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

ANNUAL COMPLIANCE REPORT, 2016	Docket No. ACR2016

COMMENTS OF THE MAJOR MAILERS ASSOCIATION,
NATIONAL ASSOCIATION OF PRESORT MAILERS, AND
THE NATIONAL POSTAL POLICY COUNCIL
(February 2, 2017)

The Major Mailers Association ("MMA"), the National Association of Presort Mailers ("NAPM"), and the National Postal Policy Council ("NPPC") ("First-Class Business Mailers") respectfully submit these comments on the Postal Service's Annual Compliance Report for Fiscal Year 2016 ("*ACR*"), filed December 29, 2016. These comments focus on the following issues:

– The Postal Service's pragmatic approach to pricing is the appropriate response to workshare discounts that exceeded 100 percent due to reductions in the estimated avoided costs. Going forward, to address the recurring problem of volatility in cost avoidance estimates, the Commission should consider averaging cost avoidance estimates over a three-year period;

– The 67.6 percent pass-through of the 5-Digit Letter workshare discount sent inefficient signals that promoted uneconomic mailer behavior in the largest category of First-Class Mail. It also meant that the Postal Service did not charge a compensatory price for sorting to the 5-Digit level in FY 2016;

– First-Class Presorted Letters/Cards once again contributed a grossly disproportionate share of institutional costs, regardless of whether measured by unit contribution ($0.271) or cost coverage (336.83 percent). That they were charged more than *triple* their cost confirms that the current rates are unjust to the most efficient mailers who must use First-Class Mail. The Postal Service failed to pass through the full costs avoided, especially at the 5-Digit Letter category, and its prevailing cost avoidance methodologies do not take into account many of the low-cost characteristics of Presorted and Automation-compatible First-Class Mail; and

– The applicability of Altman Z-Scores to the Postal Service is not self-evident, and the validity of using of a ratio derived from a subset of manufacturing firms from 1946 to 1965 to assess the Postal Service's has not been demonstrated.

I. THE COMMISSION SHOULD ACCEPT THE POSTAL SERVICE'S PRAGMATIC APPROACH TO WORKSHARING DISCOUNT PASS-THROUGHS, AND SHOULD CONSIDER ASSESSING COMPLIANCE WITH SECTION 3622(e) BY USING A THREE-YEAR AVERAGE OF COSTS AVOIDED

The Postal Service, the Commission, and mailers have long understood that estimates of costs avoided for the same worksharing activity vary from year to year. They also know that a mismatch necessarily exists between (1) the avoided costs upon which a workshare discount is set in a notice of price adjustment, and (2) the avoided costs during the time the discount is actually in effect. Those latter costs, of course, are not known until after the year is over and the Postal Service calculates them from the underlying IOCS system and the cost avoidance models.

In this proceeding, the workshare discounts in effect in FY2016 were implemented on May 31, 2015, as a result of Docket No. R2015-4. That case was an index adjustment noticed in January 2015, and the workshare discounts were based on avoided costs developed in the annual compliance review process for FY2014 (which ended on September 30, 2014).

With the exception of the Automation 5-Digit Letter rate,[1] the discounts set in Docket No. R2015-4 remained in effect after the exigent surcharge was removed on April 10, 2016.[2] Those discounts are being compared in this proceeding to FY2016 avoided costs from October 1, 2015, to September 30, 2016. That means that the Commission's Annual Compliance Determination will compare workshare discounts set using *FY2014* costs to *FY2016* costs. Given that the data upon which those discounts were set – all of which the Commission approved in Order No. 2365[3] before they took effect – are two years old, it is unsurprising that four Presort Letters and Cards workshare discounts (announced in January 2015) exceeded avoided costs calculated in late calendar year 2016.[4] In addition, three discounts in Automation Flats exceeded FY2016 avoided costs.

A similar two-year cost lag occurred in the FY2014 annual compliance review. There, the Commission acknowledged that such lags are a tradeoff for the Postal Service's pricing flexibility under the PAEA. The Commission also recognized that the two-year lag could affect the number of passthroughs that exceed 100 percent, and generally accepted the Postal Service's approach to rectifying excessive passthroughs

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1 The 5-Digit discount shrank from 2.5 to 2.3 cents. This was one of the few deviations from the otherwise across-the-board exigent surcharge. *See Annual Compliance Determination Report, Fiscal Year 2015,* at n.16 (March 27, 2015) & Order No. 1926, at 159-161 (Dec. 24, 2013).

2 *See* USPS-FY16-4 (FCM Billing Determinants workbook Tab A-4).

3 *Order on Price Adjustments for First-Class Mail Products and Related Mail Classification Changes*, at 7-9 (February 24, 2015)

4 These four discounts also exceeded the cost savings in the Annual Compliance Report for FY2015. *United States Postal Service FY 2015 Annual Compliance Report,* at 9 (Dec. 29, 2016). No index rate adjustment occurred until Docket No. R2017-1 took effect in January.

over time. *Annual Compliance Determination Report,* at 9 (March 27, 2015). It should do so again in this review.

A. The Commission Should Approve The Postal Service's Recommended Approach To Rectifying Discounts That Exceed Costs Avoided

There is no question that the prices charged for the rate tiers associated with the seven Presort discounts that the *ACR* says exceeded FY2016 avoided costs more than covered their total costs and were easily compensatory to the Postal Service. The excessive cost coverage of First-Class Presort Letters and Cards ensures that those categories covered their per-piece costs with room to spare.

As for the narrower question of the seven discounts themselves, six were set in Docket No. R2015-4 at 100 percent of FY2014 avoided costs. These were the discounts for Automation AADC Letters, Automation Mixed AADC Cards, Automation AADC Cards, Automation 5-Digit Cards, ADC Automation Flats, and 3-Digit Automation Flats. Each of those six discounts now appear to exceed the costs avoided *only* because the estimated avoided costs declined significantly in FY2016 compared to the two preceding Fiscal Years. For each of those discounts, the Postal Service states:

> No statutory exception exists to address the fact that cost avoidances for each fiscal year are estimated after the end of the fiscal year, and too late to be factored into an annual price change filed before the new cost avoidances are available. Therefore, the Postal Service is not justifying this passthrough pursuant to 3622(e)(2), but will either fix the discount in its next annual market-dominant price change or cite to a statutory exception at that time, taking into consideration other business needs at the time of the price change.

ACR at 15-19.

The lone of the seven Presort discounts that exceeded a 100 percent passthrough when set is the 5-Digit Automation Flats discount of 19.2 cents. *ACR* at 20. The Commission has twice accepted that discount under the rate shock exception authorized by Section 3622(e)(2)(B). The discount has a larger passthrough now only because of an unexpected and surprisingly large 4-cent reduction in the costs avoided estimate from FY2015 (15.9 cents) to FY2016 (11.9 cents), the lowest measured since FY2007. *ACR* at 20. The First-Class Business Mailers support the Postal Service's reliance on the rate shock exception in the *ACR* and for the further reasons it stated recently in response to a Chairman's Information Request. *See Response of the United States Postal Service to Chairman's Information Request No. 4, Question 7* (January 19, 2017).

The Postal Service observes: "Changing prices to match volatile cost avoidances is not efficient for pricing or running a business." *ACR* at 14. Business mailers fully agree that pricing volatility is undesirable, and they support the Postal Service's pragmatic approach to Section 3622(e) as the best manner currently available of dealing with the annual volatility in cost avoidances.

First, It should be noted that the Commission has already approved the discounts that took effect on January 22, 2017, and that they did not exceed FY2015 avoided costs. Thus, they are already presumptively lawful and mailers and the Postal Service have made business plans in reliance upon them.

Second, from an operational standpoint, the Postal Service rightly fears that if discounts were reduced, mailers would reassess whether to presort themselves or have the Postal Service do it. It is entirely reasonable to expect that many mailers would forego sorting the mail to finer levels and instead enter it at a less presorted level. This could materially increase the volume of mail at most costly rate categories, and could well generate significant processing challenges for the Postal Service.

Finally, an additional consideration is that the viability of mail services providers' businesses can depend on fractions of a penny. Unstable discount levels impair their business planning and operations. While they understand that discounts will change from year-to-year, abrupt and substantial changes can have very negative effects on their ability to sustain their operations and continue to reduce the Postal Service's costs. This business risk is magnified when discounts change direction by significant amounts.

Accordingly, the First-Class Business Mailers urge the Commission to approve the Postal Service's proposed approach to these seven Presort discounts.

B. The Commission Should Use A Three-Year Average Of Avoided Costs In Evaluating Compliance With Section 3622(e) In The Future

As the preceding section suggests, the estimates of the costs that the Postal Service avoids due to mailer worksharing tend to fluctuate annually to an undesirable degree. The Postal Service's *ACR* (at 15-20) presents a concise summary of the volatility in these estimates in recent years. Although the ups and downs at the 5-Digit Automation Flats level are the widest (14.1 cents in FY2013; 15.2 cents in FY2014;

15.9 cents in FY2015; 11.9 cents in FY2016),[5] similar fluctuations in cost estimates are present at other workshare levels as well.

Automation Mixed AADC Letters provide another relevant example. As the Postal Service discusses,[6] that discount (4.6 cents) itself was unchanged between the filing of the 2015 and 2016 Annual Compliance Reports. However, it exceeded the estimated costs avoided in FY2015 but did *not* in FY2016.[7] The only difference between those two years was the estimated avoided cost. In FY2015 those costs were 3.3 cents; they rose by 2.5 cents per piece in FY2016 to 5.8 cents. And they had declined in FY2015 from the previous year (4.6 cents in FY2014).

The First-Class Business Mailers have not delved deeply into the Postal Service's Library References to identify what is different in this year's calculations. However, because no methodologies have changed, the explanation likely resides in changes in IOCS tallies, mail flows, productivities, labor wage rates or piggyback factors. These matters are all within the control of the Postal Service. Nevertheless, these unexpected and abrupt changes in discount levels affect mailers.

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5 The Postal Service provided a table of the changes in cost avoidance for the First-Class Mail 5-Digit Automation Flats rate category since 2007. *See Response of the United States Postal Service to Chairman's Information Request No. 4, Question 7* (January 19, 2017). That shows the cost avoidance has ranged from 11.9 cents to as high as 18.8 cents, and both increased and declined over the past ten years only to return to its FY 2007 level.

6 *ACR* at 14.

7 The passthrough for the Automation Mixed AADC Letters discount was 139.4 percent in FY2015 (ACR2015 at 9-10) but, despite no change in the discount, declined to 79.3 percent in FY2016 because the avoided costs increased. *ACR* at 14.

As the Postal Service correctly notes, such volatility "seems contrary to Objective 2," which strives for predictable and stable rates.[8] Indeed, the Postal Service on several occasions has cited the "rate shock" exception in Section 3622(e)(2)(B) to justify avoiding rate increases that would have harmed mailers and imposed significantly higher costs on postal operations by disincentivizing worksharing. *E.g.,* Order No. 2365, Docket No. R2015-4, at 8-9 (February 24, 2015) (approving a passthrough of more than 100 percent for the 5-Digit Automation Flats discount); *ACR* at 21 (justifying Automation 5-Digit Flats passthrough).

Just as a lag unavoidably occurs between the data upon which a discount is based and the data upon which it later is evaluated, avoided costs almost always change from year to year. In recognition of these realities, the Postal Service has taken the eminently sensible position that "section 3622(e) applies over the long term, as a principle guiding pricing over a series of price adjustments." *ACR* at 7. We agree. And it similarly would make sense for the evaluation of the workshare discount passthroughs also to use longer-term costs.

In particular, the Commission should consider changing its practice to evaluating compliance with Section 3622(e) using the average of the past three years' cost avoidance estimates and not merely the most recent year. For example, in this docket the workshare discounts in effect in FY2016 would be compared to an average of the costs avoided at a particular category from FY2014 (which in this case happens

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[8] *United States Postal Service Notice of Market-Dominant Price Adjustment*, Docket No. R2017-1, at 43-44 (Oct. 12, 2016).

to be the year on which they were based), FY2015, and FY2016. For similar reasons, the Commission chose to implement the price cap using a moving average instead of a point-to-point measure of inflation change.[9]

An advantage of an averaged approach over the current point-to-point practice is that discounts would be compared at least partly to the costs avoided upon which they were initially based. Assuming, for example, that the Postal Service were to provide notice in October 2017 of price adjustments to take effect in January 2018, those rates would be based on FY2016 avoided costs. Including those FY2016 costs in the estimates to which those discounts will be evaluated – which would occur in the Annual Compliance Review for FY2018 – would be reasonable.

Averaging the avoided costs over a three-year period will not necessarily solve all of the problems arising from the timing mismatch, but should help to smooth the cost avoidances to a helpful degree and lead to more predictable price changes at the different discount tiers. While the First-Class Business Mailers are not wedded to a three-year period, that seems a sufficiently long period to moderate year-to-year costing fluctuations while remaining sufficiently contemporaneous for reasonable accuracy.

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[9] *E.g.*, Postal Regulatory Commission, *Annual Report to the President and Congress Fiscal Year 2012*, at 20 (January 3, 2013).

II. THE POSTAL SERVICE IS SENDING UNECONOMIC SIGNALS AND UNDERCHARGING FOR ITS SORTATION SERVICES AT THE AUTOMATION 5-DIGIT LETTER LEVEL

In FY2016, First-Class Automation 5-Digit Letters saved the Postal Service 3.4 cents in mail processing and delivery costs compared to 3-Digit/ADC Letters. USPS-FY16-3 Workshare Discounts.xls (Tab FCM Bulk Letters, Cards). However, mailers of Automation 5-Digit Letters received a discount of merely 2.3 cents (or 2.5 cents with the exigency surcharge) off of the 3-Digit/AADC Letter rate, a passthrough of 67.6 percent.

In economic terms, the failure of the discount to passthrough 100 percent of the costs avoided between the 5-Digit and the 3-Digit/AADC tiers violated the principle of Efficient Component Pricing, which the Commission has long recognized best promotes efficiency. *E.g., Opinion and Recommended Decision,* Docket No. R2006-1, at 61 & 128 (February 26, 2007). By not providing the correct economic pricing signal, mailers had an incentive to purchase more costly, less efficient processing from the Postal Service rather than from a more efficient upstream provider of these services. As the Commission recognized only last year:

> Although passthroughs below 100 percent are lawful, they send inefficient pricing signals to mailers. Passthroughs set as close as possible to 100 percent would promote efficiency, lower the total combined costs for mailers, and encourage the retention and growth of the Postal Service's most profitable products.

Annual Compliance Determination Report, Fiscal Year 2015 at 10 (March 28, 2016). Such inaccurate pricing signals are inconsistent with the Objective of maximizing incentives to reduce costs and increase efficiency. 39 U.S.C. §3622(b)(2).

Second, as NPPC and Pitney Bowes have noted previously, a discount set at less than avoided cost is a form of exclusionary pricing. When the Postal Service passes through substantially less than 100 percent of the costs avoided, it underprices (by effectively selling below unbundled cost) its own mail processing services (here, the mail processing and delivery from the 3-Digit/AADC to the 5-Digit level). This has the effect of excluding more efficient private sortation services.

This is best understood when viewed from the perspective of a mailer deciding whether to prepare a large mailing to the 3-Digit/AADC or the 5-Digit level. In FY2016, the Postal Service offered a discount of 2.3 cents per piece (2.5 cents per piece before the exigency surcharge was removed) for mailers to do work that cost it 3.4 cents to do. In other words, to a letter mailer shopping for mail processing services, the Postal Service offered a price of 2.3 cents to sort from 3-Digits/AADC to 5-DIgits – the amount of the incremental discount to the 5-Digit level. If it cost the mailer less than 2.3 cents per piece to take the additional step of preparing the mailing to the 5-digit level, it would have saved money by sorting the mail itself and accepting the discount. If it cost the mailer 4 cents per piece to perform that sort, the mailer's rational and efficient choice would have been to enter the mail at the 3-Digit rate, from which the Postal Service would have sorted the mail to the 5-Digit level more efficiently.

But if the mailer's cost to presort to the 5-Digit level were 3 cents per piece, in FY2016 its rational decision would have been to enter the mail at the 3-Digit/AADC level and pay the Postal Service the 2.3 cents to sort to the 5-Digit level. This would have saved the mailer 0.7 cents per piece compared to its own cost of doing it. But because the Postal Service incurred a cost of 3.4 cents to process the piece to the 5-Digit level in FY 2016, the 2.3 cents per piece (or 2.5 cents with the exigency surcharge) revenue it received resulted in a loss of 1.1 cents (or 0.9 cents) per piece. Due to this faulty price signal, a mailer that could have sorted to 5-Digits for less than it cost the Postal Service to do so found it less expensive to let the Service do the work.

With about 4.528 billion 3-Digit/AADC pieces in FY2016, underpricing its mail processing service by 1.1 cents per piece cost the Postal Service nearly $50 million last year alone. The economy-wide loss of economic efficiency cannot be calculated because each mailer's cost to presort to the 5-Digit level is unknown. But to the extent that the Postal Service's inefficient pricing took work from more efficient private mail preparation firms that eke out their business from the margins between their costs and the discounts (and for whom $50 million is a very substantial amount of money), it constituted a form of exclusionary pricing. The surest way to avoid such inefficient, uneconomic, and exclusionary pricing in the future is for the Postal Service to set its discounts – particularly such an important one as the 5-Digit discount -- at Efficient Component Pricing levels.

III. THE PERSISTENTLY HIGH COST COVERAGE OF FIRST-CLASS BULK LETTERS AND CARDS HIGHLIGHTS A FLAW IN THE CURRENT SYSTEM OF MARKET-DOMINANT RATE REGULATION

The *ACR* reports that the cost coverage paid by First-Class Presort Letters and Cards in FY2016 was 336.83 percent. This was, by a substantial margin, the highest of any market-dominant mail product.[10] Except for the relatively small Every Day Direct Mail,[11] the product with the next highest coverage was Standard High Density and Saturation Letters at 218.39 percent, far less than Presort Letters and Cards.[12]

Furthermore, despite a slight decline in the overall average cost coverage of market-dominant mail, the cost coverage of First-Class Presort Letters and Cards actually *increased* from 318.90 percent in FY2016. The cost coverage on Presort Letters and Cards was so excessive that every single one of the other First-Class products enjoyed a cost coverage below 200 percent, well below the class average of 224.28 percent. *ACR*, Table 1.

The story is the same on a unit contribution basis. The unit contribution of First-Class Presort Letters and Cards of 27.6 cents was easily the largest of any non-parcel product except for First-Class Flats, whose 42.7 cent per piece contribution equated to a cost coverage of only 143.85 percent. It was more than triple the unit contribution of High Density and Saturation Letters (8.3 cents).

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10 *ACR* at 12; USPS-FY16-2 Public-FY16CRA.xls (Tab Coversheet).

11 Every Door Direct Mail Retail had a cost coverage of 269.45 percent.

12 *ACR*, Table 2.

FY2016 marked the fourth consecutive year, and fifth in the last six, in which the cost coverage of First-Class Presort Letters and Cards exceeded 300 percent – that is, the price was more than triple the cost of this efficiently-prepared mail. And each annual compliance review proceeding under the PAEA has shown that First-Class Presort Mail consistently has been forced to pay substantially above-average cost coverages and the highest per-piece contributions to institutional costs:

First-Class Presort Letters and Cards

	Attributable Cost (cents)	Average Price (cents)	Unit Contribution (cents)	Cost Coverage (%)	System Cost Coverage (%)
FY2008[13]	11.023	33.023	22.000	299.6	164.0
FY2009[14]	11.704	34.152	22.448	291.8	164.5
FY2010[15]	11.679	34.739	23.060	297.4	161.1
FY2011[16]	11.65	34.982	23.332	300.3	159.1
FY2012[17]	12.15	35.64	23.49	293.3	160.8
FY2013[18]	11.67	36.30	24.63	311.1	165.7
FY2014[19]	11.8	37.848	26.04	320.6	184.31
FY2015[20]	12.1	38.7	26.6	318.9	183.41
FY2016[21]	11.5	38.6	27.1	336.83	181.4

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[13] PRC, *Annual Compliance Determination, Fiscal Year 2008,* at Table III-2 (Mar. 30, 2009) ("*FY08 ACD*").

[14] PRC, *Annual Compliance Determination, Fiscal Year 2009,* at Tables IV-5 & B-1 (Mar. 29, 2010).

[15] PRC *Annual Compliance Determination, Fiscal Year 2010,* at 84 Table VII-1 (Mar. 29, 2011, as corrected Apr. 8, 2011).

[16] PRC, *Annual Compliance Determination, Fiscal Year 2011,* at 96 Table VII-1 (Mar. 28, 2012).

[17] PRC, *Annual Compliance Determination Fiscal Year 2012*, at Tables VII-1 & D-1 (Mar. 28, 2013).

[18] PRC, *Financial Analysis 2013: Analysis of United States Postal Service Financial Results and 10-K Statement for Fiscal Year 2013*, at 43-44 App. A (revised Apr. 20, 2014).

[19] PRC, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2014*, at 77 (April 1, 2015).

[20] USPS-LR15-1 (Public FY15CRS.xls) (Market-dominant products only).

[21] USPS-LR16-1 (Public FY16CRS.xls) (Market-dominant mail only).

This persistently high cost coverage results from a repeated failure to take into account the many cost-saving characteristics of Presort Letters and Cards that, to date, have not been found to be within the definition of worksharing in Section 3622(e). Presort Mail has many low-cost characteristics – *e.g.*, local entry, traying and facing, entry near the destination, lower cost sales channel – that are ignored by the calculations that underlie the discounts. As a result, First-Class Automation and Presort mail has significantly lower attributable costs than other mail even before taking worksharing into account.

This is shown yet again in the FY16 CRA. It reports a unit attributable cost for Presort Letters of 11.7 cents, a decline of 0.7 cents from FY2015. In contrast, the unit attributable cost of Single-Piece letters rose from 26.9 cents to 28.1 cents. USPS-FY16-1 Public-FY16CRA.xls (Tab Cost 1). Only 9.5 cents of this 16.4-cent per piece cost difference are explained by the worksharing costs avoided calculations reported in USPS-FY16-3 (Worksharing Discount Tables, Tab FCM Bulk Letters, Cards). The remaining 6.9 cents of the cost differential arises from the many low-cost characteristics of Presort Mail that are not included in the worksharing discount calculations, and thus are not recognized in Presort prices.

In recent years, the Postal Service has often characterized First-Class Mail as a declining product, and has worried that reduced volumes for this "profitable" mail poses a long-term financial threat. But reduced volumes are an entirely predictable consequence of setting prices so far above costs, which is nothing other than the type of exploitation of a mail product that rate regulation is supposed to prevent. Prices so removed from unit costs cannot be considered efficient in any economic or just in any legal sense.

So it is no surprise that in response many business mailers have sought to migrate as many communications away from the postal system as feasible. With the emergence over the past decade of mobile and high-speed Internet connectivity, electronic alternatives offer increasingly attractive options to steadily rising postal prices. This migration, which the Postal Service's pricing exacerbates, is not in the agency's long-term financial interest. While Presort volumes may be leveling off, the Postal Service's share of the communications pie is declining because the number of total communications continues to rise steadily.

The price adjustments that took effect in Docket No. R2017-1 should ameliorate the Presort Mail cost coverage to a small degree in FY2017. Nonetheless, the problem has persisted for decades, and will require years of price adjustments to be corrected. Although this is not the proceeding to correct the Postal Service's anachronistic approach to pricing, this review is an appropriate forum in which to identify the problem.

IV. ALTMAN Z-SCORES HAVE LITTLE APPLICABILITY TO THE POSTAL SERVICE AND DO NOT GIVE A REALISTIC ASSESSMENT OF ITS FINANCIAL CONDITION

The Commission presents its review of the Postal Service's finances in the Annual Compliance Determination or, more recently, in a separate financial analysis. These reviews have repeatedly analyzed the financial condition of the Postal Service as if it were a publicly-traded, for-profit, private corporation. For example, the

Commission has applied a variety of standard univariate ratios (such as debt ratio or current ratio) to analyze financial sustainability, liquidity, activity, and solvency.

In recent years, the Commission has also presented a single multivariate calculation using the Altman Z-Score model. *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2015,* at 78 (March 29, 2016); *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2014,* at 67 (April 1, 2015). Professor Altman developed the Z-Score model in the late 1960s to predict a private firm's potential for bankruptcy. He developed his model by comparing 33 manufacturing firms that declared bankruptcy between 1946 and 1965 to 33 manufacturing firms that did not do so over the same period.[22] The mean asset size of the second group ($9.6 million) was slightly larger than that of the first group.

The applicability of Altman Z-Scores to the Postal Service apparently has never been the subject of public notice and comment. This is unfortunate, because the applicability to the Postal Service of Z-Scores devised to assess the likelihood of bankruptcy of private sector manufacturing firms is far from self-evident, and certainly has not been demonstrated.

On the contrary, before applying an Altman Z-Score to the Postal Service, it is necessary to consider:

- Can a model derived from a sample of manufacturing firms from 1946 to 1965 accurately apply to a service firm in 2017?

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22 Altman, E., *Corporate Financial Distress: A Complete Guide to Predicting, Avoiding and Dealing with Bankruptcy* (John Wiley & Sons 1983) at 105.

- Can a model derived from sample of publicly-traded private corporations from 1946 to 1965 accurately apply to a government agency in 2017?
- Can a model derived from sample of firms subject to bankruptcy law accurately apply to a government entity that is not subject to bankruptcy law?
- Can a model derived from sample of firms whose mean assets were $9.6 million or less more than 50 years ago provide any basis for drawing accurate conclusions about the Postal Service today?

In addition, the Altman Z-Score presentation that the Commission has used is incomplete. Professor Altman used *five* ratios, but the Commission uses only four. The omitted ratio compares Sales to Total Assets.

Finally, the Postal Service itself has stated that even in the event of a cash shortfall, "the U.S. government would likely prevent the Postal Service from significantly curtailing or ceasing operations." United States Postal Service, *Form 10-Q, For the Quarterly Period Ended June 30, 2016*, at 9. There is no evidence that any of the sample firms used by Professor Altman when developing his Z-Scores was in a comparable position. Thus, using Z-Scores to predict an event that would likely not be allowed to happen is inappropriate.

The Commission should refrain from presenting Altman Z-Scores in its review of the Postal Service's financial performance.

V. CONCLUSION

For the foregoing reasons, the Major Mailers Association, the National Association of Presort Mailers, and the National Postal Policy Council respectfully urge the Commission to consider these comments when making its determination pursuant to 39 U.S.C. §3653, and also to take these comments into account in connection with its upcoming review of the ratemaking system required by 39 U.S.C. §3622(d)(3).

Respectfully submitted,

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