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

COMMENTS OF AMERICAN BANKERS ASSOCIATION
(March 20, 2017)

The American Bankers Association (ABA),[1] on behalf of its member banks, is pleased to provide the following comments to the U. S. Postal Regulatory Commission (PRC) in response to the statutory review of the system for regulating rates and classes for market dominant products.

Whether through periodic statements or marketing communications, every single day banks reach out to customers to provide them with information to assist them with their financial interests. Technological innovation and costs drive banks to consider alternative forms of delivery in the service of our customers, yet mail still remains an important vehicle of distribution. Banks are one of the largest customers of the Postal Service, accounting for a significant amount of mail volume and postal service revenue annually. From the Postal Service's perspective, the billions of pieces of mail banks annually send are generally highly-profitable commercial mail, and light-weight,

[1] The American Bankers Association is the united voice of America's hometown bankers—small, regional and large banks that together employ more than 2 million women and men, hold nearly $17 trillion in assets, safeguard $12.8 trillion in deposits and extend more than $9 trillion in loans. Through a broad array of information, training, staff expertise and other resources, ABA supports America's hometown bankers as they perform their critical role as drivers of America's economic growth and job creation.

automation-compatible letter mail, making banks a key stakeholder for the Postal Service. The ABA and its member banks highly value the Postal Service and its services, and are committed to identifying long-term solutions to ensure an efficient, self-sustaining, and affordable U.S. postal system.

The Structure of the Current Rate System is Working

In an era where more and more communications are being shifted to digital channels, it is important to the long-term future of the Postal Service to have affordable, predictable, stable postal rates. Stable postage rates that remain at or below the Consumer Price Index (CPI) provide the predictability necessary for banks to plan for the robust direct and standard mail programs our members want to achieve their mission and goals. The current CPI cap system also provides effective external motivation for the Postal Service to control costs and scale to today's mail volume. As mail volumes and service continue to decline, eliminating the price cap endangers the Postal Service's financial viability because it will inevitably speed the shift to digital distribution, and thus, significantly reduced postal volume.

In the enactment of the Postal Accountability and Enhancement Act (PAEA),[2] Congress sought to promote efficiency, transparency, and accountability with respect to rate regulation of market-dominant products. The fundamental compromise of the PAEA was granting the Postal Service increased pricing flexibility in exchange for granting mailers the certainty and security of affordable, predictable postal price increases in the form of a statutory limitation on rate increases through the CPI price cap. The CPI cap

[2] P.L. 109-435 (2006).

was meant to allow mailers and businesses "to accurately budget for rate increases," and this mechanism has "reduced disruption to mailer operations and permitted mailers to plan their mail programs with regular reliability."[3] Moreover, 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 inefficiency in the Postal Service. In order to keep growth in prices equal to or under the rate of change in the CPI while earning net income, the Postal Service must keep its costs down through efficient management of its resources. It also must focus its attention on available opportunities for growth.

Those goals have largely been met. The Postal Service has significant pricing flexibility to change prices more quickly (consistent with statutory Objectives 4, 5, and 6). PAEA also grants the PRC the power to allow the Postal Service to increase rates beyond the cap in emergency, or "exigent," circumstances, as it did in 2013 when it approved a 4.3 percent exigent increase. The price cap has succeeded in moderating and smoothing out postal price increases, providing commercial mailers the certainty they need to make business and investment decisions concerning the mail. Ensuring affordable, predictable and stable price increases is essential to commercial mailers and to the future of mail (consistent with Objective 2). The price cap has also helped to drive efficiency and cost discipline in the Postal Service's operations (consistent with Objective 1). By focusing on the growth of e-commerce and package delivery, the

[3] *Outside the Box: Reforming and Renewing the Postal Service, Part I – Maintaining Services, Reducing Costs and Increasing Revenue Through Innovation and Modernization, Before the S. Comm. on Homeland Security and Gov't Affairs*, 113th Congress (Sept. 19, 2013) (written statement of Ruth Y. Goldway, Chairman, U.S. Postal Regulatory Commission, at 9).

Postal Service has offset much of the decline in volume for First Class and Standard mail.

As a result, the Postal Service maintained continuous operations despite significant mail volume declines associated with electronic diversion and the Great Recession. The effectiveness of the price cap is also demonstrated by the fact that the Postal Service continues to generate sufficient revenues on an operating basis. The Postal Service's financial report for FY 2016 showed a $610 million operating profit.[4] Indeed, for the past three years, the Postal Service has reported positive controllable income.[5] The Postal Service held approximately $8.1 billion of unrestricted cash entering FY 2017.[6] Dramatic growth is forecast on the horizon: in FY 2017, shipping and packages revenue is forecast to increase $1.8 billion through an expected volume increase of 7.6%.[7]

To be sure, the Postal Service continues to face significant financial challenges, but these challenges are caused primarily by statutorily-mandated and uncontrollable expenses related to prefunding requirements for retirement and retiree health benefits obligations. ABA strongly supports Congressional efforts to enact meaningful postal reform legislation to address these unfunded liability issues, and has actively sought enactment of proposals that provide meaningful reform.[8] These issues must be

[4] United States Postal Service 2016 Annual Report to Congress at 4, *available at* https://about.usps.com/who-we-are/financials/annual-reports/fy2016.pdf
[5] *Id*. at 15.
[6] *Id*. at 24.
[7] *Id*.
[8] *See, e.g.*, letter of the American Bankers Association and Financial Services Roundtable to the House Committee on Oversight and Government Reform, March 16, 2017, *available at* http://www.aba.com/Advocacy/LetterstoCongress/Documents/LetterforOGRPostalMarkup.pdf (advocating support for legislation that would address Postal Service legacy benefit obligations).

addressed, but the solutions for these problems are multi-faceted, far beyond the scope of the 10 year review.

The Commission's focus here is much more limited – a review of the modern rate system it established under the PAEA. Viewed through that limited focus, the Commission should draw but one conclusion: the current structure works.

CPI Cap Modification and Diversion Risk

Even if the PRC had the authority to modify the statutory price cap (as discussed below, it does not), it would be imprudent for it to do so. Trying to solve the financial problems of the Postal Service by means of price increases alone poses a significant risk for the Postal Service. As rates rise, the cost-benefit calculation made by mailers of all sizes, including many large and small banks across the United States, would change. The banking industry is a large overall mail volume industry in part because it is a convenient and cost-effective way for banks to communicate with their customers, and for customers to remit payments to banks. With the advances in technology and security that have occurred even since passage of the PAEA, consumers are increasingly using electronic means to conduct banking and other financial transactions for ease, speed, and convenience. Innovations in smart phones, tablets, and mobile internet communications have facilitated growth in electronic platforms, and are increasingly becoming the standard for banking transactions.

Large, unpredictable price increases will accelerate these trends, driving volume out of the system, and hastening USPS's financial decline.

The Financial Condition of the Postal Service Should Not Be Undersold: The PRC's Financial Ratio Analysis is Misplaced

As discussed above, the Commission's review occurs against a backdrop of a Postal Service that is, by many objective measures, improving its performance. As it conducts its review, the PRC should ensure that it is properly considering the state of the Postal Service as it evolves. The PRC should also realize the limits of some metrics that might otherwise appear useful: the Postal Service is not a business, does not have a profit motive, and should be evaluated through a lens that recognizes it is ultimately an instrumentality of the U.S. Government.

The PRC, in part, uses standard financial ratio analysis to analyze the financial well-being of the Postal Service:

> The Commission's Financial Analysis report uses "ratio analysis" to measure the profitability, solvency, and financial stability of the Postal Service. As detailed in the Commission's Financial Analysis reports, ratio analysis is used to conduct a quantitative analysis of information in a financial statement. Ratios are calculated from current fiscal year numbers and are then compared with previous years and historic averages to determine the Postal Service's financial performance. The ratios explain the Postal Service's financial health and provide valuable insight into its past performance. The financial data used in the ratio analysis is derived from accounting information not adjusted for inflation, changing demographics, industry dynamics, or government regulations.[9]

Based in part on these analyses, the PRC often finds the Postal Service to be in difficult financial conditions.

[9] Testimony of Robert G. Taub, Acting Chairman, Postal Regulatory Commission, to the Senate Committee on Homeland Security and Governmental Affairs, Jan. 21, 2016 at 12, *available at* http://www.hsgac.senate.gov/download/testimony-taub-2016-01-21.

We caution against the use of ratio analysis to analyze the financial well-being of the Postal Service, for the very same reasons that Chairman Taub, himself, recognizes: financial analysis used in the private sector may not be directly relevant to government agencies because revenue streams, equity structures, and management incentives differ.

Postal Service revenue streams, for example, are in fact different from those in the private sector, since revenues for products paid for through meters and stamps are often received well in advance of when the costs for the products are expended. Equity structures may be very different. Consider this:

- While the Postal Service carries its real estate on its books at about $13.2 billion, the Service's Office of Inspector General indicates that the fair market value of the real estate "has been estimated as high as $85 billion."[10]
- Further, although the pension liability in 2015 was $303.1 billion, the Postal Service had $282.6 billion in the fund to account for this liability.[11] That is a funding level of over 93%. While that still leaves 7% unfunded, most companies would look at the U.S. Postal Service enviously. Indeed, as the Postmaster General noted to Congress, a 93% funding level is higher than the average funding level for the Fortune 1000.[12]

[10] U.S. Postal Service Office of Inspector General, *Considerations in Structuring Estimated Liabilities* at 3, Jan. 23, 2015, *available at* https://www.uspsoig.gov/sites/default/files/document-library-files/2015/ft-wp-15-003_0.pdf.
[11] 2016 Form 10-K, United States Postal Regulatory Commission, at 24, *available at* https://about.usps.com/who-we-are/financials/10k-reports/fy2016.pdf.
[12] Testimony of Megan J. Brennan, Postmaster General and Chief Executive Officer, U.S. Postal Service, Before the Senate Homeland Security and Governmental Affairs Committee, Jan. 21, 2016 at 10.

Finally, unlike any private sector entity, the Postal Service is backed by the U.S. Government. As a result, while there may be political consequences, there is no immediate penalty associated with the failure to fund some of the Postal Service's larger obligations. This is something the Postal Service understands:

> Disruption of the mail would cause undue hardship to businesses and consumers, and in the event of a cash shortfall, the U.S. government would likely prevent the Postal Service from significantly curtailing or ceasing operations.[13]

Enjoying the comfort of knowing their operations will continue no matter what makes the Postal Service decidedly different than the private sector. Thus, traditional financial metrics comparing the Postal Service with private entities are not the most appropriate.

The Commission Does Not Have the Authority to Modify the Price Cap

The Commission does not have the authority to modify the statutory price cap and any attempt to do so would amount to a dramatic and unsupportable regulatory overreach. The Commission has previously and correctly held that the price cap is "central" and "indispensable."[14] Any suggestion that the rate cap is not applicable to an alternative system of regulation established by the ten year review would be inconsistent with and an unreasonable interpretation of the plain language of the statute.

The CPI cap is a prominent feature of statutory architecture; indeed, the very first requirement of the rate system contemplated by PAEA is the CPI cap. *See* 39 U.S.C. 3622(d)(1) ("The system for regulating rates and classes for market-dominant products <u>shall</u> (A) include an annual limitation on the percentage changes in rates to be set by

[13] 2016 Form 10-K, *supra* note 11, at 49.
[14] Docket No. R2010-4, Order No. 547 (Sept. 30, 2010) at 49.

the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index") (emphasis added). Nor can the statutory requirement that the Commission undertake this proceeding suggest that the CPI cap applied only to the *first* rate system the Commission might establish. If that were true, Congress would have said so. Rather, the consistent use of the word "system" throughout the section, rather than qualifiers such as "first system" or "initial system" or "system preceding the 10 year review," suggests Congress contemplated the same requirements applying to any and all rate structures the Commission would create. At all times there is only one system—the price cap <u>shall</u> apply to the first system, and <u>shall</u> apply to any system created thereafter. *See* 39 U.S.C. 3622(d)(1).

In any event, by its terms, this review is limited to "the system for regulating rates and classes for market-dominant products established under this section," 39 U.S.C. 3622(d)(3), which is the "modern system for regulating rates and classes for market-dominant products" the PRC created "within 18 months after the date of enactment of" PAEA. 39 U.S.C. 3622(a). In other words, Congress instructed the Commission to review the system the *Commission* created, not the limitations on that system *Congress* created. Although we are aware some stakeholders are encouraging the Commission to behave as a mini-legislature through this proceeding and remove or alter the rate cap, the Commission should resist the temptation. *See Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 842–43 (1984) (if Congress has "directly spoken to the precise question at issue," agency actions receive no deference on judicial review). The rate cap applies to any alternative system of regulation, just as it applies to the current system.

Without Scrapping It, The Modern Rate System Could be Improved

While the overall rate structure should not be changed, the Commission should use the 10 year review as an opportunity to promote efficiency and lower postage costs by requiring that the Postal Service improve workshare pricing. The Postal Service offers discounts on postage to mailers if they perform certain activities that reduce the Postal Service's costs (e.g., mail sortation, transportation, etc.). The significant majority of the mail that banks send is presorted commercial mail. This mail is among the most profitable of all postal products. Member banks should be rewarded for the work they perform that saves USPS money. Discounts that reflect the full value of the work our members perform means lower effective prices. Lower effective prices means mail remains a more attractive commercial medium and sales channel. Efficient workshare prices stimulate mail volume growth, stem erosion, and help Postal Service outsource the cost of mail processing operations, thereby minimizing costs and maximizing operational efficiency.

The PAEA states that workshare discounts cannot exceed 100 percent of the avoided costs (subject to certain exceptions). This makes sense: the Postal Service should not give away more than it saves. However, the current system does not include a floor on workshare discounts.

The Commission should by regulation require that workshare discounts be set at 100% of avoided costs (subject to appropriate exceptions). Doing so would promote efficiency objectives, and promote a more just and reasonable rate schedule (because setting workshare prices below avoided costs is exclusionary). This is consistent with Objectives 1 and 8, and Factors 5, 7, and 12. As the Commission recommended in its most recent report to Congress, requiring a "soft floor" on workshare discounts would not unduly constrain the Postal Service's pricing flexibility.[15] This is consistent with Objective 4.

Conclusion

The ABA respectfully requests that the PRC leave the current structure of the rate system in place. It is working, and has provided the Postal Service with the incentives necessary to modernize its operations in a way that should be commended. ABA values the Postal Service and stands ready to work with the Postal Service to discuss legislative solutions that address the fiscal pressures the Postal Service currently faces, and which continue to maximize the efficiency of the Postal Service, while stabilizing rates so demand for postal services remains strong. A decision by the PRC to radically change the rate structure will have short and long term consequences for the Postal Service that can and should be avoided.

[15] Postal Regulatory Commission, Section 701 Report: Analysis of the Postal Accountability and Enhancement Act of 2006 (Nov. 14, 2016) at Appendix A, https://www.prc.gov/docs/97/97815/2016%20701%20Report.pdf.

Respectfully Submitted,

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