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

STATUTORY REVIEW OF THE SYSTEM FOR REGULATING RATES AND CLASSES FOR MARKET DOMINANT PRODUCTS	)))	Docket No. RM2017-3

COMMENTS OF
ALLIANCE OF NONPROFIT MAILERS,
ASSOCIATION FOR POSTAL COMMERCE, AND
MPA—THE ASSOCIATION OF MAGAZINE MEDIA

(March 20, 2017)

The Alliance of Nonprofit Mailers ("ANM"), Association for Postal Commerce ("PostCom"), and MPA—The Association of Magazine Media ("MPA") respectfully submit these comments in response to Order No. 3673. These comments are supported by the following declarations:

1. Meta A. Brophy, Director, Procurement Operations, Consumer Reports, Inc.

2. Tracey Burgoon, Director of Direct Marketing, Disabled American Veterans.

3. Rita D. Cohen, Senior Vice President, Legislative and Regulatory Policy, MPA.

4. Jerry Faust, VP–Print & Distribution, Time Inc.

5. Craig Finstad, Assistant Vice President, Direct Response, American Lung Association.

6. Sandra Miao, Director of Membership, National Wildlife Federation.

7. Michael Nadol, President, PFM Group Consulting, LLC.

8. David O'Sullivan, Postal Affairs Manager, Guideposts.

9. Michael Plunkett, President and CEO, PostCom.

10. Quad/Graphics.

11. Bob Rosser, Director Postal Affairs, Products and Services, IWCO Direct.

12. Wendy Smith, Assistant Vice President Fulfillment & Postal Affairs, Publishers Clearing House.

13. Halstein Stralberg, consultant to Time Inc.

I. INTRODUCTION AND SUMMARY

These comments cover three issues: (1) whether the current regulatory system strikes a reasonable balance between (a) the Postal Service's revenue requirements, (b) the mailers' need for protection from abuse of the Postal Service's monopoly power, and (c) the statutory objective to maximize incentives to reduce costs and increase efficiency (Objectives 1, 5 and 8, and Factors 2 and 3); (2) whether the current regulatory system has appropriate standards for recovering the institutional costs of the Postal Service from the multiple products and classes that use it (Objectives 4, 8 and 9); and (3) whether the Commission's current standards for worksharing discounts are appropriate (Objectives 1, 4, and 8).[1] We summarize each issue in turn.

[1] The "objectives" of market dominant ratemaking are codified at 39 U.S.C. § 3622(b); the "factors" are codified at 39 U.S.C. § 3622(c). For brevity, these comments often cite to the objectives and factors instead of the specific parts of §§ 3622(b) and (c).

A. The current regulatory system properly balances the financial needs of the Postal Service with the need to protect captive mailers from abuse of the Postal Service's market power.

The Postal Service is a regulated monopoly. Because it is a monopoly, the Postal Accountability and Enhancement Act of 2006 ("PAEA"), like the Postal Reorganization Act of 1970 and the "just and reasonable" rate standard incorporated in both acts from a century of common carrier and public utility precedent, requires the Commission to limit the prices charged by the Postal Service for its market dominant mail products to levels that balance the financial needs of the Postal Service with the need to protect users of market dominant mail products from abuse of the Postal Service's monopoly power. Since the enactment of the PAEA, this balance has been reflected in the objectives and factors of 39 U.S.C. §§ 3622(b) and (c) and the Consumer Price Index-based cap on market-dominant price increases imposed by 39 U.S.C. § 3622(d).

In this docket, the Postal Service asks the Commission to shatter the CPI cap, and upend the statutory balance of carrier and mailer interests, by allowing the Postal Service to impose above-inflation price increases on captive mailers. Without this, the Postal Service asserts, it faces financial ruin. This assertion, although unfounded, has been repeated often enough that many have come to accept it, and the possibility of a panicky and destructive "solution" to a nonexistent crisis has become an increasing threat.

In fact, reports of the Postal Service's impending demise are greatly exaggerated. The revenue and earnings of the Postal Service are improving, not declining. Market dominant mail volume has stabilized, and the contribution from competitive products (especially e-commerce package delivery service) has been growing rapidly. Operating income (*i.e.*, income before expenditures for retiree health prefunding, amortization payments, and non-cash workers compensation adjustments) has been positive for the past several years. The Postal Service projects that it will earn a small profit in Fiscal Year 2017 despite the rollback of the exigent rate surcharges during Fiscal Year 2016, and earnings should be increasing over the next few years even without major productivity initiatives. These facts refute the Postal Service's claim that continuing growth in the number of delivery points makes a CPI cap unworkable. Furthermore, the Postal Service's own calculations show that the effect of the growth in the number of delivery points is much smaller than claimed by the Postal Service.

The Postal Service also has healthy liquidity. It has about $8 billion of cash, and it generated approximately $3 billion of cash from operations each year from Fiscal Years 2014 to 2016 to fund investments. This cash reserve is several times the average cash reserve held by the Postal Service since 1995.

While the *net* earnings reported by the Postal Service are still negative, this is an artifact of the arbitrary payment schedule enacted by Congress in 2006 to prefund quickly the Postal Service's *future* liabilities for pension and health benefits for its retirees. The prepayment schedule—$5 billion or more a year—proved to be too rapid for the Postal Service to meet, and Congress has not enforced it. The Postal Service's failure to meet an impossible prepayment schedule proves nothing about the Postal Service's actual financial health. These are the facts:

(1) Meeting the 2006 prepayment schedule was unnecessary. The Postal Service's pension and retiree health benefit funds now have $340 billion in assets. Even according to the conservative assumptions of the Office of Personnel

Management ("OPM"), this is enough money to cover 92.5 percent of the projected liabilities of the Postal Service's pension funds, plus about 50 percent of the projected liabilities of the Retiree Health Benefit Fund. The Postal Service's retiree benefit funds are more fully funded than the corresponding retiree benefit plans offered by the vast majority of government and private sector employers in the United States. Indeed, the Postal Service's retiree benefit accounts are well enough funded that they could pay the full amount of the pensions and retiree health benefits promised to postal retirees for decades *even in the implausible event that the Postal Service shut down tomorrow and made no further contributions to the funds*.

(2) The Postal Service funding percentages noted in the previous paragraph reflect OPM's projections of future spending on pension and retiree health care benefits. These projections, however, are highly conservative, meaning that the Postal Service's pension and retiree health benefit plans are even more richly funded than the OPM-derived figures cited in the previous paragraph indicate.

(3) The Postal Service's financial statements understate its true financial strength in a second respect: they value the Postal Service's real estate—most of it acquired years or decades ago—at depreciated historical cost (also known as "book" cost). Book cost understates the current value of commercial real estate because commercial real estate prices, like residential real estate prices, have been rising for decades. Although the use of book costs is generally accepted for financial reports, it is not appropriate here. The purpose of valuing the Postal Service's real estate in the present context is not to determine the profitability of the enterprise as a going

concern, or the size of the Postal Service's rate base for cost-of-service rate regulation, but to assess the ability of the Postal Service's assets to serve as a backstop source of funds to pay the Postal Service's debts to its employees, retirees and other creditors in the hypothetical (and unlikely) event that the Postal Service failed and was liquidated. For that purpose, the current market value of the Postal Service's real estate and other assets is the best measure of how much money could be raised by selling the assets.

(4) If the Postal Service genuinely believes that its finances need improvement, there are ample ways to achieve this under current law. Here are a few major options:

Narrow the employee compensation premium. Although 39 U.S.C. § 1003(a) establishes a policy that postal workers should receive compensation that is comparable to the compensation and benefits paid for "comparable levels of work in the private sector," postal employees continue to enjoy a massive compensation premium over the private sector. By some estimates, postal workers receive nearly twice the compensation that private firms offer for comparable work. The extraordinarily low quit rate of the career postal work force—a fraction of one percent per year—underscores the richness of the compensation that the Postal Service offers. Even a small annual narrowing of the compensation premium in future years would dramatically improve the Postal Service's finances.

Improve operating efficiency. The Postal Service's productivity has been stagnant for the last three years and, in fact, declined last year. Yet, as the Government Accountability Office has noted, the Postal Service has no new major cost saving initiatives planned. Before demanding the right to squeeze more money from captive mailers, the Postal Service needs to revive its cost saving efforts and make serious progress in network rationalization and delivery mode conversion.

Make better management and pricing decisions. The Postal Service needs to stop needlessly driving up its costs through bad management and pricing decisions such as those involving the Flat Sequencing System ("FSS"). When the FSS was still in the planning stage, experts both inside and outside the Postal Service warned that the FSS was unlikely to achieve its goals and was likely to increase, not decrease, the costs of processing and delivering flat-shaped mail. The Postal Service nonetheless chose to go forward with the FSS. Its performance has been even worse than the skeptics warned. The Postal Service should face reality, mothball the FSS, and promote efficiency by increasing the rate discounts offered for carrier route presorting from less than 60 percent to a full 100 percent of the cost savings from this preparation. Doing this would stimulate a massive surge in co-mailing, enabling Periodicals Mail and Marketing Mail Flats to cover most if not all of their reported attributable costs.

Show more creativity and resourcefulness in attracting more revenue. Instead of demanding the right to squeeze more revenue from captive mailers through above-CPI rate increases, the Postal Service needs to develop *voluntary* sources of additional revenue. In setting prices and identifying new sources of revenue, the Postal Service has operated under the 2006 legislation much like under prior law. This stasis is not what Congress intended. The Postal Service should be taking advantage of the tools created by the 2006 law (such as a streamlined Negotiated Service Agreement process) and evaluating fundamentally new sources of revenue, such as displaying advertising on mail trucks and buildings.

(5) Congress also has several ways to improve the Postal Service's finances through legislation. For instance, there is no rational justification for requiring the Postal Service to invest its massive cash reserves in low-yielding Treasury bonds. Most state and municipal government employers and most private employers are allowed to invest the cash in their retiree benefit funds in a diversified mix of stocks, bonds and other assets. Allowing the Postal Service to do the same would improve its balance sheet by more than $100 billion.

Additionally, Congress could integrate the Postal Service's retiree health programs with Medicare. Although the Postal Service contributes to Medicare for its employees, about a quarter of postal retirees and their dependents do not enroll in it, forcing the Postal Service to pay extra to provide duplicate insurance coverage to these individuals. The Postal Service has estimated that this would essentially eliminate the Postal Service's unfunded retiree health benefit liability and reduce expenses by $16.8 billion over the next five years.

* * *

By contrast, precipitously "solving" the Postal Service's finances by allowing it to impose above-CPI rate increases on mail products would be a devastating mistake. The CPI cap imposed by 39 U.S.C. § 3622(d) is the only effective protection offered to mailers and consumers by the current system of market dominant price regulation against abuse of the Postal Service's market power. The chink in this regulatory armor, however, is the credibility of the price cap. A regulator that gains a reputation for relaxing the price cap when the regulated monopoly pleads poverty destroys the credibility of the cap.

In the present context, such a loss of credibility would undermine both the will and the ability of Postal Service management to bargain effectively with postal labor and other interest groups that want to raise the Postal Service's costs. Experience teaches that the Postal Service avoids spending the management resources and political capital needed to cut costs unless forced to do so. The loss of momentum in the Postal Service's cost cutting efforts (in both collective bargaining and productivity initiatives) as the 2007-2009 recession has receded into the past illustrates this. So does the experience of light-handed rate regulation of foreign postal operators. Allowing the Postal Service to extract more money from captive mailers would not improve the Postal Service's financial stability: the past performance of the Postal Service and its foreign counterparts shows that the extra funds would be squandered through laxer control of costs.

These outcomes would violate multiple factors and objectives of 39 U.S.C. § 3622. As noted above, the PAEA did not elevate revenue adequacy to an absolute good superior to all other objectives of 39 U.S.C. §3622(b). The PAEA balances the interests of the regulated monopoly against the interests of its ratepayers and the public. Shattering the CPI cap—the only significant protection offered by PAEA to market-dominant mailers against abuse of the Postal Service's market power—to solve a nonexistent financial crisis would abdicate the Commission's obligation to balance the interests of the Postal Service with the interests of its captive customers and ultimate consumers.[2]

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[2] On October 28, 2014, ANM, PostCom, MPA, and several other parties submitted a white paper to the Commission arguing that the Commission lacks authority under 39 U.S.C. § 3622(d)(3) to rescind or even substantially modify the CPI cap established under 39 U.S.C. §§ 3622(a) and (d), and that construing § 3622(d)(3) to give the Commission this authority would raise serious Constitutional issues. In

The Commission should take the following steps. *First*, it should find that the current system of regulation properly balances the objectives of 39 U.S.C. § 3622(b) in light of the factors of 39 U.S.C. § 3622(c), issue a report to that effect, and close this docket. *Second*, the Commission should begin an investigation of the current market value of the Postal Service's real estate. *Third*, the Commission should direct the Postal Service to prepare plans for dealing with the labor compensation premium and initiating other major cost reduction initiatives. *Fourth*, the Commission should recommend to Congress that it (a) relax the current restrictions on assets in which the Postal Service may invest its cash, and (b) integrate the Postal Service's retiree health benefit systems with Medicare. The Commission is always free to revisit its findings about the performance of the regulatory system in the future if Postal Service's circumstances change. But now is not the time for the Commission to go wobbly.

B. The current regulatory system includes appropriate standards for recovering the institutional costs of the Postal Service from individual products and classes.

The standards of the current regulatory system for recovering the institutional costs of the Postal Service from the multiple products and classes that use mail (Objectives 4, 8 and 9) are appropriate and should be upheld without change. Price cap regulation for market dominant rates should be retained, and the CPI cap should continue to be applied separately to each class of market dominant

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April 2016, the Commission deferred consideration of these questions until Phase 2 of the ten-year review. Order No. 3237 in Docket No. RM2016-9¸ *Scope of Review of System for Regulating Market-Dominant Rates and Classes* (issued April 12, 2016). Accordingly, ANM, PostCom and MPA reserve comment on these issues until Phase 2.

mail. The CPI cap divorces prices from attributable costs, providing the Postal Service with needed pricing flexibility. At the same time, applying the cap at the class level, rather than to market dominant products as a whole, protects captive mailers from excessive cost increases and unjust and unreasonable rates. This balance should be preserved, as it has enabled the Postal Service to fully recover its institutional costs while protecting the interests of individual mailers.

C. To minimize the cost of flat-shaped mail, the Commission should require the Postal Service to develop a plan for expeditiously ending the disastrous FSS project and set worksharing discounts that fully reflect cost avoidances, including 100 percent of the costs avoided by presorting to the Carrier Route level.

The Postal Service must not be allowed to charge captive mailers for the added costs resulting from the Postal Service's disastrous decision to invest in the Flats Sequencing System ("FSS") instead of committing fully to co-mailing. The Postal Service made this decision against the strong advice of flats mailers and many experts within the Postal Service itself. The problems noted by these skeptics have fully materialized: far from producing large savings in sorting and delivery costs, the FSS has caused those costs to skyrocket. The FSS adds, for example, almost 17 cents to the cost of an average carrier route flat that converts to FSS processing. The Postal Service's decision to continue running the FSS is an operational matter that is the Postal Service's prerogative. But the Commission has both the power and the duty to ensure that extra costs created by this imprudent and uneconomic investment not be charged to captive mailers. The Postal Service should (1) retire the FSS machines, (2) allow mailers of flat-shaped mail to prepare their mail for (and qualify for) Carrier Route and other discounts in all zones; and (3) make Carrier Route and other worksharing discounts for flats deep enough to cover 100 percent of the costs avoided by the worksharing. These reforms alone should encourage enough co-mailing to enable Periodicals Mail and flat-shaped Marketing Mail to cover all, or nearly all, of their attributable costs.

II. THE CURRENT REGULATORY SYSTEM STRIKES A REASONABLE BALANCE BETWEEN THE POSTAL SERVICE'S FINANCIAL NEEDS AND THE MAILERS' NEED FOR PROTECTION FROM ABUSE OF THE POSTAL SERVICE'S MONOPOLY POWER, AS SHOWN BY THE PERFORMANCE OF THE SYSTEM SINCE 2007. (OBJECTIVES 1, 5, 8; FACTORS 3 AND 12)

Perhaps the most important issue in this docket—and certainly the one that the Postal Service has emphasized most during the run-up to this case—is the appropriate regulatory ceiling on the Postal Service's system-wide revenues from market-dominant products. During the past few years, the Postal Service and its allies have insisted repeatedly that the CPI cap, unless eliminated or relaxed, dooms the Postal Service to insolvency.[3] This claim misconceives both the law and the facts.

[3] *See*, *e.g*., Hearings before House Oversight and Govt. Reform Comm. (Feb. 7, 2017), prefiled testimony of PMG Megan J. Brennan ("2017 Brennan testimony") at 11-12; *id.*, prefiled testimony of Fredric V. Rolando ("2017 Rolando testimony") at 6; Docket No. PI2016-3, PRC *Section 701 Report*, USPS Comments (Nov. 9, 2016) at 1; USPS OIG Report No. RARC-WP-13-007, *Revisiting the CPI-Only Price Cap Formula* (April 12, 2013); USPS OIG Report No. RARC-WP-15-014, *CPI Study Update* (Aug. 10, 2015); International Posts (Feb. 8, 2017); USPS Fiscal Year 2017 Integrated Financial Plan at 1; Decker, Christopher, "Regulating networks in decline," 49 J. Regul. Econ. 344 (May 4, 2016).

A. Title 39 requires that the regulatory system for market dominant mail balance the Postal Service's interests with those of mailers and consumers.

We begin with the law. Section 3622(d)(3) requires the Commission to decide in this case whether the "system" for regulating market-dominant rates "is achieving" the objectives of Section 3622(b) in light of the factors of Section 3622(c). The participants in this case appear to disagree about what this means. The Postal Service has suggested that Objective 5—the revenue adequacy and financial stability objective of PAEA—overrides the other objectives and factors, so that a revenue shortfall under the existing system warrants eliminating or loosening the CPI cap of Section 3622(d) without more. *See, e.g.*, USPS comments in PI2016-13 (Nov. 9, 2016) at 1 (discussing Postal Service interests alone).

The Commission has not embraced this interpretation. But its initial notice in this docket suggests that each of the objectives will be assessed individually. Order No. 3673, the Commission's advanced notice of proposed rulemaking ("ANPR"), is organized according to the nine regulatory objectives enumerated in 39 U.S.C. § 3622(b). For each of the nine objectives, Order No. 3673 solicits separate comment on (1) the definition of the objective, (2) the best benchmarks for determining whether the objective has been satisfied, and (3) an assessment of whether the objective has been satisfied in terms of the benchmarks.

This organizational approach, while raising important and useful questions, risks obscuring the relationship between the objectives. Many of them are interrelated or in tension with other objectives, as the Commission has recognized elsewhere.[4] A sound assessment of whether the current system of regulation is achieving "the objectives" of Section 3622(b) must consider many of them in conjunction with other objectives. The question to be answered by the Commission is not how well the current system is meeting each objective individually, but how well it is balancing all of them. *How* this balance should be achieved is spelled out to a large extent by (1) the text and structure of Section 3622(b) and (c); (2) the century of judicial precedent incorporated by reference in the "just and reasonable" (or "reasonable and equitable") standard of 39 U.S.C. §§ 404(b) and 3622; and (3) Section 3622(d) itself, which reflects a legislative judgment that price cap regulation would enable the Postal Service to earn adequate revenue. We discuss each in turn.

1. The text and structure of Section 3622(b) require that the Commission consider each objective in conjunction with others.

The texts of Sections 3622(b) and (c) make explicit their holistic and interrelated character. Objective 5, read in isolation, would appear to "assure [the USPS] adequate revenues, including retained earnings, and to maintain financial stability." But many of the other objectives and factors direct the Commission to protect captive ratepayers from abuse of the Postal Service's market power, and their inclusion means that Objective 5 cannot be a blank check. Objective 1 calls for the ratemaking system to "maximize incentives to reduce costs and increase efficiency." Factor 12 likewise requires the Commission to take into account "the

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[4] *See*, *e.g.*, PRC Annual Report to the President and Congress for Fiscal Year 2016 (Jan. 13, 2017) at 24 ("Section 3622(b) establishes a tension between the restrictions of an inflation-based price cap on Market Dominant price increases and the objective that the Postal Service must assure adequate revenues and retained earnings to maintain financial stability.").

need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services."

Objective 8 calls for rates to be "just and reasonable." Factor 3 requires the Commission to take into account "the effect of rate increases upon the general public" and "business mail users." And both provisions are buttressed by 39 U.S.C. § 404(b), which requires that rates for market dominant products be "reasonable and equitable," and which limits the Postal Service to revenue "sufficient" to provide appropriate services "under best practices of honest, efficient, and economical management."[5]

The introductory phrase of § 3622(b) explicitly requires that "each" objective "shall be applied in conjunction with the others." The legislative history of Section 3622 confirms that this requirement was inserted deliberately, so that one objective would not be treated as an absolute value, overriding the others.

H.R. 22, introduced in January 2005, directed the Commission to develop a system of ratemaking "designed to meet the following [seven] objectives," much like PAEA, but lacked the language of PAEA requiring each objective to be applied "in conjunction with the others." *See* Cong. Rec. H6523 (July 26, 2005). Even without this language, however, the bill could not be construed to bestow primacy on the

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[5] Several other objectives and a factor also speak to the Commission's ratemaking standards. Objective 2 requires "predictability and stability in rates," without regard to changes in Postal Service costs. Objective 4 seeks "[t]o allow the Postal Service pricing flexibility," a goal that can be at odds with traditional cost-of-service regulation in which the regulated entity's costs strictly dictate its rates. Objective 6 requires the system of ratemaking "[t]o reduce the administrative burden and increase the transparency of the ratemaking process," again without regard to the revenue sufficiency of the rates established, and in part to reduce the cost to all parties involved with evaluating and justifying rates.

objective "[t]o assure adequate revenues, including retained earnings, to maintain financial stability." The Committee on Government Reform Report to H.R. 22 stated that under the system of ratemaking proposed, "losses could not be recovered by increasing rates beyond specified parameters without regulatory approval." H.R. Rep. No. 109-66, at 44 (2005). The Committee further explained that the pre-PAEA "rate-setting process provide[d] little or no incentive for the Postal Service to control its costs because all costs [were] ultimately passed through to the consumer regardless of how efficiently or inefficiently the Postal Service operate[d]. Under the new system, the Postal Regulatory Commission will have the flexibility to design a system that will improve efficiency and improve costs." *Id.* at 48. H.R. 22 would therefore have directed the Commission to design a rate-setting system that balanced the seven objectives enumerated in H.R. 22.

This directive to balance objectives became more explicit as H.R. 22 moved through the legislative process. After the House passed H.R. 22, the Senate amended the bill by substituting it with its own bill, S. 662. When first introduced in 2005, S. 662 also lacked the "in conjunction with the others" language of PAEA. But the bill was later amended to require expressly that the Commission apply each of the objectives "in conjunction with the others." Cong. Rec. S926 (Feb. 9, 2006) (S. Am. 2750). Thus, when the Senate passed H.R. 22 as amended, it incorporated the "in conjunction with the others" language. Cong. Rec. S928. This language persisted in H.R. 6407, the bill that ultimately was enacted as PAEA. What had been implicit in H.R. 22, as suggested in the Committee Report, became explicit in law.

Accordingly, there is no basis in the text or legislative history of Section 3622(b) to elevate one objective above another. The system of ratemaking must be designed to achieve multiple goals and balance competing objectives.

2. The "just and reasonable" rate standard of Sections 404(b) and 3622(b)(8) incorporates a century of precedent requiring that regulatory commissions balance the interests of regulated monopolies with their ratepayers.

The balance of Postal Service and mailer interests required by Section 3622 is underscored by the regulatory context in which it was drafted. Congress did not write on a blank slate. By 2006, Congress had been enacting statutes authorizing administrative agencies to regulate the rates charged by regulated monopolies under a "just and reasonable" (or its variant, "reasonable and equitable") standard for nearly 120 years. When incorporating this standard into Sections 404(b) and 3622(b)(8), Congress may be presumed to have been aware of the meaning of this term of art. *See C.I.R. v. Keystone Consol. Indus., Inc.*, 508 U.S. 152, 159 (1993) (Congress is presumed to be aware of settled judicial and administrative interpretations of words when it writes them into a statute).[6]

One of the main purposes of the "just and reasonable" rate standard of Sections 404(b) and 3622(b)(8), like its antecedents in the Interstate Commerce Act and other cognate statutes, is to prevent natural monopolies and franchised

[6] The Commission has repeatedly relied on precedent under the Interstate Commerce Act and its other progeny in construing the cognate provisions of Title 39. *See*, *e.g.*, PRC Docket No. R74-1, *Postal Rate & Fee Increases, 1973*, Op. & Rec. Decis. at 72 n.1, 109, 116, 126 n.2, 129, 135 n.1, 151 n.2, 165 n.3 (Aug. 28, 1975) (citing ICC precedent); PRC Docket No. MC2002-2, *Experimental Rate & Serv. Changes to Implement Negotiated Serv. Agreement with Capital One*, Op. & Rec. Decis. 138-39 ¶¶ 7013-14 (May 15, 2003) (citing ICC, FCC, FERC, FMC and state commission precedents).

monopolies from abusing their market power. *Munn v. Illinois*, 94 U.S. 113 (1877); James C. Bonbright, *Principles of Public Utility Rates* 33 (1961) ('It is a general doctrine of American law, almost universal in its application to public utility companies operating under special franchises or 'certificates of convenience and necessity,' that these companies are under a duty to offer adequate service at 'reasonable' (or 'just and reasonable') rates."); Stephen Breyer, *Regulation and its Reform* 36 (1982); Richard A. Posner, *Economic Analysis of Law* 346-47 (4th ed. 1992).

The just and reasonable standard requires the regulator to balance (1) the need for regulated monopolies to attract and retain sufficient capital to provide service with (2) the need to protect captive ratepayers from abuse of the regulated firms' market power. *See*, *e.g.*, *Jersey Cent. Power & Light Co. v. FERC*, 810 F.2d 1168, 1177 (D.C. Cir. 1987) (stating that zone of reasonableness is "bounded at one end by the investor interest against confiscation and at the other by the consumer interest against exorbitant rates") (quoting *Washington Gas Light Co. v. Baker*, 188 F.2d 11, 15 (D.C. Cir. 1950)); *Farmers Union Cent. Exchange, Inc. v. FERC*, 734 F.2d 1486, 1502 (D.C. Cir. 1984) (referring to "decades" of precedent holding that rates must fall within a "zone of reasonableness" where rates are neither "less than compensatory" nor "excessive," thus "striking a fair balance between the financial interests of the regulated company and the relevant public interests") (internal quotations omitted); *City of Chicago v. FPC*, 458 F.2d 731, 750-51 (D.C. Cir. 1971) (describing the necessary balance between a rate high enough to attract capital and low enough to prevent exploitation of consumers), *cert. denied*, 405 U.S. 1074 (1972).

3. The prescription of index ratemaking by Section 3622(d) specifies the balancing of interests required by the PAEA.

In truth, Congress resolved much of the tension between the objectives of Section 3622(b) by enacting Section 3622(d), which mandates that rates be limited at the class level to the rate of inflation. The CPI cap mandated by 39 U.S.C. § 3622(d) gives tangible and specific effect to the balance of the Postal Service and mailer interests stated more generally in the objectives of PAEA:

> Thus, the inflation-based price cap protects mailers from the "unreasonable use of the Postal Service's statutorily-granted [and de facto] monopoly" power while creating new pricing flexibility, incentives for the Postal Service to reduce costs, and the opportunity for the Postal Service to earn a profit.

USPS v. PRC, 785 F.3d 740, 745 (D.C. Cir. 2015) (quoting S. Rep. No. 108-318, at 19 (2004)). Regardless of whether Section 3622(d) allows the Commission to rescind or relax the CPI cap in this proceeding,[7] at a minimum the provision sheds considerable light on the meaning of the reference in Section 3622(d)(3) to the "objectives in subsection (b)," since the two provisions were enacted simultaneously as part of Section 3622.

The maximum rate standard mandated by Section 3622(d) is a form of price cap regulation, a safeguard against abuse of market power by a regulated monopoly that began to replace traditional cost-of-service regulation in the 1980s. Price cap regulation constrains regulated prices by reference to an external cost index such as the CPI, rather than the costs of the regulated firm itself.[8]

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[7] For the reasons stated at pp. 9-10, n.2, *supra*, the undersigned parties reserve this issue for discussion in Phase 2.

[8] *See*, *e.g.*, Laffont, Jean-Jacques, and Tirole, Jean, *A Theory of Incentives in Procurement and Regulation* 13-14 (1993); Viscusi, W. Kip, Harrington, J.E., and Vernon, J.M., *Economics of Regulation and Antitrust* 439-42 (4th ed. 2005); *National*

Under Section 3622(d), the Postal Service's overall revenue requirement no longer sets a floor under or a ceiling over the Postal Service's overall revenues. Instead, with narrow exceptions, 39 U.S.C. § 3622(d) limits the average annual increase in rates for market-dominant classes of mail to the rate of increase in the Consumer Price Index. 39 U.S.C. § 3622(d)(1), (2); Order No. 547 in Docket No. R2010-4 (Sept. 30, 2010) at 6-7, 10, *aff'd in relevant part*, *USPS v. PRC*, 640 F.3d 1263, 1264 (D.C. Cir. 2011). By "severing the linkage under traditional cost-of-service ratemaking" between the Postal Service's costs and rates, Congress sought to (1) create an incentive for the Postal Service to hold its cost increases below the rate of inflation, and (2) protect ratepayers if the Postal Service's costs nevertheless outstrip inflation. Order No. 547 at 11-13.

The CPI cap directly advances most of the objectives of Section 3622(b). The cap provides incentives to reduce costs and increase efficiency (Objective 1)—and the stricter the cap, the greater the incentive—by preventing the Postal Service from automatically recouping cost increases through rate increases. It creates predictability and stability in rates (Objective 2) by limiting annual increases and tying the amount of those increases to a publicly available index applied through an adjustment methodology that Congress has prescribed in detail. *See, e.g.*, Docket No. RM2007-1, *Regulations Establishing a System of Ratemaking*, Order No. 26 (Aug. 15, 2007); *id.*, Order No. 43 (Oct. 29, 2007). The CPI cap mechanism allows the Postal Service pricing flexibility (Objective 4) by divorcing prices from costs and

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Rural Telecom Ass'n v. FCC, 988 F.2d 174, 178-79 (D.C. Cir. 1993) (summarizing history of adoption of price cap regulation by FCC in the late 1980s); Order No. 561, *Revisions to Oil Pipeline Regulations Pursuant to the Energy Policy Act of 1992*, FERC Stats. & Regs. ¶ 30,985, 30,948-49 & n. 37 (1993), *aff'd*, *Ass'n of Oil Pipelines v. FERC*, 83 F.3d 1424 (D.C. Cir. 1996).

allowing unequal price changes within a class. It affords the Postal Service adequate revenues (Objective 5) by allowing the Postal Service to increase rates as fast as the CPI, a less restrictive constraint than the market forces facing many private sector businesses or the price ceilings imposed on most other regulated monopolies. See pp. 67-72, *infra*. Indeed, it even allows the Postal Service to obtain additional revenues when faced with "extraordinary or exceptional" circumstances that would prevent the Postal Service, even under best practices of efficient management, from providing necessary services without an above-CPI rate increase. 39 U.S.C. § 3622(d)(1)(E). The CPI cap also reduces the administrative burden of the rate process (Objective 6) by eliminating the 10-month rate cases that existed under the Postal Reorganization Act and replacing them with a streamlined process in which the only question to be decided by the Commission is whether the Postal Service's rates comply with the cap. It further increases the transparency of the process (Objective 6) by establishing a firm limit to price increases, tying that limit to a publicly available index, and reducing the need to investigate and evaluate Postal Service cost allocation methodologies when evaluating rates. Finally, the CPI cap furthers the goal of "establish[ing] and maintain[ing] a just and reasonable schedule for rates and classifications," 39 U.S.C. § 3622(b)(8).

The legislative history makes clear that the adoption of the CPI cap as the primary tool for balancing the interests of the Postal Service and its ratepayers was intentional. H.R. 22, as originally introduced, posited a price cap as one of many options the Commission could consider in designing a rate-making system that would meet the specified objectives. H.R. Rep. No. 109-66, at 47 (2005). The bill, while limiting the average price increase for a subclass to CPI, provided an exception to this rule if an above-CPI increase was "reasonable and equitable and necessary to enable the Postal Service, under the best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." *Id.* at 47-48. As then-Congressman Pence argued on the House Floor, "Such a cap hardly equips the U.S. Postal Service with the tools to control its costs and renegotiate labor costs." Cong. Rec. H6539 (July 26, 2005).

By contrast, the version of the bill ultimately enacted as the PAEA established a CPI-based price cap as a requirement of the system of ratemaking, depriving the Commission of the authority to design a system that met the objectives by other means. The Congressional Record shows that the sponsors of the legislation were concerned that without a cap the Postal Service would send itself into a "a potential death spiral in which escalating rates lead to lower volume, which in turn leads to even higher rates, which in turn causes the Postal Service to lose more business." Cong. Rec. S11674 (Dec. 8, 2006) (Sen. Collins); *accord* Cong. Rec. H6513 (July 26, 2005) (Chairman Davis comments on H.R. 22). In other words, the cap, rather than being in tension with Objective 5, was seen by Congress as an essential tool to ensure adequate revenue.

* * *

As we now demonstrate, Congress got things right. The current system has allowed the Postal Service to succeed while protecting its ratepayers, and it has created an environment in which even greater success is possible.

B. The current regulatory system allows the Postal Service to earn sufficient income to provide necessary services.

The case for allowing the Postal Service to charge above-CPI rate increases on market-dominant mail is unsupported. Despite the 2007-2009 recession, the long-term decline in First-Class volume, and the massive inefficiencies in the Postal Service's operations, the current regulatory system has provided—and should continue to provide—the Postal Service with sufficient revenue to provide necessary services.

Less than two months ago, Fredric Rolando, the president of the NALC, took to task the "narrow subset of commentators" who "have been writing 'sky-is-falling' pieces that mislead about Postal Service finances while ignoring the broader context of its value to our society." Fredric Rolando, "What You May Not Know About the U.S. Postal Service," Townhall (Jan. 26, 2017), *available at* https://townhall.com/columnists/fredricrolando/2017/01/26/postal-service-n2276774 (site visited Mar. 15, 2017). "Despite what you may have heard," Mr. Rolando continued, "the Postal Service is operating in the black. USPS revenue exceeded operating expenses by $610 million in Fiscal Year 2016, bringing its total operating profit the past three years to $3.2 billion." *Id.* Mr. Rolando has since touted the Postal Service's fiscal soundness elsewhere. Last month, he noted that "annual USPS revenue has been rising steadily, leading to impressive operating profits." Fredric Rolando letter to the editor of The Guardian, "The United States Postal Service isn't 'in decline' – far from it," (Feb. 26, 2017), *available at* https://www.theguardian.com/business/2017/feb/26/the-united-states-postal-service-isnt-in-decline-far-from-it (site visited Mar. 15, 2017). Mr. Rolando has further expanded on this observation:

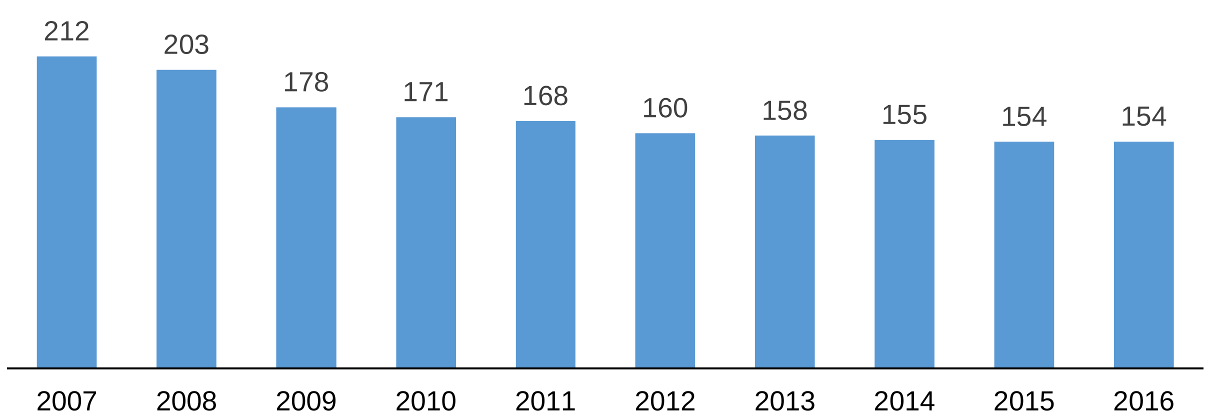
In fact, for more than three years the Postal Service has been operating at a profit, to the tune of $3.7 billion overall. Revenues have steadily risen as the economy improves and as online shipping boosts package revenues. On Feb. 9, USPS announced a $522 million operating profit for fiscal year 2017's first quarter. This is earned revenue; the Postal Service receives no taxpayer money.

Fredric V. Rolando letter to the editor of USA Today (March 7, 2017) (available at (http://www.usatoday.com/story/opinion/2017/03/07/things-bad-postal-service-say/98871900/ (site visited Mar. 12, 2017). Mr. Rolando's assessment is correct.

1. Mail volume and revenue

Market dominant mail volume and revenue indeed have largely stabilized. Fiscal Year 2016 was the fifth year in a row in which mail volume has stabilized above 150 billion pieces:

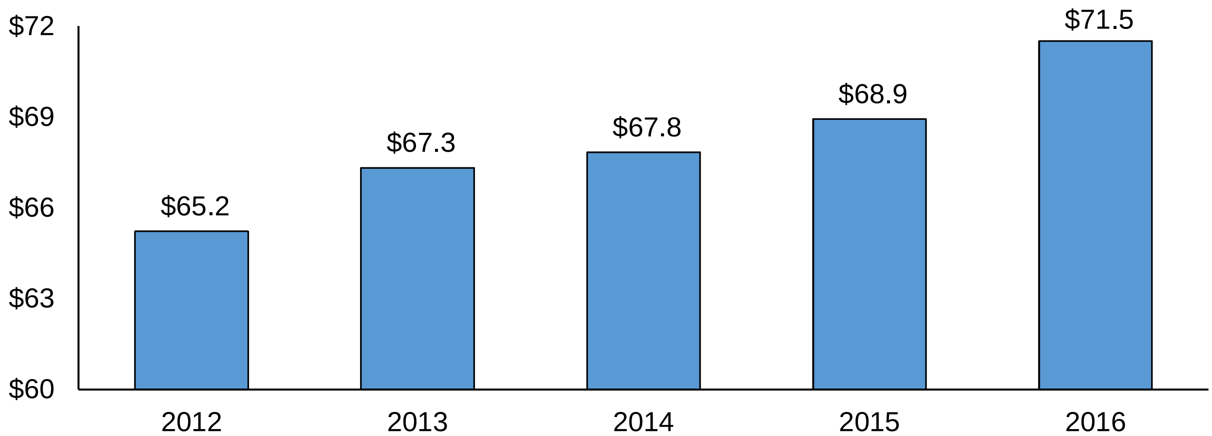
Figure 1
FY 2007 – FY 2016 Total Mail Volume
(Billions)



Brennan 2017 testimony at 3.

The Postal Service's revenue performance has been even stronger. Total revenue increased by nearly ten percent from Fiscal Year 2012 to Fiscal Year 2016:[9]

Figure 2
FY 2012 – FY 2016 Total Revenue
(Billions of Dollars)

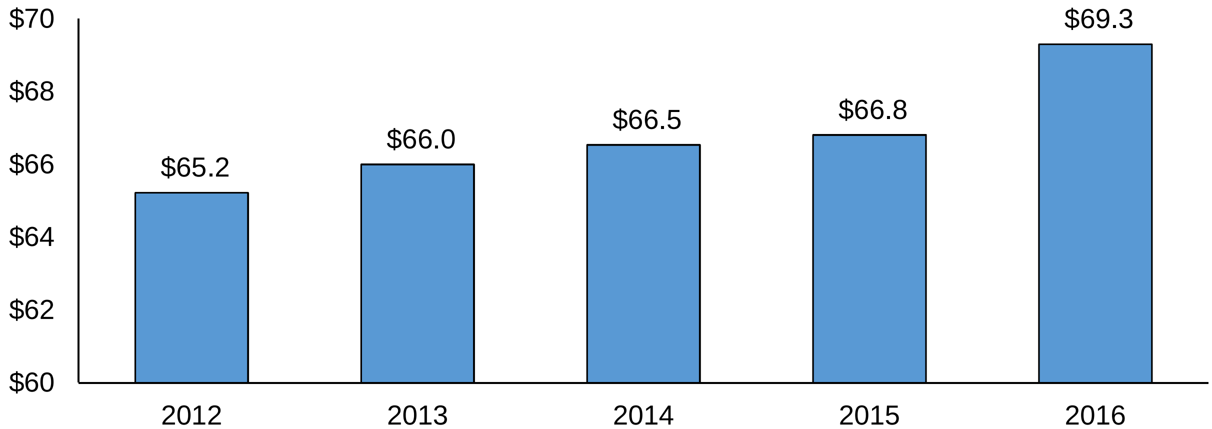


Although some of this revenue growth was due to non-recurring events, revenue grew by more than $4 billion from FY 2012 to FY 2016 even without revenue from the exigent surcharge and one-time revenue adjustments:[10]

[9] Library Reference ANM *et al.*—LR—RM2017-3/1 (worksheet "Figures 2 & 3").

[10] Library Reference ANM *et al.*-LR-RM2017-3/1 (worksheet "Figures 2 & 3").

Figure 3
FY 2012 – FY 2016 Total Revenue
(Excluding Exigent Revenue & One-Time Revenue Adjustments)
(Billions of Dollars)

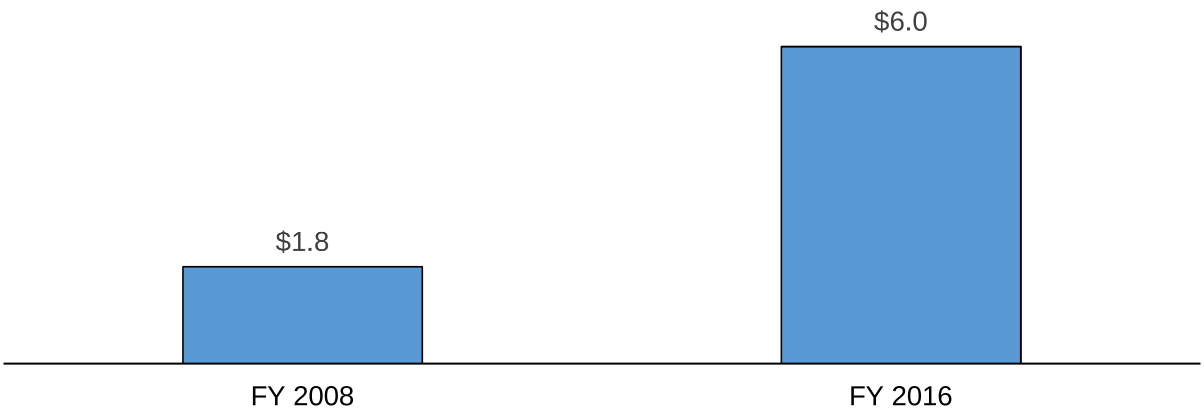


The Postal Service's business, taken as a whole, is not in a state of decline.

Competitive products have played a significant role in the financial recovery of the Postal Service. As noted by Mr. Rolando, the e-commerce boom, which shows no signs of slowing, has given a major boost to the Postal Service's financial performance. The growth in e-commerce has increased both revenue from and the profitability of competitive products for the Postal Service. Between Fiscal Year 2008 and Fiscal Year 2016, the contribution of competitive products to institutional costs has more than tripled, from $1.8 billion to $6.0 billion, and is projected to jump again to $6.8 billion in FY 2017.[11]

[11] Library Reference ANM *et al.*-LR-RM2017-3/1 (worksheet "Figure 4").

Figure 4
Growth in Competitive Product Contribution
(Billions of Dollars)



The Postal Service has tried to dismiss these favorable trends in volume, revenue and contribution on three grounds: (1) the volume of and contribution from First-Class Mail have continued to decline; (2) the growth in delivery points substantially increases Postal Service costs; and (3) the growth in competitive product volume is fragile and may reverse at any time. While each of these points has a modicum of truth, the Postal Service has greatly overstated their significance.

Contribution Effect of Volume Shifts. The Postal Service is correct that the volume of First-Class Mail, which has a high cost coverage, continues to decline. The effect of this ongoing trend, however, has been offset by increases in total contribution from other products. The overall effect of recent volume changes in *all* products (holding unit contribution constant) has been an *increase* in contribution. As Table 1 shows, recent decreases in contribution-weighted volume for market-dominant products have been more than offset by increases in contribution-weighted volume for competitive products:[12]

[12] Library Reference ANM *et al.*-LR-RM2017/3-1 (worksheets "Table 1 (FY 2014 – FY 2016)" and "Table 1 (FY 2015 – FY 2016").

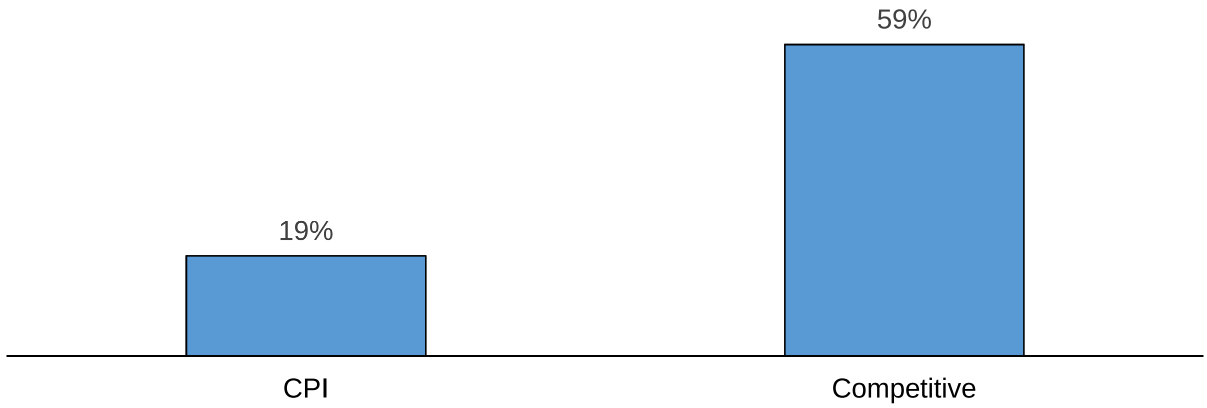
Table 1
Effect of Volume Changes on Contribution
($ Millions)

Category	FY 2014 – FY 2016	FY 2015 – FY 2016
Market-Dominant	(401.2)	(171.2)
Competitive	865.3	374.3
Total	**464.1**	**203.0**

The shift in mail mix between market-dominant and competitive products has a second benefit for the Postal Service's finances. Because competitive products have been found by Congress or the Commission to face effective competition, the Postal Service is legally permitted to raise rates for competitive products by more than inflation, further increasing contribution. Like its competitors, the Postal Service has done so. Over the last five years, the Postal Service has raised competitive product rates by an annualized 5.6 percent—4.3 percent per year more than inflation.[13] With competitive products now generating more than a quarter of Postal Service revenue, the pricing freedom enjoyed by the Postal Service in markets that Congress or the Commission have found to be effectively competitive now provides a major boost to the Postal Service's finances.

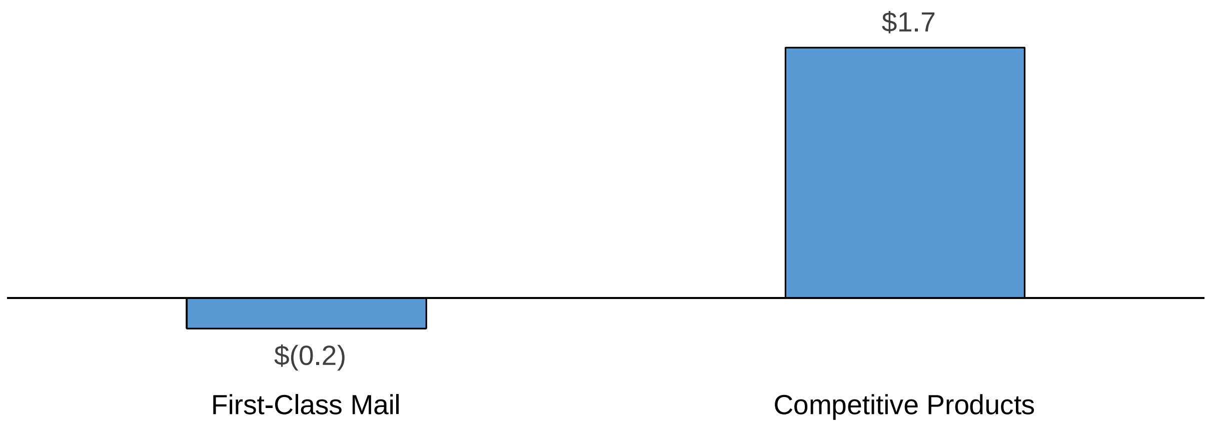
[13] Library Reference ANM *et al.*—LR—RM2017-3/1 (worksheet "Figure 5").

Figure 5
Comparison of Cumulative Competitive Product Price Increases with CPI
(FY 2007 – FY 2017)



Taking into account both changes in volumes and rates, recent increases in competitive product contribution have overwhelmed the decline in contribution from First-Class Mail:[14]

Figure 6
Change in First-Class Mail and Competitive Product Contributions
from FY 2014 to FY 2016
(Billions of Dollars)



[14] Library Reference ANM *et al.*-LR-RM2017-3/1 (worksheet "Figure 6").

Growth in Delivery Points. The Postal Service is correct that (1) the number of delivery points grows each year and (2) this growth tends to increase the Postal Service's costs. The Postal Service exaggerates the size of this effect, however, as the Postal Service's own roll-forward calculations show. When the Postal Service rolls forward (extrapolates) its historical expenses to future periods in rate cases, the Postal Service is required to quantify the effect of the increasing number of delivery points, and may not just assert that the effect is large. The increase in the number of delivery points over time is the primary input to the non-volume workload effect used by the Postal Service in its roll forward model. Docket No. RM2013-11, USPS-R2010-4R/8, Input_12.xls, "Non-vol Wkld." In Docket No. R2013-11, the most recent case in which the Postal Service filed a roll forward analysis, this effect added just $75 million each year (or 0.1 percent) to Postal Service costs. Docket No. RM2013-11, USPS-R2010-4R/8, FY2013BR.CompSumRpt.BR-Final.xls and FY2014BR.CompSumRpt.BR-Final.xls. Thus, while the growth in delivery points indeed creates a small headwind against the Postal Service going forward, the effect is much less than the Postal Service now claims. Furthermore, because the non-volume workload effect does not account for the fact that new delivery points are generally lower-cost ones (*i.e.*, centralized delivery points), the real non-volume workload effect is likely much smaller than even the roll forward analysis suggests.

Uncertainties in Competitive Product Volume. On page 29 of its Form 10-Q for Fiscal Year 2017, Quarter 1, the Postal Service asserts that it is at risk at any time of losing its competitive product volume to bypass by its largest customers:

> The growth in our Competitive service revenues over the past five years is largely attributable to three major customers. Each of those

> three major customers is building the capability which would enable them to divert volume away from the Postal Service over time. If those customers divert significant volume away from the Postal Service, the growth in our Competitive service revenues may not continue.

The Postal Service recently made a similar claim in Docket No. RM2017-1, *Institutional Cost Contribution Requirement for Competitive Products*. Docket No. RM2017-1, Initial Comments of USPS (Jan. 23, 2017) at 15-17. The Commission should view these claims with skepticism.

First, this is not a new risk. It is well known that UPS and FedEx are two of the Postal Service's largest competitive product customers. The Postal Service has grown its competitive product volumes and increased its rates even though UPS and FedEx own and operate their own networks. UPS and FedEx make heavy use of Postal Service delivery, despite owning and operating their own networks, because the address density of the Postal Service's volume enables the Postal Service to provide economical, high quality delivery service, particularly for lightweight packages sent to residential addresses. The Postal Service's network is well suited to delivery in the booming e-commerce market.

Second, the Postal Service has a track record of underestimating the projected performance of its competitive products. In its Integrated Financial Plan for Fiscal Year 2016, the Postal Service projected that "Shipping and Packages" volumes, most of which are generated by competitive products,[15] would grow by

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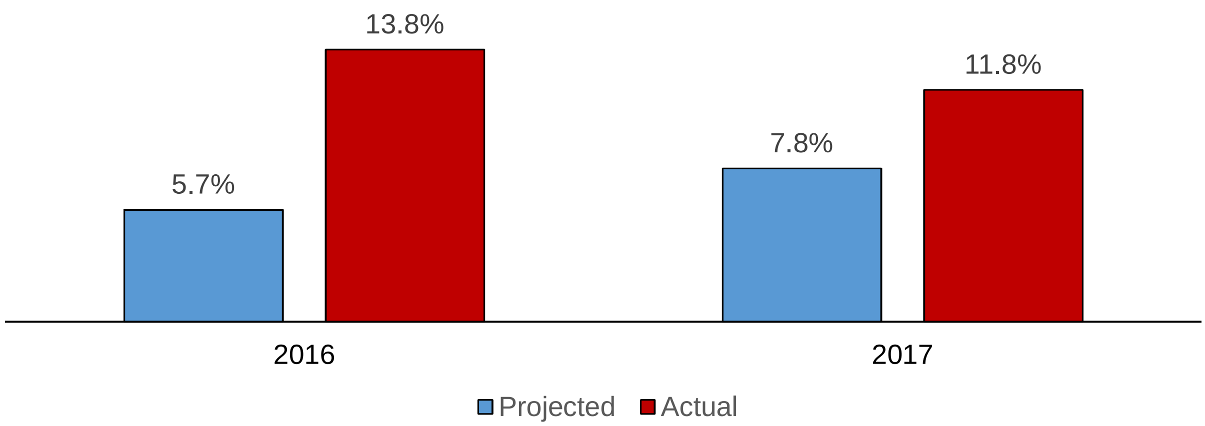
[15] "This category includes: First-Class Package Service, a shipping option for high-volume shippers of packages that weigh less than one pound and First-Class Mail parcels for shipment of boxes, thick envelopes or tubes of 13 ounces or less; Package Services for merchandise or printed matter, such as library and media mail weighing up to 70 pounds; Parcels - Parcel Select, Parcel Return Service and Standard Mail Parcel Services which provide commercial customers with a means of package shipment, typically "last-mile" products; Priority Mail, which is offered as a

5.7 percent. In fact, actual volumes grew by 13.8 percent, almost 2.5 times as much. The Postal Service predicted in its Integrated Financial Plan for Fiscal Year 2017 that Postal Service Shipping and Packages volume would grow by 7.8 percent this year; so far the volume has grown by 11.8 percent:[16]

Figure 7
Projected v. Actual Growth Rates for Shipping & Packages
FY 2016 – FY 2017



2. Operating income

Thanks to these strong fundamental trends, the Postal Service's operating income has been positive for several years, and the Postal Service projects it to remain positive in Fiscal Year 2017 despite the rollback of the exigent rate

service both within the U.S. and abroad with the domestic service offering a 1-3 day specified (non-guaranteed) delivery; and Priority Mail Express, which provides an overnight, money-back guaranteed service which includes tracking, proof of delivery and basic insurance up to $100. Priority Mail Express delivery is offered to most U.S. destinations for delivery 365 days a year." USPS Form 10-K for Fiscal Year 2016 at 3.

[16] Library Reference ANM *et al.*-LR-RM2017-3/1 (worksheet "Figure 7"). Note: Fiscal Year 2017 Actual Growth Rate is from the USPS Preliminary Financial Information (Unaudited), January, 2017, filed on Feb. 24, 2017.

surcharge. USPS Fiscal Year 2017 Integrated Financial Plan (Nov. 2016) at 3. The Postal Service reported $522 million in controllable income for the first quarter of Fiscal Year 2017,[17] and a total operating profit of $3.7 billion since the start of Fiscal Year 2014.[18]

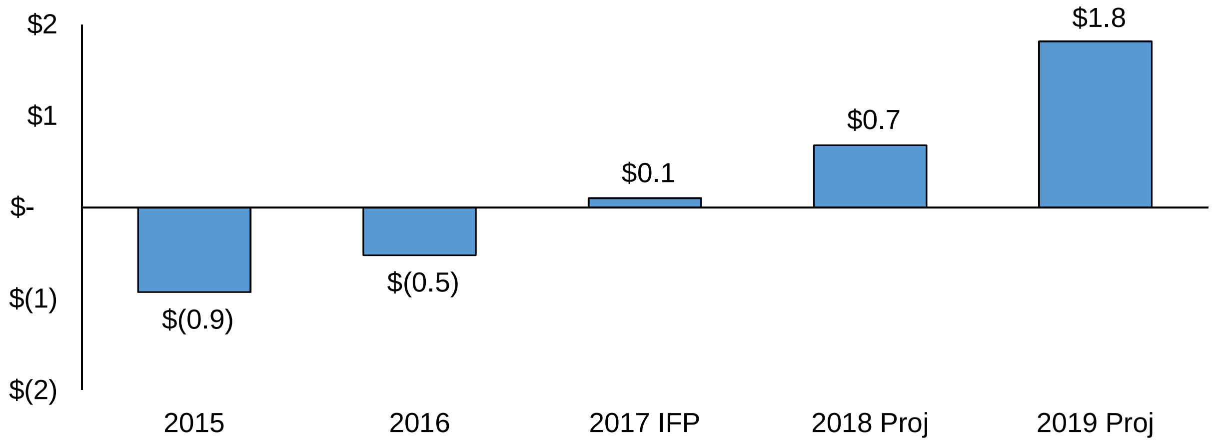
3. Projected future financial performance

The recent gains in revenue and contribution should continue in the future, even without major cost savings initiatives, if the Postal Service simply limits its cost level increases to the rate of growth of the Consumer Price Index. The roll-forward analysis documented in Library Reference ANM *et al.*-LR-RM2017-3/1, Rollfwd.xlsx shows this. Between Fiscal Year 2015 and Fiscal Year 2019, the Postal Service is projected to improve its annual controllable operating income by approximately $2.7 billion:

[17] USPS Press Release, "U.S. Postal Service Reports Fiscal Year 2017 First Quarter Results" (Feb. 9, 2017). Furthermore, the Postal Service achieved this first quarter income despite allowing its workhours to grow to 2 percent above plan. December 2016 Preliminary Financial Information (Unaudited). If the Postal Service fails to meet its planned income, the fault will lie in poor cost control, not any shrinkage in revenue.

[18] Fredric V. Rolando letter to the editor of USA Today (March 7, 2017) (available at (http://www.usatoday.com/story/opinion/2017/03/07/things-bad-postal-service-say/98871900/ (site visited Mar. 12, 2017).

Figure 8
USPS Controllable Operating Income (excluding Exigent Revenue)
In FY 2015 – FY 2019
(Billions of Dollars)



The projected increases in controllable operating income occur despite inclusion of cost increases due to delivery point growth; the use of conservative rate increases (less than the average increase USPS has implemented in recent years) on competitive products; and the use of annual volume changes lower than occurred in FY 2016. ANM *et al*.-LR-RM2017-3/1, Rollfwd.xlsx.

4. Liquidity

The Postal Service has sufficient liquidity to continue providing essential postal services for the foreseeable future. The Postal Service projects that it will have $8 billion in cash at the end of FY 2017 if it does not make amortization payments. USPS Fiscal Year 2017 Integrated Financial Plan (November 2016) at 9. Moreover, the Postal Service has recently been generating annually about $3 billion in cash, which can also be invested in new delivery vehicles and other assets. USPS Form 10-K for Fiscal Year 2016 at 42.[19]

The Postal Service suggests that this amount of cash is inadequate because it covers less than 30 "Banking Business Days" of operations. USPS Fiscal Year 2017 Integrated Financial Plan at 9. The analysis underlying this claim, however, is "not consistent with best practice." OIG Report FT-AR-17-001, *Measurement of Days of Operational Cash on Hand* 1 (Oct. 20, 2016).

First, the Postal Service has understated the number of days it could operate with only the cash that it now has on hand. A proper measure of the number of days would be approximately 50 percent higher than the Postal Service's estimate. The Postal Service erroneously "uses banking days of 251 (excluding holidays and weekends) rather than operating days of 365 in its calculation. Additionally, capital outlays are incorrectly included in its calculation, which further dilutes days of cash on hand." *Id.* at 1, 6-7.

Second, the Postal Service has failed to explain what minimum number of days of operations that should be permitted by the amount of cash on hand, however calculated. *Id.* at 8. The Postal Service's days of cash on hand today is significantly higher than the average since 1995 (6 days by the Postal Service's calculation, 9 days by the OIG's). *Id.* at 7. Moreover, if additional cash ever were to become necessary, the Postal Service could generate massive additional liquidity by tapping into the value of its real estate, *e.g.*, by selling unneeded buildings and

[19] And thanks to the nearly $2 billion "Depreciation and amortization" annual non-cash accrual, USPS would generate a great deal of cash from operations even at operational breakeven. USPS Form 10-K for Fiscal Year 2016 at 42.

entering into sale/leaseback transactions for buildings that the USPS needs to continue using. USPS OIG Report No. FT-MA-12-002, *Pension and Retiree Health Care Funding Levels* (June 18, 2012) at 6 (citing OIG Report No. FF-MA-11-118, *Leveraging Assets to Address Financial Obligations* (July 12, 2011)).

Third, and most important, the number of days of cash on hand has limited relevance for an enterprise like the Postal Service. The optimal number of days of cash on hand depends on many circumstances. www.ncbi.nlm.nih.gov/pubmed/18972996. Generally, days' cash on hand is a measure of how long an organization could operate before running out of cash if revenue were turned off completely. But Postal Service revenue will never be turned off completely unless a policy decision is made to shut down the enterprise. As discussed above, the Postal Service's cash flow is very strong. The private economy and the government rely on its continuing operations. It is a full-on federal government agency, as Chairman Taub has often noted. If the self-funding model under which it now operates stops working, the federal government will have to make a decision about a new model. "[I]n the event of a cash shortfall, the U.S. government would likely prevent the Postal Service from significantly curtailing or ceasing operations." OIG Report FT-AR-17-001 at 8-9; *accord*, USPS Form 10-Q report for Quarter 1, 2017 (Feb. 9, 2017) at 9 (same).[20] Among other things,

[20] The financial analysis that is appropriate for a government entity differs from the financial analysis appropriate for a private firm. *See* PRC FY 2015 Financial Analysis Report 75 (Mar. 29, 2016). There are two reasons for this. First, federal government enterprises are subject to statutory constraints that reflect a more complex mix of goals than profit maximization. Second, federal government enterprises enjoy an implicit guarantee of payment by the federal government, which is not subject to bankruptcy. For this reason, government-owned enterprises must be evaluated by different standards of financial stability than privately owned

Congress could raise the Postal Service's current borrowing limit of $15 billion, which has been arbitrarily frozen for some time, and now equals in inflation-adjusted dollars only about 25 percent of the Postal Service's initial borrowing limit in 1971.[21]

Finally, the Postal Service argues that its real liquidity would be much less than $8 billion if the Postal Service made the scheduled contributions to the Retiree Health Benefits Fund ($2.9 billion), the Civil Services Retirement System ("CSRS") ($1.2 billion), and the Federal Employee Retirement System ("FERS"). USPS Fiscal Year 2017 Integrated Financial Plan at (November 2016) at 9. But the premise of this argument is counterfactual. The Postal Service did not make the prefunding payment to the RHBF required by Congress in Fiscal Years 2012 through 2016, and Congress did nothing to force payment.

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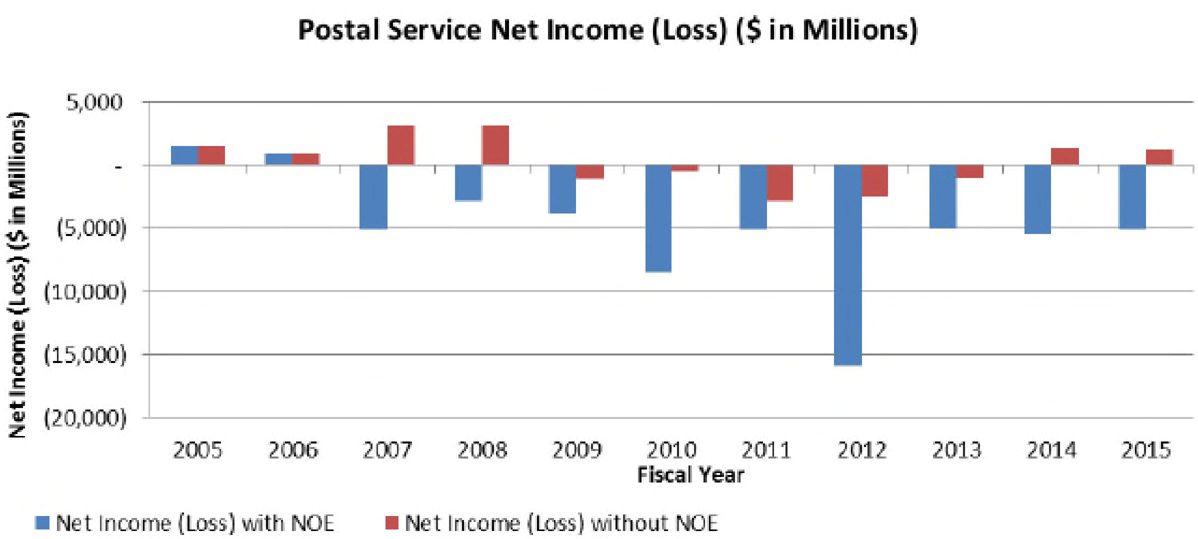
firms. As Chairman Taub has acknowledged, "[f]inancial analysis used in the private sector may not be directly relevant to government agencies because revenue streams, equity structures, and management incentives differ." Prefiled Testimony of Robert G. Taub to U.S. House Oversight and Government Reform Committee (May 11, 2016) at 9. "Stakeholders of private sector entities use financial analysis to make investment and credit decisions, and success is often measured by the company's stock valuation. In contrast, Federal agencies are mission-oriented and measure success through the provision of service." *Id.* at 12; *see also id.* at 14 (noting limitations on the predictive value of the Altman Z-Score).

[21] The borrowing limit set by the Postal Reorganization Act in 1970 was $10 billion. Pub. L. No. 91-375 (Aug. 12, 1970), § 2, 84 Stat. 740 (codified at former 39 U.S.C. § 2005(a)). This amount was equivalent to about $60 billion in 2017 dollars. *See* www.usinflationcalculator.com/inflation/consumer-price-index-and-annual-percent-changes-from-1913-to-2008/.

5. The negative net earnings reported by the Postal Service are largely an artifact of the statutory prefunding requirement.

The Postal Service, obviously aware of its favorable operating performance, emphasizes instead its reported *net* income, which has been negative since 2006. These reported losses, however, are an artifact of the Postal Service's failure to meet the arbitrary and needlessly short prefunding schedule prescribed by Congress in 2006 for the Postal Service's retiree health benefits fund. Nadol Decl. at 17-18. The following figure, published by the Commission in March 2016, dramatically illustrates the extent to which the losses reported by the Postal Service in recent years have been artifacts of the prefunding requirement and other non-operating expenses:[22]

Figure 9



Source: Postal Service Form 10-K and USPS Annual Report, FY 2005-2015.
Note: NOEs include all non-cash workers' compensation costs, the accrued payment to the Postal Service's RHBF, the FERS supplemental payment, and any one-time expense or revenue adjustments.

[22] Source: PRC FY 2015 Financial Analysis Report at 1 (March 29, 2016).

Fiscal Year 2016, which ended too late to be included in the Commission's Financial Analysis Report for Fiscal Year 2015, continued the trend. The Postal Service reported a loss of $5.6 billion in that year, but a controllable operating income of $610 million. USPS Form 10-K for Fiscal Year 2016 at 15.

There is no serious dispute that the vast majority of the Postal Service's reported "losses" in recent years would not have occurred but for the prefunding schedule prescribed by the PAEA. As NALC president Rolando has noted, the "expense of this mandate has accounted for nearly 90 percent of the Postal Service's reported financial losses since 2007." Rolando 2017 testimony at 2; *accord*, PRC Fiscal Year 2015 Financial Analysis Report 75-78 (Mar. 29, 2016); OIG Report No. RARC-WP-16-009, *Peeling the Onion: The Real Cost of Mail* (April 18, 2016) at 1 (the Postal Service would have broken even between 2006 and 2015, despite the recession, with additional cost savings or revenue of 3.1 cents per piece; of this 3.1 cent gap, 2.8 cents were due to the RHB prefunding requirement).

These unpaid installments, however, do not raise current cash flow issues. No cash will change hands between the Postal Service and its retirees until the retirees actually retire and start receiving their pensions and health care coverage: the funds transferred by the Postal Service to its pension and retiree health care accounts are still assets available to the Postal Service to pay its future liabilities to its retirees. To be sure, the underfunding of retiree benefit plans can raise serious concerns if it casts doubt on the ability of an employer to meet its financial commitments to its retirees and other creditors in the future. But the Postal Service warrants no such concern, even for the future. As shown in the next section, the Postal Service's pension and retiree health benefit funds—contrary to conventional wisdom—are extraordinarily well funded by the standards of most public and private sector employers.

C. The negative balance sheet reported by the USPS does not reflect its true financial condition.

1. The Postal Service's failure to meet the needlessly fast prefunding schedule prescribed by PAEA proves nothing about the ability of the Postal Service to meet its actual financial obligations to retirees, or its financial stability generally.

One of the main arguments offered by the Postal Service for jettisoning the CPI cap is the large excess of reported liabilities over reported assets on the Postal Service's balance sheet. *See*, *e.g*., Brennan 2017 testimony at 7 (table); USPS Form 10-K for Fiscal Year 2016 at 12. But this negative reported net worth is essentially an artifact of the same arbitrary prefunding requirements that have caused the Postal Service to report net losses on its income statement in recent years. Of the \$96 billion negative net worth reported by the Postal Service at the end of Fiscal Year 2016, all but about \$22 billion represented the unfunded portion of the Postal Service's pension and retiree health benefit plans. *Compare* Rectanus 2017 testimony (GAO-17-404T) at 15 with Brennan 2017 testimony at 7.

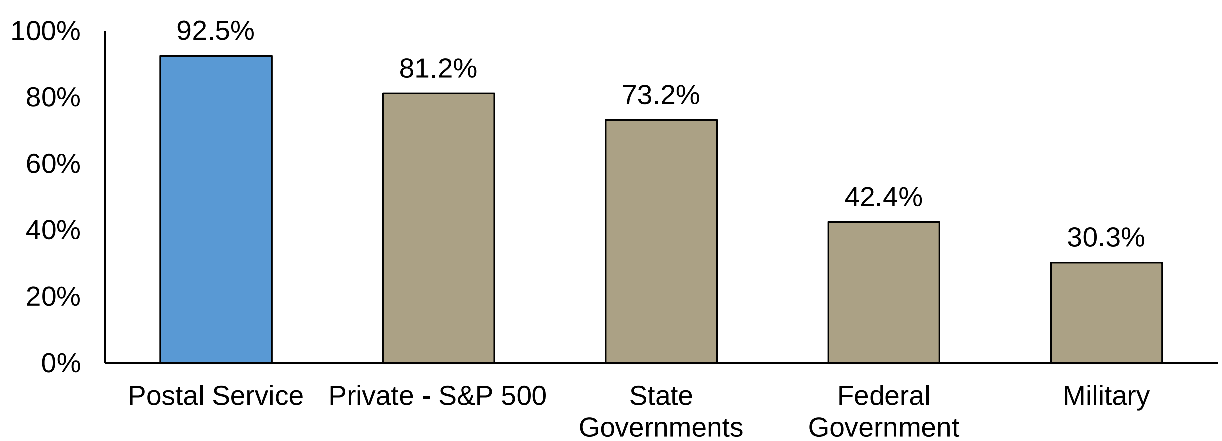
These figures, and the negative net worth reported by the Postal Service as a result, are meaningless in terms of the Postal Service's ability to meet its obligations. In fact, the Postal Service has funded its pension and retiree health benefit funds more fully than have the vast majority of government and private sector employers in the United States. Nadol Decl. at 12-18. Even according to the conservative assumptions of the Office of Personnel Management ("OPM"), the

Postal Service's pension funds already have enough funds to cover 92.5 percent of their projected liabilities, and the Retiree Health Benefit Fund already has enough funds to cover about 50 percent of its projected liabilities. *Id.* Overall, the Postal Service's retirement benefit accounts (*i.e.*, both the pension and retiree health benefit accounts) already contain over $338 billion in assets, or 82 percent of actuarial liabilities. Rectanus 2017 testimony (GAO-17-404T) at 18 (Table 4).

The Postal Service's pension funding level of 92.5 percent is far higher than the overall federal funding level, the funding level of most state and local government retirement plans, and the standards established under the Pension Protection Act of 2006 for determining whether a private employer's plan is "at risk" or "endangered." Nadol Decl. at 12-14.

Figure 10

Pension Funding Levels

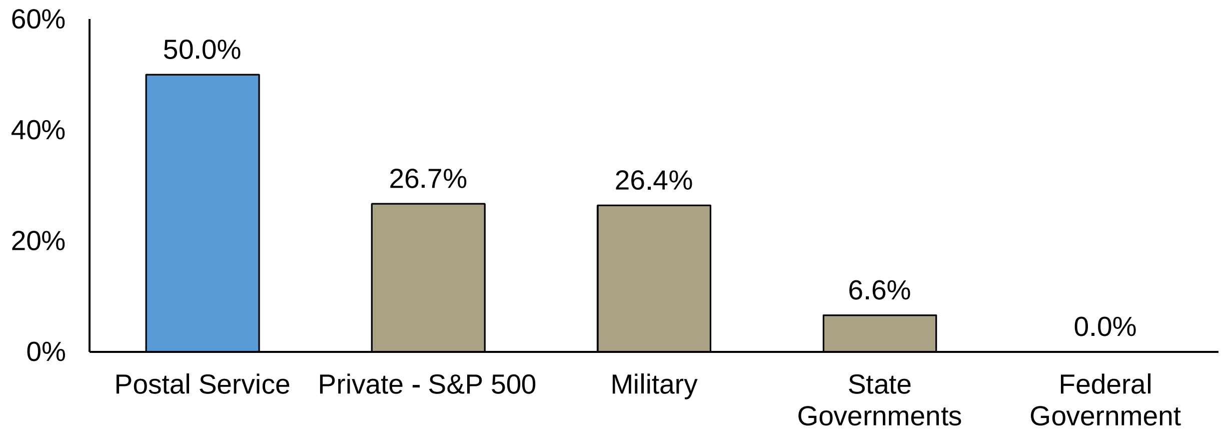


Nadol Decl. at 4, 12-14.

Likewise, the 50 percent funding of the retiree health benefit plan surpasses the funding of health care benefits by most private employers, the federal government and many state and local governments, many of which have yet to prefund this benefit at all:

Figure 11

Retiree Healthcare Prefunding Levels FY2014



Nadol Decl. at 4, 14-17; Brennan 2017 testimony at 12-13. Even without further contributions, the $338 billion of funds in the Postal Service's pension and retiree health benefit plans are sufficient to meet the Postal Service's financial obligations to its retirees for decades. Nadol Decl. at 5-6, 28-29. There is no immediate problem, let alone a crisis, here.[23]

Moreover, the Postal Service funding percentages noted in the previous paragraph are highly conservative. They reflect OPM's projections of future

[23] A moment's thought should make clear why pension and retiree benefit plans do not need to be fully funded. The financial solvency of a retiree benefit fund requires that an employee's benefits be fully funded only when the employee retires, contributions to his or her retirement fund end, and withdrawals begin. But most employees in any workforce have not reached retirement age, and their employer has years to continue funding their benefits before retirement occurs. Except in the hypothetical case in which every employee in an employer's workforce is about to retire, there is no reason why the employer's retiree benefit fund should ever be fully funded.

spending on pension and retiree health care benefits. The OPM projections assume, for example, that the actuarial and financial factors affecting the projected future level of retirement benefits for federal government retirees as a whole are a good proxy for Postal Service-specific factors. But experience shows that actual pension benefit spending for an average Postal Service retiree has been, and will continue to be, less than the average per-retiree spending for other federal employers. *See*, *e.g.*, OPM, *Federal Employees' Retirement System: Government Costs*, 81 Fed. Reg. 93851 (Dec. 22, 2016); USPS OIG Report Number FT-WP-15-003, *Considerations in Structuring Estimated Liabilities* at 7 ("Using demographics specific to Postal Service employees would reduce the combined retiree health care and pension liabilities by $8.5 billion."); USPS OIG Report FT-MA-13-024, *Using USPS-Specific Assumptions for Calculating the Federal Employees Retirement System Liability* (Sept. 27, 2013) (finding that substituting USPS-specific employee characteristics for general federal employee characteristics reduced the projected liability of the FERS pension program to Postal Service employees by $9.5 billion). Hence, the Postal Service's pension and retiree health benefit plans are even more fully funded than the OPM-derived figures cited in the previous paragraph indicate. Nadol Decl. at 19-23, 25.

The Commission has recommended that Congress amend the current required prefunding level to comport with standard industry practice in both the private and public sectors. Docket No. PI2016-3, PRC Section 701 Report (Nov. 14, 2016) at 6-7. Whether Congress takes this action or not, however, the Postal Service's failure to reach the needlessly high prefunding target prescribed by the PAEA cannot logically justify any loosening of the CPI cap. If the Postal Service can meet its obligations to its present and future retirees without reaching the statutory prefunding target, allowing the Postal Service to extract the shortfall from captive mailers through above-CPI price increases would give the Postal Service (or future mailers) a windfall at the expense of the current generation of captive mailers.

2. The Postal Service massively understates its financial resources by valuing real estate on its balance sheet at depreciated book cost instead of current market value.

The Postal Service's balance sheet also understates the Postal Service's net worth in a second major respect. In calculating its net worth, the Postal Service values its enormous portfolio of real estate at depreciated historical cost (roughly speaking, the cost at which the assets were acquired years or decades ago, minus accounting depreciation). In 2012, however, the Postal Service's Office of Inspector General estimated that the current market value of the Postal Service's real estate portfolio exceeded book cost by approximately $70 billion. OIG Report FT-WP-15-003, *Consideration in Structuring Estimated Liabilities* (Jan. 23, 2015) at 3-4 (citing OIG Report FT-MA-12-002, *Pension and Retiree Health Care Funding Levels* (June 18, 2012)). The disparity may be even greater today, since the average price of commercial property in the United States has increased by roughly 40 percent since 2012. Nadol Decl. at 30-31.[24]

[24] *See also* Green Street Advisors U.S. Commercial Property Price Index, https://www.greenstreetadvisors.com/insights/CPPI (site visited Mar. 13, 2017); Society of Industrial and Office Realtors Commercial Real Estate Index (Jan. 2017), http://www.sior.com/docs/default-source/marketing/sior-index-updated-jan-2017.pdf?sfvrsn=0 (site visited Mar. 13, 2017).

An economically valid assessment of the Postal Service's financial stability requires that the Postal Service's real estate be valued at its current market value. Depreciated original cost, although consistent with the requirements of GAAP for financial statements to shareholders and other investors, and used by many (although not all) regulators to determine the rate bases of common carriers and public utilities whose maximum rates are still regulated on cost-of-service principles, is not an appropriate measure of the financial stability of an enterprise like the Postal Service in the context of this case. The question before the Commission here is whether the Postal Service will have enough funds to pay the amounts promised to its creditors—including its current and former employees—in the "very unlikely event" that the Postal Service "were suddenly shut down" and its assets were liquidated. *Cf.* OIG Report FF-MA-11-118 at 4.[25] To answer *this* question, one needs to estimate how much the Postal Service could realize by selling some of its (by assumption) superfluous real estate and other assets on the open market. The answer depends on the current market value of the assets, not their historical book costs. Nadol Decl. at 6, 31-32. *Accord*, *Bank of Am. Nat'l Trust and Savings Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 457 (1999) ("[T]he best way to determine value is exposure to a market.") (citing *Baird: Elements of Bankruptcy* at 262); *In re The Bible Speaks*, 65 B.R. 415, 418 (Bankr. D. Mass. 1986) (noting in Chapter 11 reorganization proceeding that "it is clear that the value of this real estate is substantially in excess of its book value, which merely represents historic cost less depreciation" and taking "judicial notice of the general

[25] As discussed above, if the Postal Service's business continues on its likely course, there will be no collapse and the Postal Service's retiree benefit funds will be amply funded to pay the claims against them.

increase in real estate values … since then"); *Estate of Tully v. U.S.*, No. 488-71, 1978 WL 3453, * 12 (Ct. Cl. 1978) ("This commonly found difference between original cost less depreciation and fair market value accounts in large part for the unreliability of book values.") (additional citation omitted)).[26]

The current record does not allow for a more precise measure of the understatement of the current market value of the real estate on the Postal Service's books. Until the Commission develops a reasonable estimate of the current value of the Postal Service's real estate, any determination that the Postal Service needs to extract more funds from captive ratepayers to satisfy its future liabilities to retirees in the unlikely event of a shutdown is premature.[27]

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[26] The Postal Service has recognized that GAAP does not necessarily provide the most realistic results in all contexts. In the first quarter of Fiscal Year 2017, the Postal Service earned in $1.4 billion in net income according to GAAP. In announcing its financial results for that quarter, however, the Postal Service downplayed the $1.4 billion GAAP-compliant earnings figure because it included non-operating gains. USPS press release (Feb. 9, 2017).

[27] When the OIG investigated this issue in 2011 and 2012, the Postal Service professed not to "maintain fair market or assessed tax value records for its properties." OIG Report FF-MA-11-118 at 2 n. 6. When the undersigned parties sought discovery on the same issue in the current docket, the Postal Service objected on the ground that the mailers had "ample materials with which to attempt to advance their argument" on the issue. Response of the USPS in Opposition MPA *et al*. Motion for Issuance of Information Requests (Jan. 24, 2017) at 4. The Commission upheld the Postal Service's objection on the theory that "this stage of the docket" is not a "litigated proceeding," while reserving the option of requesting such information if the Commission "later determines that additional information is necessary." Order No. 3763 at 3, *aff'd*, Order No. 3807 at 8-9.

D. The Postal Service has ample means to improve its financial position even further without imposing above-inflation price increases on captive mailers.

As explained above, the Postal Service has sufficient income and assets to provide appropriate services and cover its liabilities without triggering a death spiral. If the Postal Service is still unsatisfied with its current finances, however, it has ample means to improve them under the existing regulatory system. The following are several of the most significant.

1. Moving toward compliance with the pay comparability requirement.

The Postal Service could save billions of dollars of costs annually by reducing the compensation premium paid to postal employees. 39 U.S.C. § 1003(a) establishes a policy that the Postal Service shall "maintain compensation and benefits for all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy." The pay comparability policy, however, has been honored in the breach for years.

When the President's Commission on the United States Postal Service considered the issue in 2003, there was considerable evidence that the Postal Service was paying compensation far in excess of the comparability standard. Nadol Decl. at 33-34.[28] In 2003, Professor Michael Wachter, Co-Director of the

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[28] *See also* Douglas K. Adie, *An Evaluation of Postal Service Wage Rates* 89-101 (1977); D. Adie, "How Have Postal Workers Fared Since the 1970 Act?" in Sherman, Roger, ed., *Perspectives on Postal Service Issues* 74-79 (1980); Sharon P. Smith, "Commentary," in *id*. at 94-98; Michael L. Wachter and Jeffrey M. Perloff, "A Comparative Analysis of Wage Premiums and Industrial Relations in the British Post Office and the United States Postal Service," in Michael A. Crew and Paul R.

Institute for Law and Economics at the University of Pennsylvania and a frequent witness for the Postal Service in wage and compensation arbitration cases, testified to the President's Commission that the "wage premium is large – econometrically estimated to be 21.2 percent or 33.9 percent by Dr. Wachter using different methods for his October 2001 testimony before the interest arbitration panel." Moreover, the total compensation premium, including benefits, was much higher than the wage premium alone. Testimony of Prof. Michael Wachter before the President's Commission (April 29, 2003) (available at www.ustreas.gov/offices/domestic-finance/usps/meetings/4-29-03/witnesses.shtml); Nadol Decl. at 33. The President's Commission, without trying to quantify the compensation premium, found that Postal Service employees enjoyed the "'best of both worlds"—an average salary of more than $42,000 and "the job security and ample benefits packages that make Federal employment attractive."[29] *Accord*, FTC, *Accounting for Laws that Apply Differently to the USPS and its Private Competitors* 39-40 (Dec. 2007).

Unfortunately—and despite the much-ballyhooed deployment of non-career employees—the Postal Service has made no progress since the enactment of PAEA in reducing the hourly compensation premium its employees receive. Nadol Decl. at 7-11. Postal Service compensation levels have risen faster than inflation over the past 10 years. Today, the compensation paid to career postal employees is

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Kleindorfer, eds., *Competition and Innovation in Postal Services* 115-137 (1991); Michael L. Wachter, Barry T. Hirsh and James W. Gillula, "Difficulties of Deregulation When Wage Costs are the Major Cost," in Crew and Kleindorfer, eds., *Future Directions in Postal Reform* 1-24 (2001).

[29] President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service* 109 (July 31, 2003).

approximately *double* the compensation offered by private employers for comparable work. Nadol Decl. at 34-48, 51-58.

The most telling evidence that the Postal Service pays a large compensation premium remains the Postal Service's "historically very low" quit rates for its career employees. Nadol Decl. at 48-49. Between 2008 and 2013, the quit rates for postal workers represented by NALC, APWU, NRLCA, and NPMHU actually fell—to approximately one-half of one percent per year. In 2013, for example, the annual quit rates were 0.5% (NALC), 0.4% (APWU), 0.7% (NRLCA) and 0.4% (NPMHU)—compared with 4.8% for the average federal sector employee and 22.3% for the average private sector employee. OIG Report No. RARC-WP-15-004, *Flexibility at Work: Human Resource Strategies to Help the Postal Service* (Jan. 5, 2015) at 12. During the same period, the average quit rates for the federal government as a whole were approximately *ten times* as high (about 4.8 percent), and the average quit rates for the private sector were approximately *40 times* as high (approximately 22.3 percent). *Id.*[30]

Relying on a variety of data sources and analyses, Mr. Nadol demonstrates in his declaration that the compensation received by the average Postal Service employee is now virtually *double* the compensation offered by the private sector for comparable levels of work. Nadol Decl. at 7-18, 34-47. The compensation premium would be massive even if the compensation levels offered by the private sector were much higher than Mr. Nadol has determined.

[30] The quit rates among USPS non-career workers are higher. *See* OIG Report No. RARC-WP-15-004 at 13 *et seq*. The main causes, however, appear to be working conditions, not rates of pay. Nadol Decl. at 49-50.

The APWU-Postal Service collective bargaining arbitration in mid-2016 illustrates the Postal Service's failure to deal effectively with the compensation premium. The neutral arbitrator on the APWU-Postal Service arbitration panel found that Postal Service compensation levels violate the comparability standard by almost every objective measure:

> [T]he package of economic benefits received by bargaining unit employees—retirement benefits, retiree health care, paid leave, low employee health care contributions, and a no-layoff provision—are superior to those typically available to private sector employees. Another factor which stands out are the quit rate data, which show that career Postal Service employees voluntarily leave their jobs at a rate far lower than do private sector employees. Despite APWU arguments to the contrary, I consider this as powerful evidence that APWU-represented employees consider their jobs with the Postal Service to be superior to the alternatives available to them elsewhere. To be sure, wages and benefits are not the only considerations that enter into an employee's decision whether to stay with the Postal Service or go elsewhere, but it would be naïve to believe that these are not major considerations. Hence, I conclude that the almost total unwillingness of APWU-represented employees to leave their jobs voluntarily is powerful evidence that they view their compensation and benefits as superior to what they would receive elsewhere, based on their skill and experience.

In the Matter of USPS and APWU, AFL-CIO, Interest Arbitration Decision and Award (July 8, 2016) at 11.

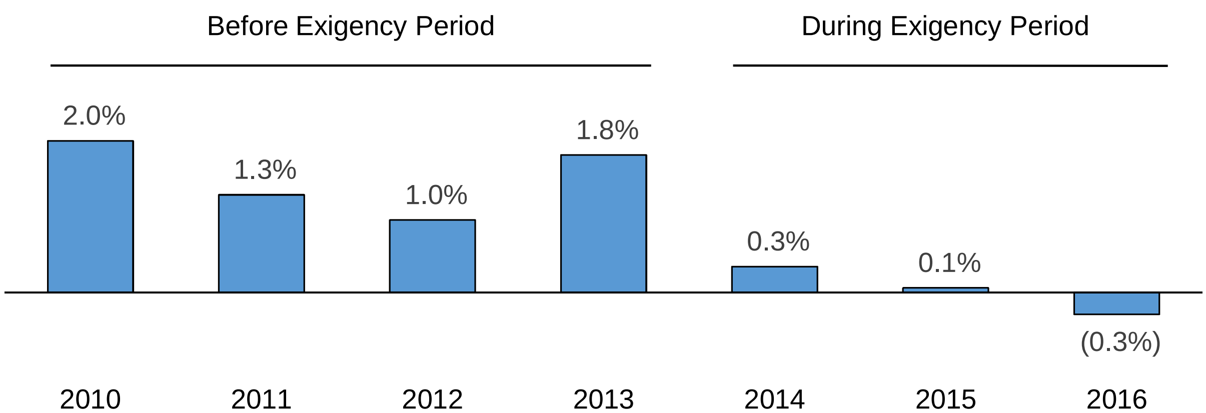
The arbitrators ultimately did not enforce compensation comparability, however. The reason illustrates the unforced errors by the Postal Service that have maintained the longstanding compensation premium. A year before the APWU arbitration, the Postal Service had *voluntarily* agreed to a collective bargaining agreement with the National Rural Letter Carriers' Association ("NRLCA") that included general pay increases of 1.2%, 1.3%, and 1.3%, lagged six months; a COLA with a 2014 base; and health benefits contribution reductions of 1% per year for three years. *Id.* at 12. Assigning "considerable weight to the USPS-NRLCA Agreement," the APWU arbitration panel awarded similar terms. "Interest arbitrators often look favorably at recent voluntary agreements," the neutral on the APWU panel explained. "I follow that line of reasoning in assigning substantial weight to the NRLCA agreement." *Id.*

The Postal Service fortunately does not need legislative reform to deal with the compensation premium. As Mr. Nadol explains in his declaration, there are two standard techniques for moving toward pay comparability, both of which have worked effectively. First, the compensation levels of current career employees are grandfathered in, but not increased. Second, the use of Tier 2 employees is greatly expanded. These approaches have worked when tried in many jurisdictions. Nadol Decl. at 9-11, 61-67. But they will not work for the Postal Service unless it tries them. And the Postal Service is unlikely to push hard for them in future collective bargaining agreement negotiations if the Commission takes the pressure off by weakening or eliminating the discipline provided by the CPI cap. *Id.* at 67; *see also* pp. 64-66, *infra*.

2. Reviving the Postal Service's cost reduction initiatives.

Another way that the Postal Service could improve its finances under current law would be to resume serious efforts to reduce costs. Between 2010 and 2013, the Postal Service achieved productivity gains in the range of one to two percent per year. Since Fiscal Year 2014—not coincidentally, the year in which the exigent surcharge approved in Docket No. R2013-11 took effect—Postal Service productivity growth has collapsed:[31]

Figure 12
USPS Total Factor Productivity (TFP) Growth Rates
(FY 2010 – FY 2016)



Despite its poor productivity performance since the beginning of 2014, the Postal Service has admitted that it "has no current plans to initiate major initiatives to achieve cost savings in its operations." Rectanus 2017 testimony at 10; *accord*, Hearings before the Senate Comm. on Homeland Security and Govt. Affairs (Jan. 21, 2016), prefiled testimony of Lori Rectanus (GAO-16-268T) at 8 (same). This approach is unacceptable. As noted above, efficiently run businesses (and nonprofit organizations) continually search for opportunities to improve productivity, particularly during economic downturns, whether company- or industry-specific or nationwide. *See* pp. 67-69, *infra*.

The Postal Service's network rationalization efforts illustrates the lack of a sustained commitment to cost control. In 2010, the Postal Service began the

[31] Library Reference ANM *et al.*-LR-R2017-3/1 (worksheet "Figure 12").

process of implementing a two-phase Network Rationalization plan. According to the Postal Service, the first phase of the plan, which was fully implemented, realized annual savings of $865 million.[32] The Postal Service, however, has halted the second phase of this plan, which was scheduled to begin in 2014, despite having estimated that Phase 2 of its plan would save $1.2 billion per year.[33] While implementation of the network rationalization plan has not been without its challenges,[34] the Postal Service is plainly leaving money on the table by halting these efforts indefinitely, since Congress has not required this. Rectanus 2017 testimony at 10.

The failure to move forward with Phase 2 of the network rationalization initiative has hurt the Postal Service's labor productivity as well. As the Postal

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[32] *See, e.g.*, ACR 2015, USPS Response to Chairman Information Request No. 7, Question 16.

[33] *See, e.g.*, OIG Report NO-AR-16-009 at 25 (reporting initial estimates of $750 million for Phase 2, subsequently revised to $1.2 billion); USPS.com, "Our Future Network: Key facts on network rationalization," https://about.usps.com/news/electronic-press-kits/our-future-network/ofn-usps-key-fact-on-network-rationalization.htm (reporting cost savings of approximately $0.9 billion from Phase 1 and anticipating total annualized savings of $2.1 billion from Phase 1 and Phase 2 combined).

[34] Indeed, implementation of Phase 2 was halted in large part because of detrimental impacts on service. *See, e.g.*, OIG Report NO-AR-16-009 at 7. But the notion that network rationalization necessarily leads to unacceptable decline in service performance warrants further consideration by the Commission. For many mailers—including nonprofit organizations, many advertisers, and magazine publishers, —reliability of service is more important than absolute speed. Most ANM, PostCom and MPA members can anticipate and adjust to changes in projected delivery times as long as the delivery times are predictable. While absolute delivery time is important for some mailers, cost control is more important for most. In any event, ANM, PostCom and MPA do not believe that service degradation—specifically in terms of reliability and predictability—is a necessary consequence of optimizing mail processing facilities.

Service noted in its FY2016/17 Report & Plan, it failed to meet its Deliveries per Total Work Hours goal (a measure of productivity) partly as a result of "a delay in plant consolidations [and] not capturing all of Network Rationalization phase 2 savings."[35] As there are no legal constraints on the Postal Service's ability to move forward with these plans, it should do so forthwith.

Another missed opportunity to save costs involves the use of less costly modes of delivery, particularly curbside and centralized mailboxes. The Postal Service has estimated that the resulting savings could be on the order of $2 billion annually. GAO Report GAO-14-144, *U.S. Postal Service: Delivery Mode Conversions Could Yield Large Savings but More Current Data Are Needed* (May 2014). While these delivery options may not be suitable for all areas, and additional investigation of the impact on response rates and the value of mail is warranted, potential savings of this magnitude should not be ignored.

3. Making better management and pricing decisions.

The Postal Service can further improve its finances under the present system by avoiding misguided pricing and investment decisions. The Flat Sequencing System ("FSS") debacle is a good example. Before the FSS was deployed, experts both inside and outside the Postal Service warned that the FSS was unlikely to achieve its goals and was likely to increase, not decrease, the costs of processing and delivering flat-shaped mail. Plunkett Decl. at ¶ 6-8. The mailing industry urged the Postal Service to commit to a rate structure that gave efficient incentives for co-mailing by mail owners, printers and mail service providers, rather than having the

[35] United States Postal Service FY 2016 Annual Report to Congress, Docket No. ACR2016, Library Reference USPS-FY 16-17 2016 Annual Report and Comprehensive Statement of Postal Operations at 22.

Postal Service invest billions in the FSS. Stralberg Decl. at 1-2; Library Reference ANM *et al.* –LR-RM2017-3/2

The Postal Service instead chose to proceed with the FSS. Its performance has been even worse than the skeptics warned. First, the Postal Service's planners greatly underestimated the extent to which mailers would sort flats to the carrier route level. Stralberg Decl. at 4. Second, the Postal Service overstated the costs of manual sequencing of carrier route flats by carriers, and thereby overestimated the costs saved by diverting the sequencing work to the FSS. *Id.*. Third, the Postal Service, erroneously assuming that practically all flats within an FSS zone would be placed in delivery sequence by the FSS, removed the vertical flats cases carriers had used for manual sequencing. *Id.* Fourth, the Postal Service's planners incorrectly assumed that nearly all flats would be machinable on the FSS. *Id.*; Plunkett Decl. at ¶ 7. Fifth, the Postal Service's predictions that practical concerns about the FSS machines themselves, including their footprint, cost, and complexity, would be solved during the design and implementation of the system proved incorrect. Plunkett Decl. at ¶ 6. Finally, because flats mail volume was lower than the Postal Service had expected, it added many outlying zones to the territory covered by each FSS machine, causing substantial service degradation. Stralberg Decl. at 1-2. Because reality unsurprisingly did not follow these incorrect assumptions, many of which industry questioned at the time, the large reductions in sorting and delivery costs that were invoked to justify the FSS program have not materialized, and almost certainly never will. *Id.* at 5-11. The FSS, for example, adds almost 17 cents to the cost of an average carrier route flat that converts to FSS processing. *Id.* at 2, 6.

It is long past time for the Postal Service to face reality, retire the FSS, allow mailers to presort flats to the carrier route in all zones (including the current FSS zones), and deepen worksharing rate differentials to recognize 100 percent (up from the current 60 percent[36]) of the costs avoided by carrier route presorting and related worksharing. The resulting increase in co-mailing and co-binding will result in huge shifts to carrier route presortation, a preparation that enables flat-shaped mail to cover its attributable costs. Quad/Graphics Decl. at 3. This threshold will never be met as long as the Postal Service keeps the FSS on life support while forbidding carrier route presorting in zones with FSS machines and maintaining a price structure that discourages efficient co-mailing and the related worksharing. *Id*. at 2-3; Stralberg Decl. at 3.

The Postal Service has offered no cogent reason for failing to take these obvious steps. In Docket No. ACR2016, the Postal Service advanced essentially two arguments against encouraging co-mailing by deepening the discounts for Carrier Route Basic presorting to 100 percent of the costs avoided by this level of mail preparation: (1) the percentage of flats presorted to the Carrier Route has increased over time even without any substantial increase in the Carrier Route discount; and (2) other rate design elements provide sufficient incentive to comail.[37] These arguments are without merit. The first is a non sequitur. That the percent of flats entered at Carrier Route mail has increased without a significant increase in the Carrier Route discount says nothing about whether a substantial deepening of the

[36] Docket No. ACR2016, FY16.3 WorksharingTables.Rev.3.6.17.xls, "Periodicals Outside County."

[37] Docket No. ACR2016, USPS-FY16-44, Report Responding to Periodicals Pricing Directives at 5.

Carrier Route discount would cause a substantially *further* increase in the percentage of flats entered at the Carrier route level. The relevant comparison is incremental. The second argument is also misplaced. The Carrier Route discount, not the bundle and container rates, remains the key incentive for comailing. Quad/Graphics Decl. at 2-3.

Whether to continue using the FSS is a managerial decision that falls within the Postal Service's responsibility. But deciding what costs may be recovered from captive mailers is the Commission's responsibility. For all of the reasons explained above, the Postal Service's failure to end its FSS project and revamp its rate structures for flat-shaped mail to give mailers stronger incentives to engage in cost-savings practices such as Carrier Route preparation and sorting is an independent ground for rejecting the Postal Service's request for the right to impose above-CPI rate increases on captive mailers.[38]

4. Looking creatively for new revenue sources as effectively operated private businesses do.

The Postal Service should emulate competitive private businesses and look for innovative ways to develop *voluntary* sources of new revenue.

Objective (4) of PAEA explicitly exhorts the Commission to grant the Postal Service pricing flexibility and to consider "the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when

[38] MPA initial comments in ACR2015 at 3-6; PostCom initial comments in ACR2015 at 1-3; Valpak initial comments in ACR2015 at 13-14; MPA reply comments in ACR2015.

available on public and reasonable terms to similarly situated mailers." Yet in the ten years since the passage of PAEA, the Postal Service has filed only five negotiated service agreements relating to market dominant products. By contrast, thus far in FY 2017, the Postal Service has already filed 129 competitive product pricing contracts. This activity on the competitive side suggests that the capability and infrastructure to negotiate pricing contracts exists, yet its use with market dominant products remains severely limited. It is disingenuous at best for the Postal Service to be arguing that the regulatory system established after PAEA is not working when it has largely ignored the pricing freedoms that the law enabled. Similarly, despite greater flexibility to experiment, the Postal Service has averaged only one market test per year since PAEA's passage.

Another potential source of revenue that the Postal Service does not appear to have pursued seriously is the rental of advertising space on mail trucks. As the USPS OIG has noted, "From public transportation to sports stadiums, venues use their prime real estate to sell space to advertisers and generate extra revenue. Take for example the Washington Metro transit system. Ad space is for sale everywhere – on buses and trains (inside and out) and even on train tunnel walls and floors." "We 'Advertise' for You?" OIG Blog (Nov. 30, 2009) (downloaded from https://www.uspsoig.gov/blog/we-%E2%80%9Cadvertise%E2%80%9D-you). The most sensible approach to selling advertising space on postal trucks is to put the necessary tasks—controlling the inventory, handling the ad sales, and execution—out for bid to media companies. One such company, Clear Channel, signed an eight-year, $151 million contract with the Metropolitan Washington Airports Authority for the right to manage advertising at the Reagan National and Dulles

International airports.[39] Another company that ran a pilot on-vehicle advertising project for the Postal Service during 2009-2011 estimated that advertising on Postal Service vehicles could raise $360 million per year. Post & Parcel (Nov. 29, 2011) (downloaded from http://postandparcel.info/44007/news/companies/advertising-on-usps-vehicles-could-raise-360m-a-year/).

There are likely to be many other opportunities for the Postal Service to develop profitable new ways to generate additional revenue. Private businesses have faced many of the same financial pressures as the Postal Service since 2007, and they have reacted in innovative ways to maintain and grow their business. The declarations included with these comments describe the actions companies such as Publishers Clearing House and IWCO Direct have taken to expand their business, seek new customers, and leverage their existing expertise into new markets when faced with declining demand for their traditional products and services. *See, e.g.*, Smith Decl. at ¶¶ 5, 8; Rosser Decl. at ¶ 9.

The Postal Service should follow the lead of these businesses. It will not do so, however, without an incentive. The CPI cap was designed to provide that incentive. Yet for its market dominant products, the Postal Service largely manages its operations as though nothing has changed. If the cap is weakened and the incentive to innovate reduced even further, the likelihood that the Postal Service will continue pursuing marketing innovations of the kind described above will be nil.

[39] "With a captive audience of 44 million, Clear Channel and MWAA launch $151M advertising deal," Washington Business Journal (Mar. 11, 2016) (available at www.bizjournals.com/washington/morning_call/2016/03/with-a-capitve-audience-of-44-million-clear.html).

E. Congress has other practical means to improve the Postal Service's financial position even further without imposing above-inflation price increases on captive mailers.

1. Allowing the Postal Service to invest its cash in assets other than low-yield Treasury bonds.

Congress has several other ways to improve the Postal Service's balance sheet if necessary. First, Congress could allow the USPS to invest its cash in a diversified portfolio of debt and equity securities instead of low-yield Treasuries. That adjustment alone would reduce the present value of the Postal Service's postretirement obligations by more than $100 billion, transforming the Postal Service's pension and retiree health benefit fund from an overall deficit of $79 billion to a large overall surplus. Nadol Decl. at 5, 19-23, 25-26.

Current law requires that funds invested in the Civil Service Retirement and Disability Fund (which holds the postal funds for both the CSRS and FERS) and the Postal Service Retiree Health Benefits Fund, as well as other cash held by the Postal Service, be invested in low-yielding Treasury bonds. 5 U.S.C. § 8909a(c). This requirement is of no benefit to the Postal Service, its employees, or its ratepayers, and it merely forces them to subsidize the rest of the federal government. As the president of the NALC has noted, "No private company in America would invest 100 percent of their pension and post-retirement health funds in such a conservative way." Rolando 2017 testimony at 9. Allowing the Postal Service to invest its cash in a well-diversified portfolio of private sector equities, bonds and real estate could massively improve the Postal Service's finances without incurring undue risk. Nadol Decl. at 21-23; *accord*, Rolando 2017 testimony at 8-11;

Hearings before the House Comm. On Oversight and Govt. Reform (May 11, 2016) at 8-13; *id*. at Attachment 2 (Lazard analysis).

Attachment A, *infra*, illustrates the dramatic effect that a higher return on invested funds would have on the Postal Service's balance sheets. The average return currently anticipated by a sample of 126 public retiree plans recently surveyed by the National Association of State Retirement Administrators is approximately 7.0 percent. *See* http://www.nasra.org/investment. Substituting this value for the discount rates of 3.9 percent and 5.25 percent discount rates currently used to determine the present value of the expected stream of future payments to retirees reduces that present value by approximately $146 billion. This one change alone transforms the Postal Service's pension and retiree health benefit from an overall deficit of $79 billion to an overall *surplus* of $66.7 billion. *See* Attachment A, *infra* (summarizing Nadol Decl. at 20-23)

These figures rely on the simplifying assumption that the Postal Service's projected future outflows will remain constant (in real dollars) in perpetuity. A more precise calculation of the effect of using a different discount rate would require time-series data on the Postal Service's projected future payments to its employees' pension and Retiree health Benefit funds. These data are not publicly available, but should be in the Postal Service's possession. Accordingly, the Commission should obtain and make this information public and analyze the effect of different discount rates on the present value of USPS retirement liabilities and the Postal Service's balance sheet.

2. Integrating the Postal Service's retiree health care system with Medicare.

Another major cost-saving reform available to Congress is the integration of the Postal Service's retiree health programs with Medicare. Although the Postal Service contributes to Medicare for all of its employees, many postal retirees and eligible dependents do not use it.[40] The unused contributions to Medicare are another unjustified subsidy of the Treasury by the Postal Service and its customers. Requiring all Postal Service retirees and survivors over age 65 to participate in Medicare Parts A and B—and establishing an Employer Group Waiver Plan ("EGWP") to take advantage of subsidies available under Medicare Part D for prescription drug benefits within each Federal Employee Health Benefit plan—would "essentially eliminate the Postal Service's retiree health benefit liability and reduce expenses by $16.8 billion over 5 years (2018-2022)." Brennan 2017 testimony at 14-15; *see also* Rolando 2017 testimony at 6. As the Postal Service noted in 2013, the resulting savings would be a "lifeline to the Postal Service" that would not "come at the expense of a single job or require the closing of any post office or postal facility."[41] Nadol Decl. at 24-27.

[40] About 8 percent of Postal Service annuitants and dependents do not participate in Medicare Part A, and 26 percent do not participate in Part B. Brennan 2017 testimony at 14.

[41] Letter from Jeffrey C. Williamson, Chief Human Resources Officer and EVP, USPS, to Lorelei St. James, Director, Physical Infrastructure, GAO (reproduced in GAO Report No. GAO-13-658, *U.S. Postal Service: Proposed Health Plan Could Improve Financial Condition, But Impact on Medicare and Other Issues Should Be Weighed Before Approval* (July 2013) at App. III).

3. Allowing the Postal Service to make rational changes in delivery frequency

Through appropriations riders enacted every year since 1984, Congress has required the Postal Service to deliver mail six days per week. *See* PRC Annual Report to the President and Congress for Fiscal Year 2016 (Jan. 13, 2017) at 46. This requirement may not be necessary for all types of mail and all areas. Providing the Postal Service with the flexibility to reduce frequency of delivery where appropriate could result in significant savings. The Commission estimated the cost of providing service six days per week, rather than five, at $2.07 billion in Fiscal Year 2015. *Id.* The Postal Service could greatly improve its finances by capturing even a portion of the savings available from eliminating six-day delivery where appropriate.

F. The current regulatory system provides important protections to captive mailers that would be undermined if the Postal Service were allowed to impose above-CPI rate increases on market-dominant products.

The current regulatory system has also provided critical protections to captive mailers by limiting the Postal Service's ability to exploit its market power by collecting monopoly rents or letting its costs run out of control. By contrast, allowing the Postal Service to impose above-inflation price increases on captive mailers is likely to lead to both sizeable price increases on market-dominant products and weaker cost discipline by the Postal Service, without any net improvement in the Postal Service's financial health. This outcome would violate the (1) the text and purpose of Section 3622(d), which established the CPI cap; (2) the efficiency goal of Section 3622(b)(1) and 3622(c)(12); and, (3) the "just and reasonable" rate standard embodied in Sections 404(b), 3622(b)(8), 3622(c)(3).

Relaxing the CPI cap on market-dominant prices almost certainly would undermine Postal Service cost discipline and lead to higher prices for captive mailers and consumers. In turn, any extra revenue generated by those price increases almost certainly would be dissipated through higher costs, and would not improve the Postal Service's financial stability. The CPI cap is the only real leverage that either the Postal Service or the Commission have under current law to hold down the Postal Service's costs and induce it to become more productive and efficient. The credibility of the CPI cap, however, is its potential Achilles heel. Once the cap is lifted permanently—or a regulated monopoly learns that the regulator will relax the cap on a case-by-case basis when the monopoly loses money—the deterrent effect of the price cap on the firm's costs is lost. *See* Nadol Decl. at ¶ 11.

The performance of the Postal Service and European postal operators provides ample support for these conclusions. Two pieces of evidence stand out:

(1) The financial pressures during and shortly after the 2007-2009 recession forced significant cost discipline by the Postal Service. *See* USPS OIG Report No. RARC-WP-16-009, *Peeling the Onion: The Real Cost of Mail*, at 4 (noting that the USPS decreased controllable expenses by reducing number of career employees, reducing work hours, downsizing and restructuring its network, reducing the use of air transportation, and redesigning delivery routes). But the recovery in mail volume and revenue in the current decade, and the $4 billion in contribution from the above-CPI price increases authorized by the Commission in Docket No. R2013-11, have lessened those pressures, and the Postal Service's productivity gains have slowed to a near standstill. See p. 52, *supra*. Indeed, in

several key respects the Postal Service's productivity gains have reversed. Rectanus 2017 testimony at 4-5 (noting rise in USPS compensation and benefits expenses since 2015).

(2) The European countries that have relaxed their regulation of maximum prices charged for market-dominant postal products have seen those prices far outstrip inflation. In late 2016, WIK-Consult studied the performance of six major foreign postal operators for the OIG. USPS OIG Report No. RARC-17-003, *Lessons in Price Regulation from International Posts* (Feb. 8, 2017). In Australia, where market-dominant postal services are subject to cost-of-service rate regulation (not index regulation), service quality has declined, and regulated prices experienced increases in the range of 40 percent to 114 percent in January 2016. *Id*. at 22, 26. In Canada, which replaced price cap regulation in 2009 with price regulation "based on political decisions rather than a fixed economic methodology," letter mail prices rose by approximately 35 to 59 percent in 2014. *Id*. at 28. In France, where the postal regulator allows a negative productivity adjustment for falling mail volume, price increases have exceed inflation several times. *Id*. at 36-40. In the United Kingdom, which has eliminated or loosened maximum rate regulation for most mail products, the price of a 100 gram first-class letter increased by 88.2 percent between 2007 and 2016; the price of a second class 100 gram letter more than doubled. *Id*. at 55-57.

Another study by WIK Consult detailed the breakdown of Royal Mail's cost discipline that has followed the loosening of maximum rate regulation. The conclusions of the WIK report are chilling. "Targeted cost savings in delivery are relatively low." WIK-Consult report to OFCOM, *Review of the Projected Costs* *within Royal Mail's Business Plan* (March 31, 2016) at 109. "The company relies on traditional ways of organising delivery and does not (yet) appear to be pursuing more innovative delivery models." *Id.* "We consider Royal Mail's parcel automation programme is less ambitious than its peers." *Id.* "[I]international peers in Denmark, Sweden, the Netherlands and Germany appear to have been more successful at managing the relationships with their employees and unions and, at the same time, agreeing [sic] higher levels of efficiency and cost flexibility, allowing them to meet market challenges more effectively." *Id.* at 110. "Overall, we conclude that Royal Mail's planned initiatives are technically feasible but, overall, less ambitious than its peers." *Id.* at 111.

There is no reason to believe that the consequences of allowing the Postal Service to "fix" its balance sheet by imposing above-inflation price increases on its captive customers would be any less destructive. Magazine Publishers would respond to the increases by closing titles, going digital only, cutting circulation or frequency, and reducing staffing. Cohen Decl. at 5-7; Faust Decl. at ¶ 12 (Time Inc.). For nonprofit mailers, above-CPI rate increases would have a "crippling effect" on organizational effectiveness, forcing cutbacks in "fundraising appeals and renewals, magazine, and other important publications" and conversions to "alternative channels of communication," a move that would "greatly impair" the ability of nonprofits to carry out their qualifying nonprofit missions. Brophy Decl. at ¶ 11 (Consumer Reports); Burgoon Decl. at ¶¶ 7-10 (Disabled American Veterans); Finstad Decl. at ¶¶ 9-10 (American Lung Association); Maio Decl. at ¶ 12 (National Wildlife Federation); O'Sullivan Decl. at ¶ 8 (Guideposts). For-profit mailers and mail service providers would be impacted as well, curtailing marketing campaigns, reducing services, and passing costs on to customers and consumers (leading to further reductions in mail volume). Smith Decl. at ¶ 4 (Publishers Clearing House); Rosser Decl. at ¶ 5 (IWCO Direct).

Allowing the Postal Service to impose above-inflation rate increases on mailers—causing layoffs among *their* rank-and-file workers and price increases for ordinary consumers—rather than requiring the Postal Service to limit its price increases to the rate of inflation—would be contrary to Objectives 1 and 8, and would be particularly unjust in light of the cost control measures and other restructuring under taken by the mailing industry since 2007. Most private sector mailers face severe cost and revenue pressures, and have been forced to implement layoffs and other painful cost control measures during the past decade. During and after the 2007-2009 recession, "many private sector companies (such as automobile companies, airlines, mail preparation and printing companies, and major newspapers) took far-reaching measures to cut costs (such as reducing or stabilizing workforce, salaries, and benefits)." GAO Report GAO-16-651T at 10.

So did the members of ANM, PostCom and MPA. For example, IWCO Direct, a service provider focused on direct mail printing, closed two facilities, resulting in the loss of 585 jobs, and engage in reductions in force across its Minnesota-based operations in 2008. Rosser Decl. at ¶ 8. Publishers Clearing House carried out five reductions in force from 2009 through 2011, eliminating 2%, 3%, and 4% of the workforce in each of the respective years). Smith Decl. at ¶ 9.

The economizing and restructuring have continued since the end of the recession. Consumer Reports has cut back its mail volume, resulting in "a falloff in subscriptions and revenue that required taking a number of austerity measures" including the shuttering of two monthly print publications and layoffs of both managerial and unionized hourly employees. Brophy Decl. ¶ 10. Disabled American Veterans has also cut back on solicitation mailings, leading to a 10 percent decline in its donor base since 2013 and an even steeper decline in net income. Burgoon Decl. ¶ 7. Guideposts has likewise curtailed its donor acquisition mailings by 50 percent since 2007, causing its active fundraising donor file to decrease by over 40 percent during the same period. O'Sullivan Decl. at ¶ 7. Guideposts has been forced to reduce employee staff levels by 30 percent and cut salaries for its remaining employees by an average of six percent. *Id.* Between 2012 and 2016, the overall revenues of the National Wildlife Federation declined each year by an average of nearly five percent. Financial pressures have forced NWF to cut or limit staff, reduce program activities, and limits is publication volume. Miao Decl. at ¶ 11.

The 22 publishing companies who responded to an MPA survey earlier this year have closed 43 titles since 2011, reduced the frequency of 45 titles, and cut circulation of 68. Cohen Decl. at 4-5. Time Inc. has lowered its cost base every year from 2011 - 2015 through staff reductions and lower print and paper costs. Time Inc. has closed eight magazine titles, sold twelve magazine titles, reduced issue frequency for seven magazine titles and cut circulation for five magazine titles since 2007 to manage costs in a market of declining magazine print advertising and circulation revenues. Faust Decl. at ¶ 11. The magazine publishing industry as a whole has reduced its head count from 142,885 employees in 2006 to 112,742 employees in 2011 to 95,674 as of September 2016.[42]

The notion that Objective 5, the revenue adequacy objective, can override the pro-ratepayer objectives of Sections 3622(b) ignores the explicit language of Section 3622(b), which requires the Commission to apply "each" of the objectives "in conjunction with the others" when designing a system for regulating rates. It also ignores the century of precedent under the just and reasonable rate standard that Congress incorporated by reference in Sections 404(b) and 3622(b)(8). And it ignores the plain language of Section 3622(d), which established the CPI cap.

The Postal Service's objection that the CPI cap is somehow unfair or anomalous because it is "not faced by private companies," *see* USPS FY 2017 Integrated Financial Plan at 2, is equally without merit. Privately owned firms with the monopoly power possessed by the Postal Service commonly have their prices regulated, often with an index mechanism that is *more* stringent than the one established by the Commission. And privately owned firms without monopoly power are subject to a *de facto* rate cap in the form of competition.

The Postal Service still has monopoly power. First, it enjoys a legal monopoly over the right to deliver most letter mail. The private carriage of "letters or packets," which have been defined to include most bulk advertising mail, is a crime. 18 U.S.C. §§ 1693-1696; 39 U.S.C. §§ 601-606; *Associated Third Class Mail Users v. USPS*, 600 F.2d 824 (D.C. Cir. 1979). Second, the mailbox monopoly, codified at 18 U.S.C. § 1725, gives the Postal Service exclusive access to even privately-owned

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[42] Source: U.S. Bureau of Labor Statistics, Series ID ENUUS000105511120, NAICS code 511120 (Periodical publishers—not including Newspapers) (data extracted on March 17, 2017).

mailboxes. Third, the economies of scale and scope still possessed by the Postal Service in mail delivery also provide it with significant market power over many products that are not legal monopolies. *See* 39 U.S.C. § 3621(a) (list of market-dominant products initially prescribed by PAEA); 39 U.S.C. §§ 3642(b)(1), (2) (recognizing that the Postal Service can have market dominance over mail products not covered by the postal monopoly). Privately-owned companies with comparable monopoly power have had their rates regulated since the 1800s. *See* 1 Alfred E. Kahn, *The Economics of Regulation* 3-4 (1970).

Indeed, the price caps used to limit the maximum rates of most other franchised monopolies in the United States are more stringent, not less, than the index mechanism under which the Postal Service has been operating since 2007. Most price caps imposed on privately-owned common carriers and public utilities include a productivity offset (or X-factor) that effectively limits regulated price increases to *less than* the full amount of inflation. See *Edison Electric Institute v. ICC*, 969 F.2d 1221 (D.C. Cir. 1992); *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 183-84 (D.C. Cir. 1993); *Bell Atl. Telephone Cos. v. FCC*, 79 F.3d 1195 (D.C. Cir. 1996); *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1435, 1437 (D.C. Cir. 1996).

There is a good reason for this. Indexing mechanisms are intended to emulate the performance of effectively competitive markets.[43] Competitive markets

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[43] *USPS v. PRC*, 785 F.3d at 745; *see generally Edison Electric Institute v. ICC*, 969 F.2d 1221, 1226 (D.C. Cir. 1992) (index ratemaking for market-dominant railroad services was designed to create "an incentive for a price-regulated industry to make prudent business decisions without at the same time allowing it to charge unreasonably high rates free of challenge"); *National Rural Telecom Ass'n v. FCC*, 988 F.2d 174, 177-178 (D.C. Cir. 1993) (describing incentive for efficiency created by price cap regulation of telecom rates); *Bell Atl. Telephone Cos. v. FCC*, 79 F.3d 1195,

compel firms over time to increase productivity—and share productivity gains with consumers by raising prices more slowly than inflation. The discipline provided by competitive markets to control costs is perhaps strongest during economic downturns, whether industry-specific or economy-wide. In competitive markets, well-managed businesses respond to economic hardship not by demanding the right to surcharge their customers with above-inflation price increases, but by controlling costs and learning to operate more efficiently. That is how many American industries responded to the 2007-2009 recession. See pp. 67-68, *supra*.

It is certainly true of the suppliers of most of the inputs used by mailers *other than* mail. Thanks to productivity growth, most inputs used by mailers have become less costly since 2007.[44] The one core cost that has increased annually during the past decade for most mailers is postage. Faust Decl. at ¶¶ 6,8; Smith Decl. at ¶ 6.[45] In 2006, postage represented 24% of Time Inc.'s total physical

1198 (D.C. Cir. 1996) ("Price cap regulation is intended to provide better incentives to the carriers than rate of return regulation, because the carriers have an opportunity to earn greater profits if they succeed in reducing costs and becoming more efficient."); *Association of Oil Pipe Lines v. FERC*, 83 F.3d 1424, 1429-30 (D.C. Cir. 1996) (adoption of index ratemaking for oil pipelines was "intended to streamline regulatory provisions and to give pricing flexibility to oil pipelines, while preventing excessive rates and charges against any captive shippers on oil pipelines."); *see also* USPS OIG Report No. RARC-WP-13-007, *Revisiting the CPI-Only Price Cap Formula* (Apr. 12, 2013) at ii ("In the absence of competition, the cap is intended to serve as a surrogate or proxy for competitive market forces by providing a control on bloat and inefficiency in the Postal Service.").

[44] *See, e.g.*, Faust Decl. at ¶¶ 6, 8; Rosser Decl. at ¶ 10 (relating how IWCO Direct, a mail service provider, reduced its prices in response to client demand).

[45] In addition to postage increases, the costs of complying with Postal Service requirements has increased as well, as the Postal Service has shifted certain mail preparation and entry costs to mailers. *See* Rosser Decl. at ¶¶ 11-15; Faust Decl. at ¶ 9.

production cost. In 2011, postage was 29% of total production costs and in 2015 it was 38%. Faust Decl. at ¶ 8. For a group of 22 magazine publishing companies (with 280 individual titles) surveyed by MPA, postage has increased from 26 percent of total manufacturing, production, and distribution costs in 2006 to 38 percent in 2015. Cohen Decl. at 4.

III. HOW INSTITUTIONAL COSTS SHOULD BE RECOVERED FROM THE MULTIPLE PRODUCTS AND CLASSES THAT USE THE POSTAL NETWORK. (OBJECTIVES 4, 8 AND 9)

Objectives 4, 8, and 9 concern how the Postal Service should recover its institutional costs from the multiple products and classes that use mail. Objective 4 seeks to allow the Postal Service pricing flexibility, and the ability to decide how much particular products and classes will contribute to institutional costs is a key component of pricing flexibility. Objective 8 calls for a "just and reasonable" rate schedule, which implies rates that will allow the Postal Service to recover its institutional costs but that do not saddle any particular product or class with an unreasonable share of institutional costs. This objective specifically notes that it does not "prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail." 39 U.S.C. § 3622(b)(8). Finally, Objective 9, which states the goal of allocating institutional costs "appropriately between market-dominant and competitive products," speaks to institutional cost allocation. *Id.* at § 3622(b)(9). The Commission should retain the CPI-based price cap applied separately to each class of mail. Applying the CPI cap separately to each class strikes the appropriate balance between providing pricing flexibility to optimize institutional cost recovery and protecting captive ratepayers from unreasonable price increases.

A. Elimination of Commission prescription of institutional cost coverages in favor of the CPI cap was a major improvement that should be retained.

Before PAEA, postal rates were based in large part on costs of service. After determining the attributable costs of each class and subclass, the Commission would determine the contribution to the Postal Service's institutional costs that each product or class should make. The latter determination often resulted in "class wars" in which, for instance, First and Third Class mailers would fiercely argue why fewer institutional costs should be attributed to their class and more to one or more other classes. These arguments were a principal driver of the lengthy and contentious rate setting process under the Postal Reorganization Act and were costly and wasteful.

One of the signature achievements of PAEA has been the elimination of these class wars.[46] By setting the price cap at the class level and allowing unequal rate changes between classes and among products within a class, PAEA eliminated any need or incentive to engage in such costly litigation. Instead, price changes are filed and approved relatively quickly with a minimum of controversy. The Commission should not underestimate the value of this change as it evaluates the current system of ratemaking.

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[46] *See, e.g.*, Cong. Rec. S11675 (Dec. 8, 2006) (Sen. Collins explaining that PAEA "replaces the current lengthy and litigious rate-setting process with a rate cap-based structure" that provides the Postal Service with "much more flexibility" while simultaneously capping rate increases).

Furthermore, there is no evidence that the move to the price cap has inhibited the Postal Service from recovering its institutional costs. While it is true that some products and classes fail to cover attributable costs as measured by the Postal Service, it has still been able to recover its institutional costs as a whole, as demonstrated by its positive controllable income. Moreover, as the Postal Service has recognized in arguing against implementing significant above-CPI increases to Standard Mail Flats, simply raising a product's price does not necessarily increase the contribution of that product to the Postal Service's institutional costs. *See, e.g.*, Docket No. R-2010-4, Statement of James M. Kiefer at 30 (July 6, 2010) ("Because postage accounts for approximately half the costs of mailing a catalog, a postal price increase of [the magnitude necessary to reach full cost coverage] would put serious additional pressures on catalog mailers, thereby reducing volumes even further than they have already fallen."). If a price increase causes volume to decline by a greater percentage than unit contribution increases, overall contribution declines. This is true even for a monopoly. Jean Tirole, *The Theory of Industrial Organization* 66 (1988). Thus, a system that mandated each product recover a fixed portion of institutional costs could have the perverse effect of reducing the Postal Service's ability to recover total institutional costs.

Therefore, there is no reason to believe an alternative regime, such as the pre-PAEA system of rate regulation, would better apportion institutional costs than the application of the CPI cap at the class level. It is not apparent that another system, including one that applies the cap at a different level, would better recover institutional costs or that it would better protect captive mailers from unreasonable price increases. What is apparent is that if the price cap were to apply to market dominant products as a whole, users of allegedly underwater products such as Periodicals and Standard Mail Flats would likely experience radical and unreasonable cost increases.

B. The attributable cost "factor" (Section 3622(c)(2)) should remain subordinate to the CPI cap requirement of Section 3622(d).

For this reason, the attributable cost "factor" of Section 3622(c)(2) should remain subordinate to the CPI cap requirement of Section 3622(d) in any ratemaking system the Commission establishes. Creating a blanket exception to the CPI cap for classes of mail or products merely because they reportedly fail to cover attributable costs would be undesirable and unfair, even assuming *arguendo* that Section 3622(d)(3) empowered the Commission to modify the CPI cap.

Periodical Mail and Marketing Mail flats illustrate why this is so. The reported cost coverage of these products has been generally declining for years despite (1) Postal Service investment in flats automation; and (2) improvements in mail preparation and worksharing by mailers that have greatly decreased the work content of Periodicals Mail and flat-shaped Standard Mail. The fundamental cause of the failure of these products to cover reported attributable costs is not any shortfall of revenue or any dereliction of mailers in worksharing, but the out of control costs of the Postal Service. Moreover, as explained above, perhaps the leading cause of the Postal Service's cost overruns is its misguided insistence on deploying and continuing to operate the FSS, and steering flats mail volume to it by requiring flats in FSS zones to comply with FSS preparation requirements, not carrier route presort preparation requirements, and failing to properly encourage co-mailing despite repeated (and ultimately correct) warnings from mailers and

Postal Service employees that this strategy was likely to drive up the Postal Service's costs of processing and delivering flat-shaped mail. *See* pp. 55-57, *supra*; ANM-MPA reply comments in ACR2014 (Feb. 13, 2015); MPA-ANM reply comments in ACR2013 (Feb. 14, 2014); PostCom comments in ACR2016 (Feb. 2, 2017) at 3-4; PostCom reply comments in ACR2016 (Feb. 13, 2017) at 3-6; PostCom comments in ACR2015 (Feb. 2, 2016); PostCom comments in ACR2014 (Feb. 2, 2015) at 1-4.

Requiring mailers of flats to pay higher prices to cover needlessly high costs resulting from Postal Service management decisions taken over the repeated objections of these mailers would not only be unfair, but would violate the policies that that postal rates be just and reasonable (39 U.S.C. §§ 404(b) and 3622(b)(8)) and that "incentives to reduce costs and increase efficiency" should be maximized (39 U.S.C. § 3622(b)(1).

In any event, the inability of certain products to recover their attributable costs is not evidence that the current system is failing to properly apportion costs. With respect to periodicals, for instance, the "underwater" condition of the class is a function of excessive costs, not overly-constrained prices and, as discussed above, can be substantially traced to management decisions made by the Postal Service over industry protestations. No system of ratemaking can entirely protect against poor business decisions, such as implementation of the FSS, that disable an enterprise from charging a price high enough to recover the cost of its misguided investment.[47]

[47] This principle has long been a feature of textbook economics. *See, e.g.*, WILLIAM J. BAUMOL AND ALAN S. BLINDER, MICROECONOMICS: PRINCIPLES AND POLICY at 441 (7th ed. 1998) (contrasting regulated markets in which a firm is guaranteed "just *one standard rate* of profit to the firm . . . . whether its management is totally

Finally, the Commission should recognize that recognize that the "underwater" products and other products with higher coverage ratios are often complementary goods. For example, subscriptions to periodicals mailed at Periodicals Mail rates generate large volumes of allied mailings (e.g., acknowledgements, renewal notices, invoices, and solicitations) that have much higher reported coverage ratios. The contribution from this complementary mail offsets most of the reported shortfall from Periodicals Mail. Cohen Decl. at 3 & Exhibit 1. Flat-shaped Marketing Mail also generates complementary mail volume with higher reported coverage ratios.

C. The CPI cap should continue to be applied separately to each class, not applied to market dominant mail as a whole.

In light of the above, the application of the CPI cap at the class level has proven to be a reasonable means of balancing the interests in granting the Postal Service pricing flexibility, protecting individual ratepayers from unjust and unreasonable rate increases, and apportioning cost recovery among classes. Even if one assumes that, contrary to the language and structure of the statute, the Commission has the authority to apply a price cap to prices at something other than the class level, there is no reason to do so.

In developing the price cap provisions of the PAEA, Congress considered applying a cap at other levels. The legislative history reflects years of debate and deliberation over the breadth of the baskets of products to which the index

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incompetent or extremely talented and hardworking" with a competitive market in which "a firm with an especially ingenious and efficient management will do better [than the average firm], and a firm with an incompetent management is likely to go broke"); *id.* at 442 (noting that "when a regulated industry is in financial trouble . . . there is nothing the regulator can do to guarantee a 'fair rate of return'").

adjustment should apply. In S. 2468, the postal reform bill passed by the Senate Homeland Security and Governmental Affairs Committee in the 108th Congress, the choice of groupings for application of the index was to be left to the regulator. The committee noted:

> The Committee expects that the Postal Regulatory Commission, in public proceedings and with the input of all interest parties, will fully and carefully evaluate the merits of a wide range of rate cap structures. This consideration should include, but should not be limited to ... the definition of the product groupings to which the caps will be applied.

S. Report No. 318, 108th Cong., 2d. Sess. 10 (Aug. 25, 2004).

The predecessor of PAEA passed by the same Committee in the 109th Congress, however, abandoned this open-ended approach by specifying directly that the rate index must be applied at the class level:

> The annual limitation under paragraph (1)(A) shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of the Postal Accountability and Enhancement Act.

S. 662, 109th Cong., 1st. Sess (reported June 22, 2005), § 201(a) (proposed 39 U.S.C. § 3622(d)(2)(A)). The Senate Committee adopted this provision despite a letter from the Board of Governors of the Postal Service expressing a preference that the index be applied at the level of the Postal Service's aggregate revenues. Letter of the Board of Governors of the U.S. Postal Service to Chairman Susan Collins (February 24, 2005).

The predecessor of PAEA passed by the House of Representatives would have disaggregated the relevant product baskets even further, applying the index as a separate constraint on each *subclass*:

> In the administration of this section, the Commission shall not permit the average rate in any *subclass* of mail to increase at an annual rate greater than the comparable increase in the Consumer Price index, unless it has, after notice and opportunity for a public hearing and comment, determined that such increase is reasonable and equitable and necessary to obtain the Postal Service, under best practices of honest, efficient and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

H.R. 22 (reported by the House Committee on Government Reform on April 28, 2005) at § 201(a) (proposing language to be codified at 39 U.S.C. § 3622(e)) (emphasis added); *see also* Cong. Rec. H6523 (July 26, 2005). "To ensure fairness," the Committee explained, "the new system provides that rates from any one subclass should not increase faster than CPI." H. R. Rep. No. 66, 109th Cong., 1st Sess. 48 (April 28, 2005).[48]

The version of the legislation ultimately enacted into law resolved the conflict between the Senate and House bills by defining the relevant baskets as classes rather than subclasses. 39 U.S.C. §§ 3622(d)(2)(A); *see also* USPS at 12-13 (discussing legislative history). The final version of the legislation did not restore the earlier Senate version that would have allowed a single index basket consisting of market-dominant mail.

Allowing unused rate increase authority to spill over into other baskets would effectively merge the multiple class-specific baskets into a single basket, accomplishing precisely what Congress rejected, and would gut the effectiveness of the cap as a safeguard for individual mail classes or individual groups of market

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[48] *See* H.R. 22 at Sec. 201 (proposing a new § 3622(e) directing the Commission to "not permit the average rate in any subclass of mail to increase at an annual rate greater than the comparable increase in the Consumer Price Index"),

dominant mailers. Allowing the Postal Service to apply the cap only to market-dominant products as a whole would allow the Postal Service to target groups of mailers that comprise only a small percentage of mail with rate increases multiple times the rate of inflation simply by holding rate increases for larger groups of other mail slightly below inflation.

Congress ultimately determined that applying the price cap at the class level struck the optimal balance between providing the Postal Service enough flexibility to design rates within a class of mail and providing an adequate level of rate stability and predictability for mailers. This determination was made in light of all of the goals of PAEA and as a holistic solution to achieving them. As Representative Shays noted, PAEA promotes "both price stability and pricing flexibility."[49] Congress's insight has proven reasonable, and the Commission should continue to enforce the CPI cap at the class level.

IV. WORKSHARING DISCOUNTS AND OTHER ISSUES OF RATE DESIGN WITHIN INDIVIDUAL RATE CLASSES (OBJECTIVES 1 AND 8)

Objectives 1 and 8 are also pertinent to worksharing discounts. Properly designed worksharing discounts "maximize incentives to reduce costs and increase efficiency" (Objective 1) and help "establish and maintain a just and reasonable schedule for rates and classifications" (Objective 8). The current system for regulating worksharing discounts does not fully satisfy these objectives.

Between 1971 and the mid-1990s, the Commission gradually moved toward a recognition that worksharing discounts promote the fairest and most efficient

[49] Cong. Rec. H9182 (Dec. 8, 2006) (Rep. Shays).

allocation of resources when rate differentials for worksharing equal 100 percent of the costs avoided by worksharing. The Commission noted this in 2006:

> In Docket No. MC95-1, the Commission provided a clear rationale for worksharing, explaining why workshare discounts were in the nation's best interest, and how the amounts of workshare discounts should properly be developed. This rationale was premised on the concept of Efficient Component Pricing (ECP).
>
> Since that case, broad support has grown for applying that principle in the development of mail processing workshare rates. Indeed, in every subclass that has worksharing discount rates, both the Postal Service and the Commission strive to obtain an ECP outcome, i.e., a one-hundred percent passthrough of the avoidable cost savings. The ECP principle has now been applied to more workshare activities, such as the costs saved as a result of mailer dropshipping. Although consideration of the pricing factors and other policies of the Act sometimes prevent attainment of a full set of ECP rates, it does provide a unifying principle across subclasses for worksharing rates.

R2006-1 Op. and Rec. Dec. ¶¶ 4004-05.

In 2006, however, a provision of the PAEA amended Title 39 to provide that worksharing discounts, with some exceptions, should not "exceed the cost that the Postal Service avoids as a result of" the worksharing. 39 U.S.C. § 3622(e)(2), (3). Although nothing in the amendment required the Commission to make worksharing differentials *less than* "the cost that the Postal Service avoids" from worksharing, the legislation has led to a proliferation of key worksharing passthroughs, *e.g.*, for Periodicals Carrier Route Basic flats and First-Class Mail 5-Digit Automation Letters, that are considerably smaller than the underlying cost avoidances. Docket No. ACR2015, FY 2015 Annual Compliance Determination (Mar. 28, 2016) at 12, 19. Perhaps the most serious example of this trend is the Postal Service's policy of suppressing carrier route discounts for flat-shaped mail along with the Postal

Service's FSS debacle. *See* pp. 55-57, *supra*. The FSS debacle is a textbook example of what can go wrong when the Postal Service performs functions that mailers (or mail services providers) could perform at a lower cost.

The Commission's Annual Compliance Determination has admonished the Postal Service to send more efficient Periodicals price signals by setting more appropriate passthroughs for 5-Digit and Carrier Route presortation, *i.e.*, reducing the greater-than-100 percent 5-Digit passthrough and increasing the less-than-100 Carrier Route passthrough. Docket No. ACR2015, FY 2015 Annual Compliance Determination at 18-19. As discussed above, the Postal Service has repeatedly rebuffed this correct approach. If the Commission is serious about wanting Periodicals Mail and flat-shaped Marketing Mail to cover 100 percent of attributable costs, the Commission should order the Postal Service to correct its dysfunctional price structure for flat-shaped mail by ending the FSS debacle, setting worksharing rate differentials for Periodicals Mail at 100 percent of avoided costs, and setting rate differentials for Carrier Route and non-Carrier Route Marketing Mail that equal at least 100 percent of the cost differences between the two products.

CONCLUSION

The Commission faces a clear choice. One is to maintain the current regulatory system. If the Commission does that, the Postal Service will not only survive but, with a modest amount of resourcefulness and economical management, grow and prosper. The Postal Service's volume, revenue, earnings, cash flow, and net worth will continue to improve. The Postal Service's pension and retiree health benefit plans, which are already extraordinarily well funded, will become fully funded with ample time to spare.

By contrast, "solving" the Postal Service's finances by allowing it to impose above-CPI rate increases on mail products—even "temporarily," in "narrow circumstances," or "just this once"—would be a tragic mistake. The most fragile link in price cap regulation is the credibility of the regulator's will to enforce the cap. The collapse of the Postal Service's productivity growth after obtaining the exigent rate surcharge in Docket R2013-11, and the similar experience of several large postal operators in Western Europe in recent years, confirm that allowing the Postal Service to breach the CPI cap would undermine both the will and the ability of postal management to bargain effectively with the interest groups that want to raise the Postal Service's costs. Hence, allowing the Postal Service to extract more money from captive mailers is unlikely to improve the Postal Service's finances for long. Cost increases would follow on the heels of the revenue increases, and the extra funds would quickly vanish.

For the reasons explained above, the Commission should find that the current system of regulation properly balances the objectives of 39 U.S.C. § 3622(b) in light of the factors of 39 U.S.C. § 3622(c), issue a report to that effect, and close this docket. The Commission should also take several actions beyond this docket. First, it should begin an investigation of the current market value of the Postal Service's real estate. Second, it should direct the Postal Service to prepare plans for dealing with the labor compensation premium and initiating other major cost reduction initiatives. Third, the Commission should recommend to Congress that it (a) relax the current restrictions on the asset classes in which the Postal Service may invest its cash, and (b) integrate the Postal Service's retiree health benefit systems with Medicare.

Respectfully submitted,

/s/

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ATTACHMENT A

EFFECT OF A HIGHER RETURN ON INVESTED FUNDS ON THE POSTAL SERVICE'S BALANCE SHEETS

This attachment illustrates the dramatic effect that a higher return on invested funds would have on the Postal Service's balance sheets. The average return currently anticipated by a sample of 126 public retiree plans recently surveyed by the National Association of State Retirement Administrators is approximately 7.0 percent. *See* http://www.nasra.org/investment. Substituting this value for the discount rates of 3.9 percent and 5.25 percent discount rates currently used to determine the present value of the expected stream of future payments to retirees reduces that present value by approximately $146 billion.

This one change alone transforms the Postal Service's pension and retiree health benefit from an overall deficit of $79 billion to an overall *surplus* of $66.7 billion. In particular, increasing the assumed discount rate to 7.0 percent raises the funded ratio of the USPS share of the CSRS and FERS pension plans from 92.5 percent to 114.6 percent, and the funded ratio of the USPS Retiree Health Benefits Fund from 49.9 percent to 73.1 percent.

In the aggregate, the overfunding in the pension plans exceeds the remaining retiree healthcare liability, and the reported total funding of all three plans combined exceeds 100%.

Tables 2 and 3 on pp. 20-23 of Mr. Nadol's declaration show these results in tabular form:

Nadol Table 2

Federal Pension Plans - USPS Share - September 30, 2014[1]			
5.25% Discount Rate			
	CSFRS	**FERS**	**Total**
Accrued Actuarial Liability	201.5	104.5	306.0
Assets (at Par Value)	182.1	100.9	283.0
Unfunded Actuarial Liability	19.4	3.6	23.0
Funded Ratio (Calculated)	90.4%	96.6%	92.5%
7.00% Discount Rate			
	CSFRS	**FERS**	**Total**
Accrued Actuarial Liability	162.6	84.3	247.0
Assets (at Par Value)	182.1	100.9	283.0
Unfunded Actuarial Liability	-19.5	-16.6	-36.0
Funded Ratio (Calculated)	112.0%	119.6%	114.6%

(1) Units other than percentages in billions of dollars.

Nadol Table 3

USPS Retiree Health Benefits Fund - September 30, 2016[1]	
3.90% Discount Rate	
	USPS RHBF
Accrued Actuarial Liability	104.0
Assets (at Par Value)	51.9
Unfunded Actuarial Liability	19.4
Funded Ratio (Calculated)	49.9%
7.00% Discount Rate	
	USPS RHBF
Accrued Actuarial Liability	71.0
Assets (at Par Value)	51.9
Unfunded Actuarial Liability	19.1
Funded Ratio (Calculated)	73.1%

(1) Units other than percentages in billions of dollars.