

UNITED STATES OF AMERICA  
POSTAL REGULATORY COMMISSION  
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Chairman;  
Nanci E. Langley, Vice Chairman;  
Mark Acton; and  
Tony Hammond

Statutory Review of the System  
for Regulating Rates and Classes  
for Market Dominant Products

Docket No. RM2017-3

ADVANCE NOTICE OF PROPOSED RULEMAKING ON THE STATUTORY REVIEW  
OF THE SYSTEM FOR REGULATING RATES AND CLASSES  
FOR MARKET DOMINANT PRODUCTS

(Issued December 20, 2016)

I. INTRODUCTION

On December 20, 2006, the Postal Accountability and Enhancement Act (PAEA) was signed into law.<sup>1</sup> The PAEA required that the Commission establish a modern system of regulating rates and classes for market dominant products.<sup>2</sup> The PAEA also mandated that the Commission review this system 10 years later to determine if it is achieving the objectives, taking into account the factors, established by Congress.<sup>3</sup> If the Commission determines that the system is not achieving the objectives, taking into

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<sup>1</sup> Pub. L. 109-435, 120 Stat. 3198 (2006).

<sup>2</sup> 39 U.S.C. 3622(a).

<sup>3</sup> 39 U.S.C. 3622(d)(3).

account the factors, the Commission may, by regulation, make modifications or adopt an alternative system as necessary to achieve the objectives. *Id.*

In accordance with 39 U.S.C. 3622, this Notice and Order establishes the beginning of the Commission's statutory review of the ratemaking system. Based on the Commission's analysis and relevant information obtained through this proceeding, the Commission will determine if the objectives, taking into account the factors, are being achieved by the current system. If the Commission finds that the objectives, taking into account the factors, are not being achieved, the Commission may propose modifications to the system or propose to adopt an alternative system as necessary to achieve the objectives.

## II. SCOPE OF THE REVIEW<sup>4</sup>

The Commission intends to examine all aspects of the ratemaking system provided within section 3622, including the annual limitation on the percentage changes in rates,<sup>5</sup> the schedule for rate changes,<sup>6</sup> the 45-day notice before the implementation of rate adjustments,<sup>7</sup> expedited rate changes due to extraordinary or exceptional circumstances,<sup>8</sup> class level application of the annual limitation,<sup>9</sup> the rounding of rates

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<sup>4</sup> The Postal Service previously petitioned the Commission to initiate a proceeding to clarify the scope of the statutory review. See Docket No. RM2016-9, Petition of the United States Postal Service for the Initiation of a Proceeding to Clarify the Scope of the Review of the System for Regulating Market-Dominant Rates and Classes, April 7, 2016. In Order No. 3237, the Commission found the petition premature and held the petition in abeyance pending the start of the review. See Docket No. RM2016-9, Order No. 3237, Order Holding Petition in Abeyance, April 12, 2016. The Commission defines the scope of the review at this time.

<sup>5</sup> 39 U.S.C. 3622(d)(1)(A); see also 39 U.S.C. 3622(d)(1)(D).

<sup>6</sup> 39 U.S.C. 3622(d)(1)(B).

<sup>7</sup> 39 U.S.C. 3622(d)(1)(C).

<sup>8</sup> 39 U.S.C. 3622(d)(1)(E).

<sup>9</sup> 39 U.S.C. 3622(d)(2)(A).

and fees,<sup>10</sup> the use of unused rate authority,<sup>11</sup> and workshare discounts.<sup>12</sup>

### III. REVIEW FRAMEWORK

To assist commenters, the Commission presents preliminary definitions for the objectives as well as potential methods that may be used to evaluate whether the objectives, taking into account the factors, are being achieved. Proposed definitions and potential evaluation methods for each objective are discussed in section IV. After the Commission receives comments and conducts its analysis, the Commission will determine if the current system is achieving the objectives while taking into account the factors listed in 39 U.S.C. 3622(c). If the Commission finds the system is not achieving these objectives, taking into account the factors, it may propose rules that modify the system or adopt an alternative system to achieve the objectives.

### IV. OBJECTIVES

Based on research of legislative history, Commission precedent, stakeholder comments in various past dockets, and other sources, the Commission presents preliminary definitions for each objective. In addition, the Commission suggests measurable key concepts within each objective. These key concepts could be measured quantitatively and/or qualitatively to determine if each objective as a whole has been achieved. Because the statute does not require that factors be independently achieved, the Commission is not proposing definitions or measurement methods for the factors. However, over the course of the review, the factors will be taken into account for each objective, as required by the statute.

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<sup>10</sup> 39 U.S.C. 3622(d)(2)(B).

<sup>11</sup> 39 U.S.C. 3622(d)(2)(C).

<sup>12</sup> 39 U.S.C. 3622(e).

- A. Objective 1: To maximize incentives to reduce costs and increase efficiency.<sup>13</sup>

*Preliminary definition.* A system achieving Objective 1 uses available mechanisms, such as flexibility under the price cap, pricing differentials, and workshare discounts, to the fullest extent possible to incentivize the reduction of costs and increases in operational and pricing efficiency.

*Potential measurement.* There are three measurable key concepts within this objective: (1) maximize incentives, (2) reduce costs, and (3) increase efficiency.

First, “maximize incentives” could be measured by determining if the maximum benefit was provided by each incentive mechanism (e.g., price cap, price differentials, and workshare discounts), taking into account associated statutory constraints. For example, a review of whether workshare discounts provided the maximum incentives possible would take into account the constraints set forth in 39 U.S.C. 3622(e).

Second, measuring “reduce costs” could include an evaluation of the costs, including unit operating costs and controllable costs, before and after the PAEA was implemented.

Third, “increase efficiency” could include a review of operational and pricing efficiency. Measuring operational efficiency could involve reviewing trend analyses of total factor productivity, real unit operating costs, productivity data, and workhours. To measure pricing efficiency,<sup>14</sup> a comparison of actual prices and prices that adhere to principles of efficient component pricing could be conducted.

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<sup>13</sup> 39 U.S.C. 3622(b)(1).

<sup>14</sup> Pricing can promote allocative efficiency by setting prices at marginal costs or by applying second-best pricing. Pricing can also promote productive efficiency by application of the Efficient Component Pricing Rule.

B. Objective 2: To create predictability and stability in rates.<sup>15</sup>

*Preliminary definition.* A system achieving Objective 2 fosters rates, including prices for all market dominant products and promotions, that are capable of being consistently forecast with regard to timing and magnitude and that do not include sudden or extreme fluctuations.

*Potential measurement.* There are two measurable key concepts within this objective: (1) predictability, and (2) stability.

Potential approaches for measuring predictability include measuring the time between notices of market dominant price adjustments, or the amount of time between a notice of market dominant price adjustment and the effective date of those prices. The outcomes of these measurements could be compared to price adjustments prior to the passage of the PAEA, or other relevant benchmarks to measure the predictability of the current system.

One potential method for measuring stability is to measure average price increases over time and compare them to objective measures, such as the Consumer Price Index for All Urban Consumers (CPI-U). Another method may be to evaluate the number of price categories that deviate significantly from percentage changes in objective measures, such as the CPI-U or the average price adjustment for the class or product.

C. Objective 3: To maintain high quality service standards established under section 3691.<sup>16</sup>

*Preliminary definition.* A system achieving Objective 3 is designed for the Postal Service to consistently achieve, for each class of mail, stated days to delivery at a desired target rate.

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<sup>15</sup> 39 U.S.C. 3622(b)(2).

<sup>16</sup> 39 U.S.C. 3622(b)(3).

*Potential measurement.* The key measurable concept within this objective is “high quality service standards.”

Potential approaches for the measurement of “high quality service standards” include measuring the Postal Service’s performance, both for discrete time periods and since the passage of the PAEA. Some of these measurements are already conducted in the Commission’s Annual Compliance Determination (ACD) Reports.<sup>17</sup> For example, the Commission typically details the number of percentage points a class or product is above or below its service performance target.<sup>18</sup> In addition, measurement of this objective could include analysis of changes in service standards over time, analysis of service performance results over time, and determining how satisfied mail users are with service standards.

D. Objective 4: To allow the Postal Service pricing flexibility.<sup>19</sup>

*Preliminary definition.* A system achieving Objective 4 allows for the Postal Service to exercise its discretion to set prices, the price structure, and the price schedule for market dominant products, subject to other requirements under the law.

*Potential measurement.* The key measurable concept within this objective is “pricing flexibility.”

Potential measurement methods for this term include comparisons to other systems, such as the pricing flexibility afforded to and/or exercised by foreign posts, utilities, the Postal Service pre-PAEA, and private carriers. Measurement of “pricing flexibility” could also include a review of price adjustment proceedings and Annual Compliance Report (ACR) dockets, which highlight the pricing flexibility exercised by the Postal Service. Analysis of the time it takes for the approval of a price adjustment, the number of price categories approved without material alteration, and reviewing

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<sup>17</sup> See, e.g., Docket No. ACR2015, Annual Compliance Determination, March 28, 2016, Chapter 5 (FY 2015 ACD).

<sup>18</sup> See, e.g., FY 2015 ACD at 123.

<sup>19</sup> 39 U.S.C. 3622(b)(4).

discussions of pricing flexibility in other Commission proceedings could also be conducted to determine if this objective is being achieved.

- E. Objective 5: To assure adequate revenues, including retained earnings, to maintain financial stability.<sup>20</sup>

*Preliminary definition.* In a system achieving Objective 5, the Postal Service is financially solvent while able to respond to changes in its environment (e.g., volume erosion, legal or regulatory framework, demographic trends) and meet its statutory obligations (e.g., pricing and universal service).

*Potential measurement.* The key measurable concept within this objective is “financial stability,” which incorporates adequate revenues and retained earnings.

“Financial stability” could be measured by reviewing short-term, medium-term, and long-term financial stability of the Postal Service. Short-term financial stability could be measured by the Postal Service’s operating profit (i.e., operational revenue – operational expenses). Medium-term financial stability could be measured by economic profit (i.e., total revenue – [variable cost + fixed cost]). Long-term financial stability could be measured by solvency (i.e., total assets / total liabilities).

The Commission has analyzed these concepts in its recent financial reports and could potentially use those analyses to determine if this objective is being achieved.<sup>21</sup> For example, in Chapter 4 of its FY 2015 Financial Report, the Commission included an analysis of the Sustainability, Liquidity, Activity, and Financial Solvency of the Postal Service’s financial status.<sup>22</sup>

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<sup>20</sup> 39 U.S.C. 3622(b)(5).

<sup>21</sup> See, e.g., FY 2015 Financial Analysis of United States Postal Service Financial Results and 10-K Statement, March 29, 2016 (FY 2015 Financial Report).

<sup>22</sup> See FY 2015 Financial Report at 75-86.

- F. Objective 6: To reduce the administrative burden and increase the transparency of the ratemaking process.<sup>23</sup>

*Preliminary definition.* A system achieving Objective 6 balances the (sometimes competing) concepts of reducing the costs imposed by rate proceedings or regulatory requirements generated by those proceedings, and the availability of comprehensive understandable material relating to each rate proceeding.

*Potential measurement.* There are two measurable key concepts within this objective: (1) reduce the administrative burden, and (2) increase the transparency. In order to achieve this objective, the ratemaking system must balance reducing administrative burden with increasing transparency.

“Reducing the administrative burden” of the ratemaking process could be measured by evaluating the complexity of rate adjustment filings and proceedings and/or quantifying the length, number of information requests and/or staff hours required to review the price adjustment proposal, ACRs, complaints, or dockets related to price setting.

“Increasing transparency” could be measured in several ways. An analysis of the necessary interaction between stakeholders and the Postal Service and/or Commission could be conducted. Another option could be to analyze the amount and type of information filed under seal compared to publicly available information. These features could also be compared to levels of transparency and administrative burden present prior to the passage of the PAEA.

- G. Objective 7: To enhance mail security and deter terrorism.<sup>24</sup>

*Preliminary definition.* A system achieving Objective 7 encourages methods of safeguarding the mail system from illegal or dangerous use, or terrorism.

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<sup>23</sup> 39 U.S.C. 3622(b)(6).

<sup>24</sup> 39 U.S.C. 3622(b)(7).



*Potential measurement.* There are two measurable key concepts within this objective: (1) enhance mail security, and (2) deter terrorism. Possible metrics to determine if Objective 7 is being achieved include a review of available safeguards (and associated available funds) that are intended to enhance security and deter terrorism, and a review of the availability of an exigent-like provision to ensure funds are available to respond to specific threats.

- H. Objective 8: To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.<sup>25</sup>

*Preliminary definition.* A system achieving Objective 8 requires that rates and classifications are linked to distinct cost or market characteristics, and the amount charged for each service is neither excessive to the mailer nor threatens the financial integrity of the Postal Service.

*Potential measurement.* There are two measurable key concepts within this objective: (1) just, and (2) reasonable. These two concepts are associated with both the schedule of rates and the schedule of classifications.

To determine whether the schedule of rates and classifications is “just,” a review of instances of excessive price increases could be conducted, including a review of classification changes. A review of price and cost relationships could also be conducted to ensure that customers are protected from misuse of the Postal Service’s monopoly power. Additionally, a review of the cost or market characteristics that define a price category, product, or service could be conducted.

To determine whether the schedule of rates and classifications is “reasonable,” an examination of the relationship between price and cost could be conducted to ensure prices and classifications do not threaten the Postal Service’s financial integrity. Another option to measure the concept “reasonable” could be an examination of the

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<sup>25</sup> 39 U.S.C. 3622(b)(8).

total compensation provided by products/services, classes, and all market dominant classes.

- I. Objective 9: To allocate the total institutional costs of the Postal Service appropriately between market dominant and competitive products.<sup>26</sup>

*Preliminary definition.* A system achieving Objective 9 has a mechanism to appropriately divide total institutional costs between market dominant and competitive products in a manner reflecting the relevant statutory considerations.

*Potential measurement.* The key measurable concept within this objective is “allocate the total institutional costs appropriately.” This objective is related to sections 3633(a)(3) and 3633(b). The measurement of Objective 9 could rely on a historical review of the allocation of institutional costs between market dominant and competitive products. The measurement of this objective could also include a review of any action the Commission takes to analyze the competitive products’ minimum contribution to institutional costs.

## V. NOTICE OF COMMISSION ACTION

Using this framework of potential definitions and measurement methods, the Commission establishes Docket No. RM2017-3 to begin its review of the market dominant ratemaking system. The Commission invites comments from interested persons regarding the process and structure of the review, as well as whether the current system is achieving the objectives, taking into account the factors. In particular, the Commission invites comments in response to the following questions:

1. Is the framework proposed by the Commission appropriate for the review?
  - a. For each objective, is the preliminary definition reasonable? If not, please suggest alternative definitions.

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<sup>26</sup> 39 U.S.C. 3622(b)(9).

- b. For each objective, are the potential metrics for measuring the achievement of the objective reasonable? If not, please suggest alternative metrics for measuring whether the objective is being achieved.
2. If the proposed framework is not appropriate for the review, please identify the framework that should be used for the review and describe how to measure the achievement of the objectives in that alternative framework.
3. Based on the Commission's proposed framework or an alternative framework provided in response to question 2, is the current system achieving each objective, while taking into account the factors? Please note that review of the system shall be limited to section 3622 as discussed in section II above.
4. If the system is not achieving the objectives, while taking into account the factors, what modifications to the system should be made, or what alternative system should be adopted, to achieve the objectives?

Comments are due no later than March 20, 2017. No reply comments will be accepted. Commission regulations require that comments be filed online according to the process outlined at 39 CFR 3001.9(a). Additional information regarding how to submit comments online can be found at: <http://www.prc.gov/how-to-participate>. However, given the unique nature of this docket, the Commission will waive these requirements for filers who mail their comments.<sup>27</sup> All information and comments provided, whether filed through the Commission's filing system or sent by mail, will be made available on the Commission's website (<http://www.prc.gov>).

Pursuant to 39 U.S.C. 505, the Commission appoints Richard A. Oliver to represent the interests of the general public (Public Representative) in this proceeding.

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<sup>27</sup> Filers who choose to mail in their comments should be mindful of possible delays given the irradiation process for mail delivered to the Commission.

## VI. ORDERING PARAGRAPHS

*It is ordered:*

1. The Commission establishes Docket No. RM2017-3 to initiate the review of the market dominant ratemaking system as required by 39 U.S.C. 3622.
2. Comments regarding the process and structure of the review, as well as whether the current system is achieving the objectives, while taking into account the factors, and if not, whether and what modifications to the system or an alternative system should be adopted as necessary to achieve the objectives, are due no later than March 20, 2017.
3. Pursuant to 39 U.S.C. 505, Richard A. Oliver is appointed to serve as an officer of the Commission (Public Representative) to represent the interests of the general public in this proceeding.
4. The Secretary shall arrange for publication of this Order in the *Federal Register*.

By the Commission.

Stacy L. Ruble  
Secretary