final cost-based rate case at the Postal Service's option. Such a rate case would have established a higher rate floor for future rate increases tied to the CPI-U. 39 U.S.C. § 3622(f).

Under the PAEA, the prominent group of products is market dominant and the majority of those costs, both attributable and institutional, are expected to be recovered through revenue derived from market dominant classes of service which are subject to a price cap as well as subject to an extremely limited opportunity for exigent rate relief when needed to

[39] Charles F. Phillips, The Regulation of Public Utilities, Theory and Practice, Public Utilities Reports, Inc. Arlington, Virginia, 1993 at 171.

relieve financial difficulties due to certain events. There is no specific provision requiring recovery of all institutional costs apportioned to market dominant products.[40]

The recovery of institutional costs from competitive products appears somewhat of an afterthought. The PAEA does not require competitive products to make up for the shortfall in institutional costs not recovered by market dominant classes of mail. The PAEA includes only the statutory admonition that the Commission "promulgate (and may from time to time thereafter revise) regulations to … (3) ensure that all competitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service." 39 U.S.C. § 3633(a). That is the only directive, *i.e.* requirement, in the PAEA regarding competitive product recovery of institutional costs. By regulation, the Commission has determined the "appropriate share" is to provide a minimum of 5.5 percent of institutional costs. 39 CFR § 3015.7(c). This appropriate share amount does not begin to make up the institutional revenue shortfall legislatively imposed by the PAEA's price cap on market dominant rates.[41] Capped market dominant rates cannot be adjusted to assure adequate revenues in order to return to financial stability, except in very limited circumstances not now available, for current critical financial needs.[42]

To be sure, there are objectives listed in the PAEA that suggest recovery of total costs, including institutional costs, when establishing market dominant rates. The relevant

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[40] One of the many factors the Commission shall take into account in its regulations for market dominant rates and classes is that each class or type of mail service shall bear, besides attributable costs, "that portion of all other costs of the Postal Service reasonably assignable to such class or type." 39 U.S.C. 3622(c)(2). This provision is predicated with the phrase "the requirement," but the price cap has been determined to supersede this section so that (c)(2) recedes to an equal place with all other factors and provides no assurance whatsoever that all costs will be recovered.

[41] The 10 year review will permit the Commission to revise its regulations to improve the system of modern rate regulation, including the appropriate apportionment of institutional costs. 39 U.S.C. § 3622(d)(3). However, issues have already raised about the breadth of the Commission's authority, if any, to modify the underlying provisions of section 3622 such as the price cap requirement or the exigent provisions. See {Postal Service and UPS filings] Immediate legislation to require recovery of total costs could eliminate years of potential litigation over the issues raised.

[42] Docket No. ACR2010, Annual Compliance Determination, March 29, 2011, at 18-19, 13-14.

objectives are: “to assure adequate revenues …to maintain financial stability, 39 U.S.C. § 3622(b)(5), to establish and maintain a just and reasonable schedule for rates, 39 U.S.C. § 3622(b)(8), and to allocate the total institutional costs …appropriately between market-dominant and competitive products. 39 U.S.C. § 3622(b)(9). Section 3622(b) states that the objectives of the modern system for regulating rates and classes for market-dominant products shall be designed to achieve the list of all 9 objectives. However, these objectives have been held to be subservient to the price cap requirement in section 3622(d)(1)(A) that necessarily has led to revenue shortages and the narrow terms of the financial relief valve in section 3622(d)(1)(E) strictly limiting qualification for exigent rate increases, although rate increases are otherwise necessary. Legislative modification of the PAEA is necessary to require rates necessary to recover the Postal Service’s total costs when provisions of the law have placed the Postal Service finances in an unhealthy state.

The Postal Service’s financial stress also has caused it to engage in potentially questionable cost savings initiatives. Reduced service performance scores for FY 2015 are indicative of the after-effects of financial stress. In the area of service performance, one such questionable initiative was its Mail Processing Network Rationalization (MPNR) program. The Commission provided the Postal Service with an Advisory Opinion concerning this initiative on September 28, 2012 in Docket No. N2012-1.[43] This initiative was to have been implemented in two phases for significant cost savings. According to the Postal Service, Phase 2 of MPNR began in January 2015, but has been deferred and there is no currently scheduled date for completion.[44]

Given the provisions in the PAEA which expanded the Postal Service’s funding obligations for employee retirements and health benefits, together with the limitation on

[43] Docket No. N2012-1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012.

[44] Docket No. ACR2015, Response of the United States Postal Service to Question 7 of Chairman’s Information Request No. 11, February 18, 2016.

market dominant price increases tied to the CPI-U Index, and the limited availability of exigent rate increases, the Postal Service is now in a distressed financial situation. The recent very low service performance results are an outgrowth of the limitations on Postal Service revenue since the PAEA was passed.

The Postal Service asserted in the proceeding that to capture the projected financial benefits of realigning its networks, it must modify service standards for First-Class Mail, Standard Mail, Periodicals, and Package Services. The changes to service standards would ultimately eliminate all overnight delivery service for single-piece First-Class Mail, and delay much of current First-Class Mail from 2-day delivery to 3-day delivery. Presorted First-Class Mail and Periodicals would have to meet new mailing requirements, including new accelerated entry times, to maintain eligibility for overnight service. Standard Mail and Package Services would be affected to a lesser extent.

The Commission concluded that it was possible for the Postal Service to undertake significant network rationalization and realize substantial cost savings while preserving most of the then-current service levels. The Commission advised the Postal Service to consider its recommendations, including alternatives that would preserve service levels, before proceeding with full implementation of MPNR.

The Commission also concluded that in order to capture the anticipated cost savings upon full implementation of MPNR, the Postal Service would have to improve average systemwide productivity by over 20 percent. The Commission cautioned that improvements of this magnitude are remarkably ambitious and involve some risk.

The Commission estimated that MPNR cost savings could be as low as $46 million annually, assuming mail processing productivities remained at current levels, or as high as $2 billion annually if all proposed assumptions proved correct. The Commission was concerned that cost savings could be offset by reduced contribution to the bottom line from volume loss by mailers who no longer believe the level of service provided meets their postal needs. Although MPNR commenced January 1, 2015, the Commission has not received any updated cost savings estimates.

Despite the Postal Service's efforts through this initiative, even with newly relaxed service standards, the Commission's FY 2015 ACD pointedly noted: "For the first time, since the Postal Service began reporting service performance of all Market-Dominant mail products, no First-Class Product met or exceeded its service performance targets."[45] In addition, the Postal Service's quarterly district level service performance reports illustrate that all quarters, not just quarters where severe weather occurs, have reported results less than the target.

The Postal Service generally attributed its poor FY 2015 First-Class Mail service performance results to winter weather and *implementation of Network Rationalization* in addition to problems in its transportation network. FY 2015 ACD at 133 (emphasis supplied). The Postal Service explained that Phase 2 of MPNR caused a shift in mail volume between mail processing facilities, which resulted in additional interrupted network flows due to insufficient air carrier capacity in the needed locations. The Postal Service also explained (FY 2015 ACD, USPS-FY15-29 at 8) that "the disruption caused by realigning staffing and educating employees in new jobs resulted in slippage of performance." New service standards resulting from the Phase 2 implementation of Network Rationalization resulted in a change in operating windows. This change led to 're-bidding' of the majority of craft employee assignments at mail processing locations". FY 2015 ACD at 134.

The currently required recalculation of the funding payments in 2017 may alleviate, but far from eliminate, the Postal Service's inability to recover its total costs. Yet, the only relief that can begin to solve the Postal Service's financial difficulties to solidify its finances is legislation requiring an immediate true-up rate case to realign Postal Service rates with the

[45] FY 2015 ACD at 131.

Postal Service's total costs. Experience indicates that due to the unpredictability of the economy, falling customer demand for First-Class Mail, reductions in mail density, as well as the now growing risk of potential competition from internet giants such as Amazon, further delay in realigning revenues with total costs ensures continued revenue shortfalls amounting to billions of dollars. Without legislative relief, these revenue deficiencies will continue and the Postal Services financial condition will continue to deteriorate.

➢ *Need to Provide for Periodic Revenue Reset Adjustments*

In the 1980s, theoretical research on incentive regulation evolved rapidly.[46] The PAEA introduced incentive regulation through rates tied to the CPI-U index. Its purpose was to deal with a problem with cost of service regulation, namely, the possibility that management might exert too little effort to control costs, thereby increasing costs above efficient levels. *Id*. at 5. An alternative to setting a fixed price *ante* going forward (cost of service) in a dynamic setting was to adjust prices for exogenous changes with input *price indices* and other exogenous indices, *i.e.* a price cap mechanism. *Id.* at 6. However, as Jaskow points out, a price cap must operate with a breakeven constraint.

Joskow emphasizes that a price cap regime includes the need to recover all costs. Under a price cap mechanism, if the firm is inherently high cost, prices under the "price cap will be high enough to cover the firm's (efficient) realized costs." *Id*. However, a price cap alone is suboptimal because when rates are constructed to ensure total costs are recovered, they provide management incentives for cost reduction but are "very poor at "rent extraction' for the benefit of consumers and society…due to the …need to adhere to the *firm viability* …constraint." (emphasis supplied). Joskow further says, "the regulator seeks to extract rent

[46] Paul J. Joskow, *Incentive Regulation in Theory and Practice: Electricity Distribution and Transmission Networks*, January 21, 2006, Prepared for National Bureau of Economic Research Conference on Economic Regulation, September 9-10, 2005 at 4. Paul Joskow is Professor of Economics, Emeritus, MIT and former head of MIT's Department of Economics.

from the firm for the benefit of consumers, *subject as always to a firm breakeven constraint"* (emphasis supplied). *Id*. at 9.

Under the PAEA's price cap regime, since price caps were implemented, rates subject to the price cap limitation have not been allowed to be set high enough to cover the Postal Service's realized costs. Congress became, in effect, the regulator when it removed the Commission's discretion, except in limited circumstances, to adjust rates to a breakeven level to cover realized costs. Under the PAEA, breakeven is not a constraint as it should be, but a happenstance, outside the Commission's control.

Jaskow observes that a price cap without any cost-sharing (i.e. without a sliding scale mechanism) is not likely to be optimal …. *Id.* at 20. He concludes therefore that, "[t]he application of a ratchet from time to time that resets prices to reflect observed cost is a form of cost-contingent dynamic regulatory contract. It softens cost-reducing incentives but extracts more rents for consumers in the long run." *Id*. As discussed below, except in extremely limited circumstances, the PAEA price cap does not contain the necessary rate ratchet mechanism to reset prices periodically.

- *Amendments to the PAEA Are Necessary to Permit a True-Up Rate Case*

Although the PAEA assumed that at the starting point in 2007 the Postal Service's rates were covering costs, it permitted the Postal Service to file one final cost-based rate case at the Postal Service's option. Such a rate case would have established a higher rate floor at, or near, the breakeven level at which future rate adjustments tied to the CPI-U would occur. 39 U.S.C. § 3622(f).

If the Postal Service had filed one more traditional rate case in 2007 it might have, for instance, increased revenues by $ 2 billion; then in the ten years since that time, without adjusting for compounding effects of the rate increases or for the impact of demand elasticities, the Postal Service would have received close to $20 billion more revenue that it did receive. Similarly, a $3 billion rate increase at that time would have amounted to approximately $30 billion more in revenues for the Postal Service since 2007. Such amounts would have greatly improved the Postal Service's financial position today.

Unfortunately, no such rate case was filed and the Postal Service has suffered financially from the loss of that potential revenue, a loss which, in the absence of a reset mechanism, is accumulating yearly. A rate case at this time to restart the rates at breakeven is needed to reinvigorate the Postal Service's finances.

A true-up case now to restart the rates would provide the necessary ratchet to allow rates to recover total costs, subject to a price cap and would permit the accumulation over a few years of additional vitally needed revenue. This is not to say that the Public Representative believes a return to total cost of service regulations is necessary or desirable. However, an opportunity to adjust revenue by resetting rates at a level to give the Postal Service an opportunity to recover total costs is needed as a platform for future indexed price cap adjustments.

B. The Market Dominant Rate System

1. Prior Commission Recommendations Regarding the Market Dominant Price Cap

Addressing the market dominant rate system in the 2011 Section 701 Report, the Commission found that the annual rate limitation for market dominant products as expressed by the price cap had kept prices stable and predictable since the passage of the PAEA. 2011 Section 701 Report at 28. Based on experience up to that time, the Commission found that no legislative changes were needed with respect to the price cap. *Id.* However, the Commission recommended that Congress consider providing an opportunity for the Postal

Service to achieve increased pricing authority for increases in quality of service. *Id*. No method to institute that recommendation was offered in the Commission's Report.

2. Developments Since the 2011 Section 701 Report

As discussed in Section III.A., above, the Postal Service's economic circumstances have continued to deteriorate, notwithstanding a slow and limited improvement over the last five years as operations, aided by the temporary exigent surcharge, posted some profits.~~,~~ The Postal Service remains in precarious financial straits and, to say the least, faces a challenging financial future.

In addition to the problems presented by the requirement of lump-sum PSRHBF payments, the exhaustion of Postal Service's borrowing authority, and the termination of the exigent surcharge, the Postal Service's financial viability will be further hampered by the way the price cap operates in an environment in which mail volumes are decreasing and the number of delivery points is increasing. Moreover, experience under the price cap has shown that the Postal Service's authority to determine when to implement rate adjustments can work at cross-purposes with the Commission's efforts to ensure that workshare discounts cover avoided costs.

3. Recommendations of the Public Representative

To address the foregoing problems, the Public Representative submits that legislative changes are needed to modify the operation of price cap:

a. Adjust the Price Cap to Account for Declining Mail Volume and an Increasing Number of Delivery Points

➢ *The Role of the Price Cap in Maintaining Financial Stability*

Both the PAEA and its predecessor the Postal Reorganization Act of 1970 recognized the fundamental principle of regulation. The entity regulated, in this case the Postal Service, should recover all of its costs from sufficient revenues through rates paid by ratepayers who send mail and purchase ancillary services. When revenues continually fall short of total costs and, if taxpayers do not pick up unrecovered costs in the longer run, without the recovery of all costs the regulated entity must eventually wither away and discontinue operations. As shown above, this principle has been expressed by economists in several important books on the subject of rate regulation. As with any regulated concern, that principle remains of paramount importance to ensure the continued long term survival of the Postal Service.

The primary mechanism in the PAEA to ensure the Postal Service's continued recovery of all its costs is the ratcheting of rates to changes in the CPI-U index. Unless the change in the CPI-U Index mirrors reasonably the Postal Service's costs as controlled by honest efficient management, there will be a disconnect between the revenue received and total costs of the Postal Service. Experience since the PAEA was passed indicates the CPI-U has not been sufficiently flexible to respond to declining mail volumes brought about by losses of First-Class Mail volume to the internet, a recession, as well as declining mail density.

➢ *Amendment of CPI-U Price Cap Is Necessary to Reflect Postal Costs*

The price cap on Postal Service prices was established by the PAEA signed in 2006. Under the price cap selected by Congress from among several that were considered, Congress determined that price increases for each class of market dominant mail are to be limited by the change in the Consumer Price Index–Urban (CPI-U).[47] In the absence of competition, the price cap is intended to serve as a

[47] The Senate bill, No. S. 2468, considered in 2004, provided for a price cap potentially drawn from several indices. *See* Committee on Government Affairs, United States Senate, Report 108-318, S. 2468, August

surrogate or proxy for competitive market forces by providing a control on bloat and inefficiency in the Postal Service. In order to keep growth in postal prices equal to or below the rate of change in the CPI-U, while earning net income, the Postal Service must keep its costs down through efficient management of its resources. However, as a Postal Service OIG Report[48] noted:

> In the particular context of the Postal Service, however, countervailing forces have blunted any efficiency–promoting qualities of the price cap. These forces include, among other issues, 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.[49]

Thus, the price cap maximizes incentives to reduce costs and increase efficiency per Objective 1 of the PAEA, 39 U.S.C. § 3622(b)(1), but limits the Postal Service's options to accomplish this task.

The effectiveness of the price cap in maintaining the Postal Service's financial viability is highly dependent on mail volume. For the Postal Service, with additional delivery points each year, the price cap works best when volumes are increasing each year. The price cap has not been as effective since volumes have been constantly declining. It is doubtful that anyone foresaw the unprecedented volume declines experienced by the Postal Service soon after passage of the PAEA or the recession that contributed greatly to the volume decline.

25, 2004, at 10. The proposed legislation wisely provided for flexibility in the choice of index by permitting the Commission to determine the appropriate index. Under this mechanism, the Commission also had the flexibility to revise its choice of indices as necessary. *Id.*

[48] U.S. Postal Service Office of the Inspector General, Revisiting the CPI-Only Price Cap Formula, Report Number: RARC-WP-13-007, April 12, 2013. (OIG Report).

[49] *Id.* at ii.

Reduced mail volume resulted in reduced delivery economies of density—a decline in mail volume per delivery point.[50]

Prior to the release of the OIG Report in 2013, which we discuss in more detail below, the Public Representative's Initial Comments in Docket No. ACR 2010[51] noted that the Postal Service's number of delivery points increased by 739,580 or 0.49 percent in FY2010, resulting in an increase in fixed delivery costs. Yet, revenue per delivery point decreased by 2 percent in FY 2010 due to volume declines. The Public Representative concluded that the Postal Service needed a new source of revenue to cover the costs of new delivery points. The Public Representative further suggested that Congress be asked to add a second index to the price cap. This index would serve as a proxy for changes in delivery points. One such possible index suggested by the Public Representative at the time would apply the most recent annual change in the Census Bureau's estimate of housing units. At that time, the most recent data showed that the number of housing units in the U.S. increased 0.5 percent between July 2008 and July 2009. This percent increase would be multiplied by annual postal revenue to derive the extra revenue that would be allowed by the price cap and thereby raised from new rates. This income would be in addition to the income allowed by CPI-U. The suggestion by the Public Representative to add an index to the price cap was a precursor to the Postal Service's plan responding to the decline in mail volume per delivery point.

Subsequently, in its Request for an Advisory Opinion in Docket No. N2010-1,[52] the Postal Service proposed to transition from six-day to five-day street delivery. The Postal Service indicated that it had experienced steady and precipitous declines in mail volume,

[50] *Id.* at iii.

[51] Docket No. ACR2010, Public Representative Comments in Response to Order No. 636, February 2, 2011.

[52] Docket No. N2010, Request of the United States Postal Service for an Advisory Opinion on Changes in the Nature of Postal Services, March 30, 2010 (Request for an Advisory Opinion).

driven largely by an acceleration of the diversion of First-Class Mail and other communications. It further noted that delivery addresses continue to increase every year. The Postal service concluded that it was ”delivering considerably less mail to more addresses at a time when the evolving mail mix has been generating less revenue and contribution to overhead per piece. This is an unsustainable mix of circumstances.” *Id.* at 4. The Postal Service estimated it could save over $3 billion annually from such a change.[53]

The Public Representative’s comments in Docket No. ACR2010, and the Postal Service’s observations in its Request for an Advisory Opinion, each touch upon the problem undermining the Postal Service’s financial stability – declining economies of density or the decline in mail volume per delivery point. An underlying aspect of the problem is that the declining volume of mail per delivery point reflects the Universal Service Obligation to offer services not counter-balanced by an obligation to maintain the same level of consumption.

The OIG Report discusses the problem of declining mail volume per delivery point in great detail and presents two alternate price cap formulas that would keep the CPI-U price cap but also provide adjustments to account for declining volume and a growing delivery network. OIG Report at iv.

The OIG Report illustrates the decline in mail density, *i.e*., pieces per delivery point, from FY 2000 though FY 2010. It can be seen that pieces per delivery point declined from FY 2000 to FY 2003, but turned up slightly through 2005 and then continued to decline through FY2010.[54] In FY 2010, the Commission’s ACD Report showed 1,333 pieces per delivery point.[55] What isn’t shown in the OIG Report, however, is that pieces per delivery point have continued to decline to only 995 pieces per delivery point in FY 2015, a further decline from

[53] *Id.* The Commission’s cost savings estimate was less than $2 billion. Advisory Opinion on Eliminatioin of Saturday Delivery, March 24, 2011, at 1.

[54] OIG Report at 7, Figure 3.

[55] FY 2015 ACD at 151.

FY 2010 of over 12 percent. For the period FY 2000 to FY 2006, pieces per delivery point declined by only 5.6 percent. However, between FY 2006 and FY 2015, pieces per delivery point declined by nearly 32 percent.[56] This drop by one-third is much more dramatic than the much smaller declines apparent, or that might have been anticipated, during consideration of the PAEA index mechanism.

The OIG Report also performed financial simulations of alternative rate cap formulas as discussed below.

- *Revenue-per-Delivery Point (RDP) Price Cap Adjustment*

The first alternative discussed by the OIG is labeled the revenue-per-delivery-point (RDP) cap. The RDP cap formula starts with the CPI-U, but also adjusts for the change in the number of delivery points and the change in the volume per delivery point each year. Larger price increases would be allowed as volume declines and the number of delivery points rises, while smaller increases would be mandated when volume is rising. The RDP cap thus allows revenue per delivery point, rather than prices, to rise at the same rate as the CPI. The report notes that one potential problem with the RDP cap is that it would overcompensate the Postal Service for declining volume because it does not take into account that "volume-variable" costs go down as mail volumes decline. Under the RDP cap, the Postal Service would perform well financially when volumes decline, but would do worse if volume rises because the RDP cap is designed to make up for declining economies of density, and would restrict prices as volume increased.

The second alternative developed in the OIG Report is referred to as the "hybrid cap" and combines the current price cap and RDP approaches. Like the RDP cap, the hybrid cap formula starts with the CPI, and adjusts for changes in delivery points and volume. However, as volume declines under the hybrid cap, the Postal Service cannot implement price

[56] *Id*., OIG Report at 7, Figure 3, and Postal Service Annual Report to Congress FY 2000.

increases to recover volume variable costs that it should be reducing. The hybrid cap's adjustment for declining volume only applies to institutional costs, which remain when volumes decline. OIG Report at iv.

In its evaluation of these approaches, the OIG Report concluded that while both the RDP and hybrid caps have the potential to result in positive net income if volumes continue to decline, the hybrid cap might be considered the more balanced. The RDP cap has a potentially unattractive feature in that it could encourage mail volume reductions. The hybrid cap would allow the Postal Service's financial health to improve even if volume continues to decline. In terms of the objectives of the PAEA, the OIG Report made clear that both of the alternative cap formulas could continue the existing policy of predictable and stable annual price changes while still incentivizing optimization of the network.

The scenarios calculated in the OIG Report utilized a base year of 2010 and projected net income and percent rate increases yearly to 2015. The CPI was assumed to increase by 2 percent per year, and it was assumed that Postal Service Total Factor Productivity increased annually by the average amount of the economy as a whole. More importantly, it was assumed that Congress granted the Postal Service $5 billion in annual cost reductions during the period simulated and the 2010 rates are adjusted to eliminate the remaining deficit to facilitate a breakeven start. *Id*. at 21.

Under the CPI-U only price cap, the simulations show that the Postal Service would have had a net loss in 2011 (the first year projected). By 2015, that net loss would have increased to $3.3 billion, based on a volume of 153 billion pieces. The OIG Report noted that their calculations showed that even with a breakeven start, the Postal Service would need productivity gains more than *double* the assumed economy-wide average.

Under the CPI-based RDP cap, the allowed increase in postal rates (in 2010) would have generated net income of $1.0 billion in 2011. In this scenario, net income would have increased to $7.1 billion in 2015 on mail volumes projected at 146 billion in 2015. Under the

CPI-based hybrid cap, net income would have increased very slowly over the simulation period to $0.8 billion. Total mail volume was projected to be 150 billion pieces under this scenario. *Id*. at 22.

Based on these simulation results, the OIG Report observed that the reason the RDP and Hybrid cap scenarios would generate net income is that the Postal Service would be allowed to increase its rates above the (simulated) CPI-U cap by 2 percent per year. Under its base case assumptions, the OIG Report indicated that rates would have needed to increase 3.18 percent per year for the years 2011 through 2015 in order for the Postal service to break even. *Id*. The average annual rate increase under the CPI-based RDP cap alternative would have increased by 5.77 percent per year (the CPI increase plus a 3.77 percent output per delivery point adjustment). Perhaps the most important observation concerning these simulations is their projection that without a breakeven start, the Postal Service faces financial losses under *all* of the cap formulas discussed in the OIG paper.[57]

A Senate Report on proposed legislation in 2004 for S.2468 leading up to the PAEA, but not adopted, indicates the Senate would have conferred upon the Commission the task of establishing the rate cap mechanism.[58] The Senate Committee proposed the Commission evaluate the merits of a wide range of rate cap structures. This consideration would include, but not be limited to, the relative merits of different inflation indices, including the Consumer Price Index, the Employment Cost Index, and the Gross Domestic Product Price Index; the definition of the product groupings to which the caps would be applied, and the use of productivity factors or offsets. In addition, the Commission was to consider the experience gained and lessons learned from the construction and application of rate or price caps in other industries. Overall, the Senate Committee believed that the rate cap structure

[57] A discussed above, legislation requiring a breakeven restart via a True-up rate case is necessary.

[58] Report of the Committee on Governmental Affairs, U.S. Senate, Report 108-318, 108th Congress, 2d Sess., S. 2468, Postal Accountability and Enhancement Act, August 25, 2004, at 10.

established by the Commission should provide for the maximum possible pricing flexibility while maintaining adequate financial safeguards and incentives for cost control.

Alternatively, a price index prepared by the Bureau of Labor Statistics exists which tracks monthly changes in input prices to the Postal Service as defined by the North American Industry Classification System (NAICS). This index has risen approximately 33 percent between January 2007 and December 2015. Instead, the final version of the PAEA mandated use of the CPI-U price index as part of the rate cap on the Postal Service's prices for market-dominant products. The CPI-U index by comparison rose only 17 percent over the same period.

The use of a different price index might result in a different, and perhaps higher permitted level of price increases for the Postal Service. However, it would not directly address the Postal Service's problem of declining economies of density and thus likely not prove to be adaptable to the Postal Service's operating environment. Thus, the Public Representative supports more "targeted" adjustments in addition to legislative imposition of an appropriate price index, such as in the OIG's proposals, versus simply selecting an index with increases greater than the CPI-U index.

Recent history has demonstrated that some adjustment to the price cap is necessary through legislation. This would permit the Postal Service's rates to adjust periodically and more consistently to recover increasing costs the Postal Service must pay for its operations and other funding requirements that do not conform to the changes in the CPI-U Index. Continuing to limit postage and fee increases to the consumer cost of living increases which bear little or no relationship to the cost increases the Postal Service must pay for its operational inputs merely extends the disconnection between allowable revenue increases and Postal Service's total costs.

b. Require Annual Adjustment of Workshare Discounts to Reflect the Most Recent Avoided Cost Estimates

The PAEA gives the Postal Service the authority to determine when to adjust prices. However, that flexibility should be balanced with the need for prices to reflect costs.

In its first 701 Report, the Commission expressed concern over the possibility that the Postal Service could file price adjustments in the months of October, November or December. When price adjustments are filed during these months "available cost data are more than a year old." 2011 Section 701 Report at 38. Prior to FY 2012, the Postal Service had filed price adjustments in January and February which allowed the Postal Service to use recent avoided cost estimates when setting workshare discounts. However, beginning in October, 2011, the Postal Service began filing price adjustments during September and October, when the avoided cost data was at its oldest. *See* Table 7.

Table 7 shows that when the Postal Service files a price adjustment in September and October, available cost data is at least 12 month old, and when prices adjustments are implemented cost data is 16 to 17 months old.

Table 7: Market Dominant Price Adjustments and Available Avoided Cost Data

Docket No.	Date of Request	Date of Final Approval	Implementation Date	Available Cost Data	Age of Cost Data at Request (months)	Age of Cost Data at Implementation (months)
R2008-1	February 11, 2008	April 9, 2008	May 12, 2008	FY 2007	5	8
R2009-2	February 10, 2009	April 9, 2009	May 11, 2009	FY 2008	5	8
R2011-2	January 13, 2011	February 16, 2011	April 17, 2011	FY 2010	4	7
R2012-3	October 18, 2011	November 22, 2011	January 22, 2012	FY 2010	13	17

R2013-1	October 11, 2012	December 11, 2012	January 27, 2013	FY 2011	13	17
R2013-10	September 26, 2013	December 11, 2013	January 26, 2014	FY 2012	12	16
R2015-4	January 15, 2015	May 7, 2015	May 31, 2015	FY 2014	4	8

Setting discounts equal to or below avoided costs is a requirement of the PAEA. *See* 39 U.S.C. § 3622(e). However, the PAEA does not require the Postal Service to file annual adjustments to ensure workshare discounts continuously reflect annual avoided cost estimates. Postal legislation could be improved by requiring the Postal Service to adjust workshare discounts annually to reflect the most recent avoided cost estimates. For example, one month after avoided cost estimates are reported, the Postal Service should be required to file a price adjustment that aligns discounts with avoided costs. If avoided costs did not change, a price adjustment would not be necessary. This change would ensure that discounts continuously reflect avoided costs.

The proposed change is important because avoided costs tend to fluctuate annually. To illustrate this point, Table 8 shows the avoided cost estimates for Automation 5-digit First-Class Mail Letters from FY 2007 through FY 2015.

Table 8
Example of Avoided Cost Fluctuations
Automation 5-Digit First-Class Mail Letters

Fiscal Year	Avoided Cost	Annual Change
2007	$0.022	
2008	$0.024	9.1 percent
2009	$0.026	8.3 percent
2010	$0.026	0.0 percent
2011	$0.025	-3.8 percent
2012	$0.025	0.0 percent
2013	$0.029	16.0 percent

2014	$0.031	6.9 percent
2015	$0.036	16.1 percent

Sources: FY 2007 ACD at 64; FY 2008 ACD at 52; FY 2009 ACD at 70; FY 2010 ACD at 87; FY 2011 ACD at 98; FY 2012 ACD at 83 ; FY 2013 ACD at 18; FY 2014 ACD at 12; and FY 2015 ACD at 12.

Setting discounts equal to avoided costs is important to ensure the Postal Service is sending efficient price signals. If discounts are set too high, the Postal Service could give away more money than it saves by offering the discount. If the Postal Service sets discounts too low, it does not encourage enough mail to take advantage of the discount. Therefore, it is best for discounts to equal avoided costs.

If Section 3622, as enacted by the PAEA, is amended to ensure that workshare discounts reflect recent avoided cost estimates, there would be price cap compliance implications. But, it is important to highlight that the Postal Service can readily align workshare discounts with avoided costs with minimal impact to its price cap compliance calculations. First, it is likely that there will be some price increases and some price decreases that may offset. Second, the Postal Service is able to adjust workshare benchmarks and workshare discounts to minimize the overall percentage change in prices for the class. For example, assume there are two price categories: (1) Price Category A which is priced at $0.55; and (2) Price Category B which is priced at $0.50. Price Category B reflects a $0.05 discount off of its benchmark (Price Category A). This discount was aligned with its avoided cost of $0.05 in the last price adjustment. But, the updated avoided cost is $0.04. The Postal Service has two options to align the discount with its avoided cost. The first option is that the Postal Service could increase the price of Price Category B to $0.51. The second option is the Postal Service could reduce the price of Price Category A to $0.54. Both of these options would create a discount of $0.04, which is equal to its avoided cost estimate. The first option would increase overall percentage change in prices and second option would reduce overall percentage change in prices. This example highlights that the Postal Service can align discounts with avoided costs even if it does not have any price cap available.

Ensuring that workshare discounts reflect avoided costs is an important part of the PAEA. The Public Representative recommends that workshare requirements in the PAEA should be strengthened to ensure that discounts are aligned with avoided costs, as avoided cost estimates are updated.

C. Negotiated Service Agreements

➢ *Competitive Product NSAs*

1. Prior Commission Recommendations Regarding Competitive Product NSAs

In the 2011 701 Report the Commission focused its review of NSAs on Competitive NSAs. The Commission recommended no legislative change related to NSAs. 2011 701 Report at 52.

2. Developments Since the 2001 Section 701 Report

The Commission now has reviewed and approved over 800 Competitive NSAs since the passage of PAEA. Since the 2011 701 Report, the Commission has continued to expeditiously review competitive NSAs and the process continues to work well.

3. Recommendations of the Public Representative

The Public Representative proposes no legislative changes related to competitive NSAs.

➢ *Market Dominant NSAs and Special Classifications*

4. Prior Commission Recommendations Regarding Market Dominant NSAs and Special Classifications

At the time the Commission issued its 2011 Section 701 Report, the Postal Service had only initiated one market dominant negotiated service agreement (NSA)—an NSA with Discover Financial Services.[59] In addition, the Postal Service offered three volume incentive programs for First-Class Mail and Standard Mail.[60] The PAEA, specifically 39 U.S.C. § 3622(c)(10), sets strict requirements for these types of special classifications. The special classifications must either improve the net financial position of the Postal Service or enhance performance. In addition, all special classifications must not cause unreasonable harm to the market place.

The Postal Service has only requested agreements or incentives that it contends improve the net financial position of the Postal Service. Improving the net financial position of the Postal Service has proven to be a difficult requirement to meet. The Commission requires the Postal Service to demonstrate, through an elasticity-based approach,[61] that volumes will exceed "anyhow" volumes[62] by enough to offset reduced revenues from discounted prices. When requesting these special classifications, the Postal Service has

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[59] *See* Docket Nos. MC2011-19 and R2011-3, Order Adding Discover Financial Services 1 Negotiated Service Agreement to the Market Dominant Product List, March 15, 2011 (Order No. 694). The Commission subsequently approved an amendment to the agreement. Docket Nos. MC2011-19 and R2011-3, Order Approving Proposed Amendment to Discover Financial Services 1 Negotiated Service Agreement, May 17, 2013 (Order No. 1720). However, the Commission later rejected a subsequent Discover NSA in Docket Nos. MC2015-3 and R2015-2. *See infra.* The Commission found that the Postal Service's alternate approach to demonstrate an improved financial position was "improperly based on subjective intuition rather than the objective evidence necessary to support its claims". Order No. 2410 at 2.

[60] *See* Docket Nos. R2009-3, Order Approving Standard Mail Volume Incentive Pricing Program, June 4, 2009 (Order No. 219); Docket No. R2009-5, Order Approving First-Class Mail Incentive Pricing Program, September 16, 2009 (Order No. 299); and Docket No. R2010-3, Order Approving Standard Mail Volume Incentive Pricing Program, April 7, 2010 (Order No. 439).

[61] The current accepted methodology for evaluating NSAs is designed to use the mailer's price elasticity to estimate the new mail volume generated by the discount provided pursuant to the Agreement. *See* Docket No. RM2010-9, Notice of Proposed Rulemaking Concerning Methods to Evaluate Volume Changes Causes by Pricing Incentive Programs, June 8, 2010 (Order No. 469).

[62] Volume that would have been mailed absent the discount. *See* Order No. 469 at 6.

relied on subclass elasticity estimates. Ideally, the Postal Service would have specific elasticity estimates for each NSA partner.[63] In Docket No. RM2010-9, the Commission explored alternate approaches to estimate net contribution changes resulting from special classifications. However, the Commission closed the docket because it was "not persuaded that the alternatives offer a demonstrable improvement over the current method."[64] Therefore, the Commission continues to rely on an elasticity based test to ensure special classifications will improve the net financial position of the Postal Service.

Despite the Commission's strict review, special classifications as a whole have not improved the Postal Service's financial position. For example, the Commission found that the 2009 Standard Mail Volume Incentive Pricing Program lost $36.9 million, and the 2009 First-Class Mail Volume Incentive Pricing Program lost $7 million. FY 2009 ACD at 88 and FY 2010 ACD at 89.

5. Developments Since the 2011 Section 701 Report

Since the issuance of the 2011 Section 701 Report, the Commission has ruled on three Postal Service requests to initiate a new NSAs. On August 23, 2012, the Commission granted a request for approval of a market dominant NSA between the Postal Service and Valassis Direct Mail, Inc.[65] On June 19, 2014, the Commission approved a Postal Service request for approval of an NSA with PHI Acquisitions, Inc. (PHI).[66] On March 24, 2015, the Commission rejected a Postal Service request for approval of a new market dominant NSA with Discover. Order No. 2410. In the latter proceeding, the Postal Service was unable to

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[63] *See* Docket Nos. MC2015-3 and R2015-2, Order Rejecting the Postal Service's Request to Add Discover Negotiated Service Agreement to the Market Dominant Product List, March 24, 2015 (Order No. 2410).

[64] Order Terminating Proceeding, May 27, 2011 (Order No. 738).

[65] Docket Nos. MC2012-14 and R2012-8, Order Approving Addition of Valassis Direct Mail, Inc. Negotiated Service Agreement to the Market Dominant Product List, August 23, 2012 (Order No. 1448).

[66] Docket Nos. MC2014-21 and R2014-6, Order Adding PHI Acquisitions, Inc. Negotiated Service Agreement to the Market Dominant Product List, June 19, 2014 (Order No. 2097).

provide sufficient documentation that the agreement will meet the requirements of 39 U.S.C. § 3622(c)(10). In Order No. 2410, the Commission highlighted that the Discover NSA is similar to other NSAs, which have failed to provide the Postal Service with a net financial benefit. Order No. 2410 at 30. Using the elasticity based approach to analyze the NSA, the Commission found that the agreement would likely result in the Postal Service losing $6,180,863 in the first year of the Agreement. *Id.* at 10.

Experience with market dominant NSAs since issuance of the 2011 Section 701 Report has been mixed. The Commission has reported that the Discover NSA lost $25 million over 3 years. FY 2014 ACD at 59. In FY 2015, the Commission reported that the PHI NSA provided $112,000 in increased contributions. FY 2015 ACD at 74. The profits obtained from the PHI NSA are unlikely to offset the losses produced by other special classifications.

6. Recommendations of the Public Representative

Since passage of the PAEA, there have been numerous occasions for the Postal Service, the Commission, and the mailing community to refine NSA analysis. In the past, the Commission has given the Postal Service some flexibility to attempt to meet the requirements of 39 U.S.C. § 3622(c)(10).

The Commission now has 10 years of experience, and has determined that using elasticities to determine if a special classification will improve the Postal Service's financial position is the best option. The elasticity approach challenges the Postal Service and the NSA partner to demonstrate through objective analysis that the agreement will improve the Postal Service's financial position.

The Public Representative believes the Commission's approach is consistent with the PAEA. The Public Representative also believes the PAEA sets the appropriate standards to ensure the Postal Service does not engage in unprofitable agreements. Therefore, the

Public Representative recommends that the language of 39 U.S.C. § 3622(c)(10) remain unchanged, and carried forward into any future postal legislation.

D. Post Office Closing/Consolidation Procedures

Post Office closings and consolidations are subject to the provisions of 39 U.S.C. § 404(d). Subsections 404(d)(1) through 404(d)(4) set forth legal requirements for Postal Service closing and consolidation determinations. Subsection 404(d)(1) requires notice at least 60 days prior to a closing or consolidation. Subsection 404(d)(2) sets forth factors the Postal Service is required to consider in making a determination on an appeal. Subsection 404(d)(3) requires that Postal Service determinations be in writing, contain findings regarding the factors that must be considered, and be made available to persons served by the post office. Subsection 404(d)(4) prohibits the Postal Service from taking actions to close or consolidate post offices until 60 days after its determinations are made available to persons served by the affected post office.

Subsections 404(d)(5) and (d)(6) establish procedures for appeals to the Commission of Postal Service closing and consolidation determinations. Subsection 404(d)(5):

- establishes a 30 day deadline for appealing; requires the Commission to review the closing or consolidation determination on the basis of the record developed by the Postal Service;
- sets forth the grounds on which Postal Service determinations, findings, and conclusions can be set aside;
- authorizes the Commission to affirm the Postal Service's determinations or return the entire matter to the Postal Service for further consideration, but prohibits the Commission from modifying the determination;

- authorizes the Commission to suspend the effectiveness of the Postal Service's determination until final disposition of the appeal; and
- precludes the Commission from using the hearing procedures of APA sections 556 and 557 in conducting appeal proceedings,

Subsection 404(d)(6) establishes the method for appealing a Postal Service closing or consolidation determination.

1. Prior Commission Recommendations Regarding Post Office Closing Procedures

In its 2011 Section 701 Report, the Commission traced the statutory and regulatory basis for appeals of post office closings and consolidations; described Commission proceedings involving the Postal Service's practice of imposing emergency suspensions of post office operations for extended periods; and discussed then-recent amendments made by the Postal Service to its closing and consolidation regulations. 2011 Section 701 Report at 71-77.

Although the Commission did not find it necessary to recommend changes to the statutory procedural requirements in section 404(d), it did recommend (1) that Congress consider requiring the Postal Service to provide regular reports to the Commission on the Postal Service's plans and activities regarding its retail network, including the identification of all post offices that have been suspended and those where closure actions have been taken, 2011 Section 701 Report at 77-78; and (2) that the scope of the Commission's appellate review of closing and consolidation determinations be clarified to include Postal Service stations and branches. *Id.* at 78.

2. Developments Since the 2011 Section 701 Report

Following the issuance of the 2011 Section 701 Report, the Postal Service promulgated regulations governing post office closings and consolidations, 39 C.F.R. part 241. In those regulations, the Postal Service addressed, at least in part, the Commission's concern regarding the use of emergency suspensions as a response to lease terminations. For example, the new regulations provide that, "wherever possible … responsible personnel should initiate the initial feasibility study [of the possible discontinuance (closing or consolidation) of a retail Postal Service facility due to a lease cancellation] sufficiently in advance of the circumstance prompting the emergency suspension…." *See* 39 C.F.R. § 241(a)(5)(iv). The goal is to ensure an opportunity for meaningful public input. *Id.* If public input cannot be sought sufficiently in advance of the end date of the lease, "personnel should endeavor, to the extent possible, to continue operation of the … facility for the duration necessary to gather public input and make a more fully informed decision on whether to proceed with a discontinuance proposal." *Id.*

3. Recommendations of the Public Representative

Section 404(d), by its terms, establishes standards and procedures for closing or consolidating post offices. The statute says nothing about emergency suspensions of postal operations. Nevertheless, circumstances beyond the Postal Service's control can arise in which the Postal Service is compelled to suspend postal service. To deal with such circumstances, the Postal Service has adopted policies and procedures governing "emergency suspensions."[67] Some of the circumstances relied upon by the Postal Service in imposing emergency suspensions (*e.g.* fires or natural disasters that irreparably damage

[67] Post Office Discontinuance Guide, Handbook PO-101, Chapter 6 – Special Considerations, Subchapter 61-Emergency Suspensions (Discontinuance Handbook).

post offices with no suitable alternative facilities available) were, as a matter of common sense, genuine emergencies requiring the suspension of operations. Other situations, such as the anticipated termination of a long term lease, did not appear to be genuine "emergencies" that warranted an emergency suspension.

It appeared that the Postal Service had been using emergency suspensions as a means of imposing *de facto* closing of post offices. In 2008, the Commission instituted a public inquiry proceeding to investigate, among other things, the number and duration of emergency suspensions.[68] That inquiry disclosed a relatively large number of emergency suspensions, some lasting decades, during which time no effort was made to make a formal closing determination as required by section 404(d).[69] Although the Commission ultimately closed Docket No. PI2010-1 without taking action, it continued to monitor emergency suspensions by means of information requests in annual compliance determinations conducted under 39 U.S.C. § 3653.

a. Establish Deadlines for Initiating Discontinuance Studies for Leases That Are Terminated or Not Extended

While the Postal Service's new regulations governing post office closings and consolidations represent an improvement over earlier regulations, problems remain. For example, the new regulations state that responsible personnel "should" initiate a feasibility study and "should" endeavor to keep the affected facility open. The use of the word "should" transforms what should be obligations into mere suggestions. For example, in cases in which the Postal Service knows months in advance that a lease will terminate, a "suggestion" that an initial feasibility study (or discontinuance study) should be undertaken falls short of what is needed —a requirement that a

[68] Docket No. PI2010-1, Notice and Order Providing an Opportunity to Comment, November 9, 2009 (Order No. 335).

[69] Docket No. PI2010-1, Initial Comments of the Public Representatives, March 2, 2010, at 10.

discontinuance study be initiated not later than the date upon which either party to the lease exercises its right to terminate or fails to exercise a right to extend the lease. Without more definite requirements for action, “emergency suspensions” will continue to leave customers in limbo without an adequate opportunity to provide meaningful input or to have their postal needs adequately addressed.

b. Establish Deadlines for Initiating Discontinuance Studies for Post Offices Whose Operations Are Suspended

Other problems with the emergency suspension mechanism also need to be addressed with legislation. At present, there is no deadline for the Postal Service to decide to propose discontinuance of a Postal Service facility that is the subject of an emergency suspension. Experience has shown that once an emergency suspension is imposed, years may pass without any further action. What begins as an emergency suspension, at some point, becomes a *de facto* closure that deprives customers of their right to have input into their future service and to appeal the decision to close the facility.

c. Establish Deadlines for Completing Discontinuance Studies

A similar problem may arise when the Postal Service institutes, but fails to complete, a feasibility study considering closure of a Postal Service facility. Failure of the Postal Service to complete a feasibility study within a reasonable time should also be grounds for an appeal to the Commission, with the Commission empowered to order completion of the study by a date certain.

In the proceedings in Docket No. N2011-1, the Postal Service, through its witness James R. Boldt, indicated that it had developed an expected timeline for completing a discontinuance study.[70] That expected timeline was based upon an estimate "that, in normal circumstances, a discontinuance study may be concluded in 138 days, including the posting period and subsequent waiting period after the posting of a final determination, assuming that no appeal to the Postal Regulatory Commission is received." *Id.*

To ensure that discontinuance studies are completed in a reasonable time, a deadline should be established by statute, with authority in the Commission to extend the deadline for good cause shown. If the deadline is not met, the persons served by the affected post office should have a right of immediate appeal to the Commission. The Commission should be authorized to order the Postal Service to take the same types of remedial action as when it fails to secure alternative quarters, take corrective action, or initiate a feasibility study following the imposition of an emergency suspension.

d. Require Reports on Retail Network and Clarify Scope of Commission's Appellate Authority

Finally, the Public Representative urges the Commission to reiterate to Congress the two recommendations it previously made in the 2011 Section 701 Report, namely (1) require the Postal Service to provide regular reports to the Commission on the Postal Service's plans and activities regarding its retail network, including the identification of all post offices that have been suspended and those where closure actions have been taken; and (2) that the scope of the Commission's appellate review of closing and consolidation determinations be clarified to include Postal Service stations and branches,

[70] Docket No. N2011-1, Retail Access Optimization Initiative, Direct Testimony of James J. Boldt on Behalf of United States Postal Service, USPS-T-1, July 27, 2011, at 21.

E. The Advisory Opinion Process

The Postal Service is required by 39 U.S.C. § 3661(b) to request an advisory opinion from the Commission whenever the Postal Service "determines that there should be a change in the nature of postal services which will generally affect service on a nationwide or substantially nationwide basis". The Commission cannot issue an advisory opinion "until an opportunity for *hearing on the record under sections 556 and 557* [of the Administrative Procedure Act] has been accorded to the Postal Service, users of the mail, and an officer of the Commission who shall be required to represent the interests of the general public." 39 U.S.C. § 3661(c). The requirement of a *hearing on the record* "has historically been interpreted by the Commission to require formal, trial-type proceedings."[71]

1. Prior Commission Recommendations Regarding the Advisory Opinion Process

In its 2011 Section 701 Report, the Commission summarized the then-current statutory and regulatory requirements of the advisory opinion process, and the Commission's experience with that process. The Commission presented two recommendations for legislation. Section 2011 Section 701 Report at 78-83. First, it recommended that section 3661 be amended to authorize the Postal Service to seek expedited processing of time-sensitive advisory opinions. *Id.* at 84.

Second, the Commission recommended that section 3661 be amended to require the Postal Service to provide a written response to advisory opinions and that both the Commission's advisory opinion and the Postal Service's response be submitted to Congress. *Id.* As part of the Postal Service's obligation to respond to the advisory opinion, the Commission suggested that the Postal Service be required to reconsider its proposed plan in

[71] Docket No. N2012-1, Order Denying Motion for Reconsideration of Ruling Establishing Procedural Schedule, January 31, 2012 (Order No. 2283).

light of the advice it received from the Commission and present the results of that reconsideration in its response. *Id.* at 85.

2. Developments Since the 2011 Section 701 Report

Following the issuance of the 2011 Section 701 Report, the Commission instituted a rulemaking proceeding to "address[] the need for more timely completion of [advisory opinion] proceedings."[72] Following the receipt of written comments from the Postal Service, members of the public, and a Public Representative, the Commission adopted new procedures for issuing advisory opinions.[73]

The new procedural rules, governing the issuance of advisory opinions, address the Postal Service's desire for more expeditious processing of proposed changes in postal service subject to section 3661. The new rules would make the Commission's first recommendation in the 2011 Section 701 report unnecessary. Under the new rules, advisory opinions are to be issued not later than 90 days after the Postal Service files its request for an opinion, unless the Commission determines for "good cause" that a longer period is needed. 39 C.F.R. § 3001.72. As adopted by the Commission, section 3001.72 permits the issuance of advisory opinions in less than 90 days if the proposal is well-documented by the Postal Service and presents relatively straight-forward, uncomplicated issues. If, on the other hand, more information than initially provided by the Postal Service is needed to examine relevant issues, or if the issues presented by the proposal are more complicated, the Commission can, upon a finding of good cause, extend the 90-day deadline for issuing an opinion.

[72] Docket No. RM2012-4, Order No. 1738, Notice of Proposed Rulemaking Regarding Modern Rules of Practice for Nature of Service Cases under 39 U.S.C. § 3661, May 31, 2013.

[73] Docket No. RM2012-4, Order No. 2080, Order Adopting Amended Rules of Procedure for Nature of Service Proceedings under 39 U.S.C. § 3661, May 20, 2014.

One alternative previously proposed by the Postal Service to foster expeditious issuance of advisory opinions has been its suggestion that section 3661 be amended to eliminate the requirement of a *hearing on the record*.[74] The Public Representative opposes this suggestion. The *hearing on the record* requirement is essential to ensure meaningful examination of proposed service changes with far-reaching consequences. The *hearing on the record* requirement ensures that stakeholders, the Public Representative (on behalf of the general public), and other interested persons have the opportunity, through the discovery and adjudicatory hearing procedures, to explore the potential implications of the Postal Service's proposals.

Unlike other Commission proceedings, advisory opinion proceedings often present the Commission with proposals for which there is no established body of relevant data and information. By contrast, rate proceedings, even exigent rate proceedings, permit participants and the Commission to draw upon data that is routinely collected and readily available for use in examining the Postal Service's proposals. The same can be said for the Commission's Annual Compliance Determination proceedings. Extensive documentation and information, such as extensive library references, are routinely filed by the Postal Service as part of its Annual Compliance Report.

3. Recommendations of the Public Representative

a. Do Not Disturb "Hearing on the Record" Requirement

For the foregoing reasons, the Public Representative submits that the Commission's new advisory opinion procedural regulations adequately protect the interests of the Postal Service, interested stakeholders, and the public generally and that the *hearing on the record* requirement in section 3661 should not be eliminated or modified.

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[74] *See* Docket No. RM2012-4, United States Postal Service Initial Comments, June 18, 2012, at 2.

b. Require Postal Service Responses to Advisory Opinions, Postal Service Consideration of Advisory Opinions Recommendations, and Submission to Congress of Advisory Opinions and Responses

Finally, for the same reasons given by the Commission in its 2011 Section 701 Report, the Public Representative recommends that section 3661 be amended to require that the Postal Service provide a written response to advisory opinions; that the Postal Service be required to reconsider its propose plan in light of the advice it received from the Commission and present the results of that reconsideration in its response: and that the Commission and the Postal Service be required to submit their advisory opinions and responses to Congress,

F. Market Tests

1. Prior Commission Recommendations Regarding Market Tests

In the 2011 701 Report, the Commission found that the market test provisions of PAEA had worked as intended, and gave the appropriate level of flexibility. 2011 701 Report at 70. The Commission recommended that the Congress increase the maximum revenue limitation to allow the Postal Service to experiment with larger market tests. *Id.* However, the Commission did not suggest a new figure for the revenue limit. At the time of the 2011 701 Report, the Commission had reviewed and approved six market tests. *Id.* at 69.

2. Developments Since the 2011 Section 701 Report

Since then, the Commission has reviewed and approved four additional market tests, and the Commission is currently reviewing one market test.[75]

[75] Following issuance of the 2011 701 Report, the Commission approved Market Tests in Docket Nos. MT2012-1, MT2013-2, MT2013-2, and MT2014-1. The Commission is currently reviewing the proposed Market Test in Docket No. MT2016-1.

3. Recommendations of the Public Representative

The PAEA sets a revenue limit of $10 million on market tests, which may be increased to $50 million.[76] While some may consider these limitations too low, the Public Representative finds that the limitations are appropriate. These limits allow the Postal Service to experiment with new products and gather data when the Postal Service is unsure if a product will be successful. If the market test product is successful, the Postal Service has the option to propose the market test product as a permanent product.

The revenue limit for Market Tests should not exceed the revenue generated by current permanent postal products. In FY 2015, the Within County Periodicals product generated $67 million in revenue and the Standard Mail Parcels product generated $66 million in revenue. If the Postal Service is confident that a new product will be successful and generate revenues in excess of the market test revenue limit of $50 million, the product should be proposed as a new product from the onset and bypass the market test regulations.

The Public Representative finds that the PAEA and the Commission regulations regarding Market Tests are working as intended and should not be altered. The PAEA and the Commission regulations strike the appropriate balance between flexibility and ensuring all permanent postal products meet the requirements of 39 U.S.C. §§ 3622 and 3633.

G. Public Representative Requirement

The Commission is required by 39 U.S.C. § 505 to "designate an officer of the Commission in all public proceedings … who shall represent the interests of the general public." In its order instituting these proceedings, the Commission has solicited comments "on the utility of the public representative in Commission proceedings, and any improvements

[76] The Commission has developed regulations that adjust both the $10 million and $50 million limits by the Consumer Price Index. *See* 39 CFR § 3035.16.

the Commission should consider to improve the public representative program." Order No. 3238 at 13.

1. Prior Commission Recommendations Regarding Public Representatives

In its 2011 Section 701 Report, the Commission did not address the statutory requirement that a public representative be appointed in Commission proceedings.

2. Developments Since the 2011 Section 701 Report

Public Representatives are Commission staff members and are typically attorneys chosen from the Office of General Counsel or technical experts chosen from the Office of Accountability and Compliance. In some cases, such as the instant case, a single attorney is designated as the Public Representative, but is provided support from additional Staff members. The Public Representative and all other Staff members assigned to assist are governed by the Commission's ex parte rules and participate in a proceeding on an equal footing with all other participants in a proceeding.

Based upon experience in some cases as a Public Representative and in other cases as a member of decisional Staff, the undersigned submits that the participation of Public Representatives in Commission proceedings has contributed to better informed Commission decisions. For example, in cases involving appeals of Postal Service determinations to close post offices, the Public Representatives frequently obtain useful information from local post office patrons and present that information to the Commission in publicly available filings. The public benefits from the availability of an experienced Commission Staff member who is capable of presenting information and arguments in a form that is familiar to decisional Staff. The Commission benefits from having information that might not otherwise be available or available in a useful form. The interests of the Postal Service and others are protected, because Public Representative filings are publicly available and subject to responses either opposing or confirming the information that is presented.

A further advantage of Public Representative participation in Commission proceedings can be found in those proceedings, such as proceedings involving negotiated service agreement (NSA) proceedings. NSA proceedings typically involve filing by the Postal Service of non-public information. In those cases, both Public Representatives and assisting Staff members are, like the members of decisional Staff, provided access to such non-public information. The participation of Public Representatives and assisting Staff members in NSA proceedings on an equal footing with decisional Staff members reinforces the integrity of the regulatory process and Commission findings that NSAs satisfy applicable statutory and regulatory requirements

The value of the Public Representative program is underscored by the professionalism of Commission Staff members who take their responsibilities seriously and seek to persuade the Commission by presenting arguments based upon the record and applicable legal and regulatory principles.

3. Recommendations of the Public Representative

The Public Representative recommends no change to the statutory requirement that the Commission appoint a public representative in all public Commission proceedings.

Respectively submitted,

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