Postal Regulatory Commission
Submitted 3/20/2017 4:14:04 PM
Filing ID: 99554
Accepted 3/20/2017

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 THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

(March 20, 2017)

On December 20, 2016, the Commission gave notice that it was opening the process for it to review the system for regulating rates and classes for market dominant products as required by the Postal Accountability and Enhancement Act of 2006 (PAEA). As a stakeholder that is a major user of the mail, but more importantly as the bargaining representative for thousands of postal employees committed to the mission of the U.S. Postal Service and its long-term financial sustainability, the American Postal Workers Union, AFL-CIO (APWU) submits the following comments to aid the Commission's review of the rate system for market dominant products.

In Part I, we give a general overview of the statutory mandate directing the Commission's review, and how that mandate must be exercised based on the important principle of Universal Service. In Part II, we detail ways in which the Postal Service is unable to achieve the Objectives and Factors established by Congress because of a rate system that artificially restrains the revenue necessary for the Postal Service's financial and operational sustainability. In Part III, we conclude with the recommendation that the Commission modernize the rate system for market dominant products by eliminating the Price Cap.

PART I: The PAEA Ten-Year Review

The APWU and its Stakeholder Interest

The APWU represents approximately 200,000 employees of the United States Postal Service, and hundreds of employees working in the private sector postal industry. The APWU was an important part and product of the creation of our modern-day Postal Service through the Postal Reorganization Act of 1970, and has been an active observer and participant in many of the changes in the postal industry over the past fifty years. The workers the APWU represents are not only the very front line of mail processing and retail services, but community members and mailers living and working in every state, from distant Alaska, to rural Missouri, to urban New York City. Our union and our members are intimately aware of the challenges the Postal Service faces in satisfying not only the Objectives in Section 3622 of the PAEA, but the overriding principle of Universal Service set out in Section 101 of the PRA. The APWU is also a major mailer itself, sending millions of mail items in all classes, including First Class. Even at the individual member level, APWU members facilitate the daily use of the U.S. Mail through their volunteer activities for thousands of civic, church, and social organizations throughout the country. It is because of the interest of postal workers and postal industry employees in doing their part to ensure a financially sustainable and thriving Postal Service that the APWU makes these comments to aid the Commission in its review and modification of the pricing system of market dominant products.

The Universal Service Obligation

Since Congress' reorganization of the Post Office Department in 1970, the U.S. Postal Service has been guided by a mission and policy statement premised on equity and fairness to the public, to its employees, and to mailers. This is clearly seen in the Universal Service Obligation by which Congress required that:

> (a) The United States Postal Service shall be operated as a basic and fundamental service provided to the people by the Government of the United States, authorized by the Constitution, created by Act of Congress, and supported by the people. The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities. <u>The costs of establishing and maintaining the Postal Service shall not be apportioned to impair the overall value of such service to the people.</u>
>
> (b) The Postal Service shall provide a maximum degree of effective and regular postal services to rural areas, communities, and small towns <u>where post offices are not self-sustaining. No small post office shall be closed solely for operating at a deficit, it being the specific intent of the Congress that effective postal services be insured to residents of both urban and rural communities</u>.[1]

The PRA policy statement, which drives the Postal Service's operations and policies, goes on to require the fair and equitable apportionment of operating costs to all users of the mail as well as the setting of minimum standards for providing competitive salaries and benefits for postal employees and ensuring expeditious collection, transportation, and delivery of important letter mail.[2]

---

1 Postal Reorganization Act, 39 U.S.C. §101 (emphasis added).

2 39 U.S.C. §101 (d), (c), and (e).

The Commission's 2008 *Report on Universal Postal Service and the Postal Monopoly* makes two cogent points important to this review. First, the Commission affirmed, correctly, that Universal Service – the requirement that a baseline of postal services be provided and available to every U.S. resident -- is a paramount and integral part of the Postal Service's mission and purpose. The second point speaks to the challenge facing the Commission in this review. Among the aspects that make up the Universal Service Obligation are two primary priorities -- affordability and quality of service. Universal Service must be affordable to users or risk being inaccessible because of cost. But at the same time, to be a worthwhile public service, Universal Service must be a guarantee of quality postal services for both mailers and recipients. Providing the latter while ensuring the former is the key balance the Commission should strike as it considers the efficacy of the rate system for market dominant products.

A balance that provides the Postal Service with sufficient revenue and the public with affordability and quality service is not impossible to find. The Postal Service's Inspector General recently studied price elasticity of postal services, and concluded that postal services, particularly market dominant services, are not price sensitive.[3] Not only is increasing rates not discouraging to the average mailer, but lowering rates does not have a noticeable impact on mail volume. On this last point, the OIG noted that

> Widespread discounting among these market dominant products that lowers price levels will reduce revenue. Such indiscriminate use of discounting, therefore, is a counterproductive pricing strategy. Mailers are unlikely to increase volume sufficiently to offset the reductions in price.[4]

---

[3] USPS OIG, *Analysis of Postal Price Elasticities* (May 1, 2013).

[4] Id. at 7.

The conclusion to be drawn from this study is that to maintain the quality of Universal Service, the Postal Service has room to raise rates without negatively impacting affordability or mail volume.

The PAEA 10 Year Review and the Commission's Authority

It is important to the sustainability of the Postal Service that the Commission comprehensively review the rate system from various perspectives, and recognize the Commission's power to make changes including substituting an alternative system for the CPI rate cap. The Commission does not have authority to change the law on or regulate, for example, employee rights and representation found in Chapters 10 and 12 of the PRA. These provisions pre-date the PAEA and were successful in establishing stability in the area of employment and labor that Congress saw fit not to disturb in 2006. Similarly, the Commission's authority to revise Section 3622 (e) on Workshare Discounts is limited in that its placement in the PAEA following Section 3622 (d) (3) indicates that Congress intended to put Workshare Discounts outside of the "system" the Commission is charged with reviewing. Congress did intend, however, that the Commission would have the authority to make substantive changes to the rate system itself to ensure the Objectives and Factors – including the important Objective Five – are met even as circumstances change. As Senator Susan Collins, Chairwoman of the Senate Committee for Homeland Security and Government Affairs, noted from the floor of the Senate about the passage of the PAEA:

> After 10 years, the Postal Regulatory Commission will review the rate cap and, if necessary, and following a notice and comment period, the Commission will be authorized to modify or adopt an alternative system.

While this bill provides for a decade of rate stability, I continue to believe that the preferable approach was the permanent flexible rate cap that was included in the Senate-passed version of this legislation. But, on balance, this bill is simply too important, and that is why we have reached this compromise to allow it to pass. We at least will see a decade of great stability, and I believe the Postal Rate Commission, at the end of that decade, may well decide that it is best to continue with a CPI rate cap in place. Is also, obviously, possible for Congress to act to reimpose the rate cap after it expires. But this legislation is simply too vital to our economy to pass on a decade of stability. The consequences of no legislation would be disastrous for the Postal Service, its employees, and its customers.[5]

[5] Cong. Rec. S11675 (H.R. 6407, S.662) (December 8, 2006).

PART II: The Present Rate System for Market Dominant Products Is Failing to Meet Congress' Objectives

Postal Service Challenges Caused by the Price Cap

While the rate system for market dominant products must meet Objectives required by Congress, it is important that the Commission not view the Objectives in isolation from the overall policies and mission of the Postal Service. In fact, the Objectives should be viewed as guideposts that lead the Postal Service towards satisfying Congress' policy statement in the Postal Reorganization Act, a policy statement that did not change with the PAEA. Even if any single Objective may seem to be met, therefore, it is important to view them as part of a whole. When looked at holistically, one thing is clear – the Postal Service is failing on a number of key performance indicators because of the revenue limits caused by the Price Cap. Without a rational, flexible system that allows the Postal Service to respond to increasing numbers of delivery points, changes in mail volume, as well as the economy and costs more generally, the Postal Service is limited in its ability to innovate, modernize, or plan and deliver reliable secure postal services.

The importance of First Class mail to the sustainability of the Postal Service cannot be overstated, even today with falling mail volumes. In 2007, First Class mail made up about 65 percent of the total amount of what all mail and services contributed towards institutional costs. Standard mail contributed about 27 percent and the products that would become competitive products (plus parcels) contributed a little less than six percent. In 2016, First Class mail still made up almost 56 percent of total contribution (its contribution did fall by $2.3 billion with the decrease in mail volume), standard mail contributed about 23 percent, and competitive products (including parcels) contributed almost 21 percent of the total contribution. At the same time, total delivery points grew by five percent between 2007 and 2016, an increase of 8.1 million delivery points. This growth in delivery points shows the value of the postal network, which allows mailers to touch every business and household in the country. It also points, however, to risks arising from First Class mail's support of the system as well as problems with evaluating the wrong metrics to gauge whether the current system is achieving the Objectives.

The challenge, as noted earlier, is achieving quality Universal Service and having a revenue system that is flexible and sustainable. Looking at private sector models is unsatisfying; private sector comparisons lack the complexity of the Postal Service's unique business model. Chairman Taub has correctly rejected industry efforts to equate the Postal Service with a private business.[6] He pointed out that, unlike private firms, the Postal Service's ability to adjust to decreased volume level is limited by its Universal Service Obligation. This exposes an underlying inconsistency in many industry objections to elimination of the Price Cap. On the one hand, mailers argue the Postal Service should adjust to adverse conditions by downsizing and cutting costs, as a private business can. But if the Postal Service is truly analogous to a private business, there would be no need to regulate postal rates at all -- the Postal Service would be as free as any other private market actor to make pricing decisions unilaterally and inequitably across markets. If the Postal Service were a private enterprise, it would balance added revenue against the risk of losing customers as its sole business

[6] PRC Order No. 1926, Dissent of Vice Chairman Taub at 5-6.

judgment. In that case, the wisdom or folly of Postal Service pricing decisions would not be a matter for regulatory review; it would simply be tested and determined by market forces.

The Commission must balance the demands of commercial mailers to lower or restrain rates with the need for revenue to operate a viable business and system. The industry argument for rate "fairness" presumes the public status of the postal monopoly.[7] Commercial mailers claim they are captive consumers like ratepayers of a public utility, precisely because users of First Class Mail do not have the same options as they do with competitive products.[8] But by the same token, the Postal Service does not have the same flexibility as a private firm to adjust in response to adverse conditions, because it has a Universal Service Obligation. The key problem is not, therefore, external and it is not necessarily an issue of proper management – it is the Price Cap which, in effect, sets postal revenue with no correlation to real costs or demand. The Price Cap has not allowed the Postal Service to reflect in its rates the real cost of delivering to every address at current standards.

The dilemma facing the Postal Service is clear – without the ability to adjust pricing in response to external conditions, the Postal Service is constrained in the ways in which can cover its financial deficiency. The primary concern that held up initial passage of the PAEA in 2005 was the sentiment that prices for First Class mail would

---

[7] *See* Verizon Communications v. FCC, 535 U.S. 467, 477 (2002).

[8] *See* National Association of Greeting Card Publishers v. U.S. Postal Service, 607 F.2d 392, 403-404 (D.C. Cir.1979).

rise disproportionately higher for individual mailers than for commercial mailers.[9] But the protection intended by having a Price Cap has left the Postal Service without the flexibility to respond to market forces and ensure fair rates for quality service. The Postal Service has largely realized all the efficiencies it can, forcing it to turn to service cuts and forestall capital investments in efficiency and new product development. In essence, the Price Cap has had the opposite effect from what was intended. Lower rates lead to a lowering of the quality of service. Rather than meeting the service objectives of enhancing the value of postal services, providing regular and effective access to postal services, and ensuring delivery, reliability, speed and frequency commiserate with industry best practices,[10] the Postal Service is locked into diminishing service to stay in line with a revenue stream suppressed by a Price Cap.

The Present System is Not Meeting Key Statutory Objectives

The Postal Service and the Commission were charged by Congress in ensuring the accomplishment of nine Objectives:[11]

(1) To maximize incentives to reduce costs and increase efficiency.

(2) To create predictability and stability in rates.

(3) To maintain high quality service standards established under section 3691.

---

[9] "Sen. Christopher S. Bond (R-Mo.), who has a hold on the bill, said it would mainly help corporate mailers. 'I'm going to continue to make sure the Postal Service isn't given the ability to hike unfairly the price of a stamp on the little guy while giving away the store to the large junk mailers,' said Bond, whose state is the headquarters of Hallmark Cards Inc. 'It's just a sham disguised as reform.'" C. Lee, *2-Cent Stamp Increase Is Only Temporary Fix for Postal Woes*, Washington Post (January 9, 2006).

[10] 39 U.S.C. §3691 (b).

[11] 39 U.S.C. §3622 (b).

(4) To allow the Postal Service pricing flexibility.

(5) To assure adequate revenues, including retained earnings, to maintain financial stability.

(6) To reduce the administrative burden and increase the transparency of the ratemaking process.

(7) To enhance mail security and deter terrorism.

(8) To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.

(9) To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

In determining whether the present system meets the statutory Objectives, the APWU urges that the Commission consider the system's overall ability to achieve the policies and mission of the Postal Service set out in 39 U.S.C. §101 and not merely the Factors listed in 39 U.S.C. §3622 (c). Moreover, the metrics the Commission proposes using to evaluate the Objectives show an inter-connectedness that is important for the Commission to consider. In several key respects, many of the metrics are interlinked in that successfully achieving one may result in failure of another. A matrix of check boxes where each Objective is evaluated with separate and distinct metrics does not provide an overall picture that allows the Commission to evaluate the success of the system and is not in keeping with Congress' intent. Thus, the Commission's analysis should not rest on a totaling of scores for a list of metrics. Ultimately, the APWU believes that when the Objectives are assessed in a dynamic interconnected way, the answer to whether the current system allows the Postal Service to meet the Objectives is an overwhelming "no."

As directed by the PAEA, each of the Objectives "shall be applied in conjunction with the others." In reality, prioritizing the Objectives is necessary for the Commission to assess the quality and sustainability of the system. Two of the nine Objectives are the most critical to the Postal Service achieving success as defined by the PAEA. If the system fails to support the Postal Service's efforts to meet Objective Three and Objective Five, it has to be considered unable to meet the required Objectives overall and, more importantly, the policies and mission of the Postal Service set out in Section §101. The Postal Service itself operates with a primary focus on these two Objectives as illustrated most recently in its four corporate performance goals for 2017: 1) deliver high quality service; 2) provide excellent customer experiences; 3) ensure a safe workplace and engaged workforce; and 4) sustain controllable income.[12] A Postal Service that does not have enough revenue to meet these performance goals, to deliver the mail on time, and to be financially stable enough to invest in the infrastructure needed to ensure future deliveries is not accomplishing its statutory mission.

Reviewing Key Objectives

Section 3622 (a) of the PAEA sets out nine Objectives that the system should be designed to achieve along with fourteen factors that should be considered in the process. This points to one major difference between the goal of the current docket and

[12] *Response of The United States Postal Service to Question 1 of Chairman's Information Request No. 25, ACR 2016* (March 10, 2017).

the goals of the Commission's Annual Compliance Determination (ACD). The latter is very narrowly focused on a few metrics measuring the Postal Service's compliance with the current system. The most recent ACD for FY2015 mentions the Objectives only six times, and three of those cite to the same Objective: "[t]o maximize incentives to reduce costs and increase efficiency." Nowhere in the most recent ACD does the Commission appear to evaluate how well the system is achieving each of the Objectives. When it comes to service standards, the ACD does not speak to Objective Three but rather to Section 3652 on the requirements related to reporting on the Postal Service's performance with respect to its service standards. It is clear, however, that Objective Three, "[t]o maintain high quality service standards established under section 3691," and Objective Five, "[t]o assure adequate revenues, including retained earnings to maintain financial stability," are paramount to the sustainability of the Postal Service. These two Objectives are, therefore, where we begin our analysis.

Objective Three – Maintain High Quality Service Standards in Accordance with the PAEA

The Commission has explained that the service standards detailed by the Postal Service in 39 C.F.R. § 121.1 are service "expectations," not service "requirements."[13] The Commission recognizes, nonetheless, that:

> Service standards play an important role, even though they do not act as legal requirements. They provide information to the customer on what service level is to be expected for various postal products. They also provide a starting point by which actual service performance can be evaluated. This provides the impetus for the Postal Service to meet customer expectations, including designing a postal network capable of meeting these expectations.[14]

In its 2015 ACD, the Commission stated that "the Commission finds that the majority of products failed to meet their service performance targets for FY 2015."[15] While the Commission's role in the ACD process limits its input to expressing "concern", requiring additional data, and requesting plans for improvement, this ten-year review sets a greater opportunity for the Commission to review Objective Three. Whether service standards are considered "requirements" or "expectations and targets," the fact remains that the current system of rate determination does not provide enough revenue for the Postal Service to maintain the higher quality service standards that were in place in 2006 when the current nine Objectives were set out. Nor does the Postal Service seem

---

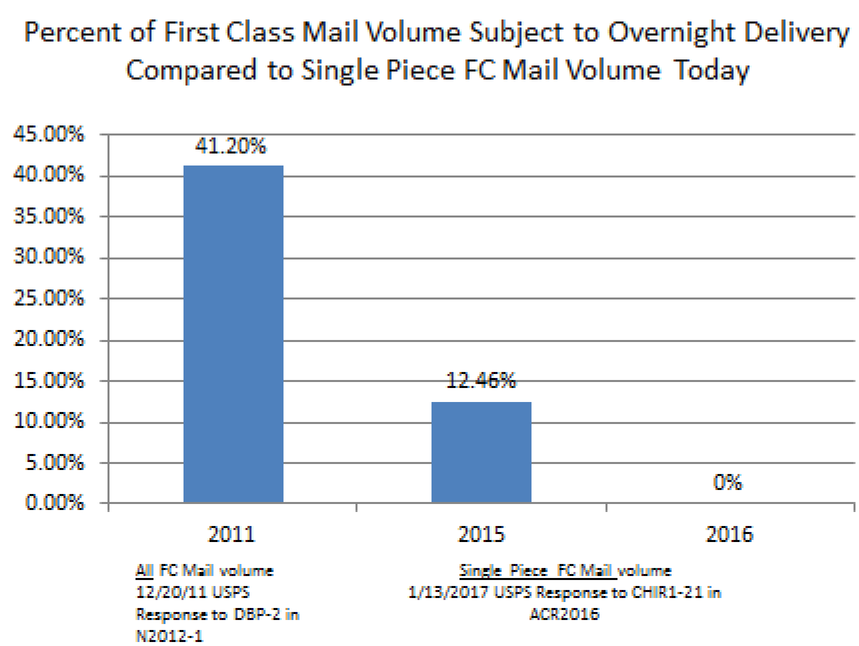
[13] PRC Order 2512 at 9 (May 27, 2015).

[14] Id. at 10.

[15] Annual Compliance Determination FY 2015 at 3.

able to meet the today's lower targets given that several of the comments in the 2016 ACR docket point specifically to the failure of the Postal Service to provide good service.[16]

Service has degraded under the Price Cap. While pre-2006 data is not readily available, in late 2011, 41.2% of First Class mail was delivered overnight.[17] In contrast, in 2016 there was no overnight mail delivery for First Class single piece letters and cards, and only a small percentage of First Class presort letters and cards were delivered overnight.[18]



16 *See* Reply Comments of the Association for Postal Commerce (February 13, 2017); Comments of the Public Representative (February 2, 2017).

17 USPS Response to DBP-2 in N2012-1 (December 20, 2011).

18 While the percentage of First Class presort letters and cards delivered overnight does not appear to have been requested in the most recent ACR, the service standard reports imply that ten to twelve percent of this class is delivered overnight if mailers can place mail in the system early enough in the day.

Furthermore, the Postal Service is struggling to meet its current lower level of service for First Class mail (this is true for most of the rest of its classes as well). The Postal Service has never attained the service standards for First Class flats and parcels since they were first set in 2010. Despite significantly reducing its service commitments in January 2015, the Postal Service has been unable to attain any of its First Class standards in FY2015 or FY2016. It also fell short on First Class 2-day and 3-5 day goals except for 2-day presort letters in FY2014, and missed all the 3-5 day goals except for presort letters in FY2013. It has never gotten closer than about nine points on achieving its periodicals service standards, and has consistently fallen short on its standard mail service standards except for high-density and saturation letters.

Meanwhile, service complaints are growing. Although certainly not a complete census of the country's mail problems, the Commission's list of Comments and Inquiries by Issue show that the number of service complaints are increasing. In FY2010, the Commission reported that of 392 complaints, the single highest category was "missing mail" accounting for about a third of all complaints. By FY2014, the Commission was receiving over 7,000 Comments and Inquiries, with the two largest categories – together nearly 45 percent of the total – having to do with delayed or undelivered mail. During the next two years, the total number of complaints declined somewhat (although still exceeding 4,000 in FY2016), but over 40 percent of the complaints received still had to do with delayed or undelivered mail.[19]

[19] *Postal Regulatory Commission FY2016 Annual Report* at 18.

Several members of Congress have joined the criticism of the Postal Service's service, making their own observations on delayed mail and surveying their constituents on the topic with unfavorable results. Representative Jeff Fortenberry (R-NE), House Subcommittee on Government Operations Chairman Mark Meadows (R-NC), and Senator Heidi Heitkamp (D-ND)[20] have all noted numerous constituent complaints and reports about mail service. Numerous other reports of mail delays made by individual mailers fill the news, including complaints about delayed election ballots, a letter that took 69 days to go one block, and tax bills and insurance notices that are delayed or never arrive.[21] APWU-represented postal employees hear these complaints regularly and see the frustration of even the most loyal postal users as the reliability and speed of service decrease. These types of problems combine to make the average First Class mailer less and less confident in using the mail, not only for important payments and correspondence, but also for commercial mail and Internet purchases. It is evident that the current system, principally the restriction on revenue which leads to cutting service, is not supporting the quality service Congress expects.

---

[20] https://fortenberry.house.gov/media-center/fort-reports/fort-report-got-mail; https://youtube/FVqXeRGfUh4?t=1h9m23s; http://www.heitkamp.senate.gov/public/index.cfm/fixmymail

[21] http://www.goerie.com/grave-site-ceremony-honors-wilson-letters-to-the-editor; http://www.roanoke.com/news/dan_casey/casey-check-was-in-the-mail---for-days/article_7108d66c-4d8e-548c-be22-201ee22bf457.html?utm_source=apwu&utm_medium=sm&utm_campaign=wire; http://www.telegram.com/article/20151020/NEWS/151029886

Objective Five –
Assure Adequate Revenues to Maintain Financial Sustainability

Objective Five requires that the rate system assure adequate revenues, including retained earnings, to maintain the Postal Service's financial stability. Financial stability, in turn, speaks not only to the Postal Service being able to meet its financial obligations in the current quarter, but also having enough capital to invest in operations going forward that will maintain customer confidence in its continued viability.

Over the past decade, the Commission itself has noted numerous times that the financial stability called for in Objective Five is not being met. As the Commission has observed:

- "The Postal Service is not currently generating sufficient funds to cover mandated expenses or invest in critically deferred capital needs."[22]

- "Despite the slight improvement in liquidity, the Postal Service faces significant financial challenges. The net book value of the Postal Service's assets remains significantly lower than its liabilities, and the Postal Service has been unable to make the statutorily required payments to the RHBF since FY 2012."[23]

- "Postal Service liquidity is insufficient to significantly improve operational efficiency."[24]

---

[22] *Section 701 Report Analysis of the Postal Accountability and Enhancement Act of 2006* at 4 (November 14, 2016).

[23] *Financial Analysis of United States Postal Service Financial Results and 10-K Statement FY2015* at 3 (March 29, 2016).

[24] *Financial Analysis of United States Postal Service Financial Results and 10-K Statement FY2014* at 2 (April 1, 2015).

- "By using a qualitative assessment of the Postal Service's finances, the Commission concludes that the Postal Service's financial condition has deteriorated significantly since the passage of the Postal Accountability and Enhancement Act (PAEA)."[25]

- "[T]he Postal Service's current financial situation calls into question its long-term viability."[26]

- "To remain viable, prices must be set to cover the total costs of the Postal Service. As volume declines, the fixed costs must be spread over fewer pieces. The difficulty in recovering fixed costs through pricing has led the Postal Service to find ways to substantially reduce those fixed costs. The Postal Service has proposed a new delivery schedule that includes package delivery Monday through Saturday, and mail delivery Monday through Friday. It has also begun moving forward with significantly reducing overnight and two-day service, and consolidating approximately 50 percent of its mail processing network."[27]

- "The Postal Service's basic function is to 'provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people.' 39 U.S.C. § 101(a). The Commission developed a modern ratemaking system as required by the PAEA which, among other things, 'assures adequate revenues, including retained earnings, to maintain financial stability.' Despite this objective, the Postal Service's ability to continue to meet its service obligation is in serious jeopardy, in part, due to its inability to generate sufficient revenues to meet all of its financial obligations."[28]

---

[25] *Financial Analysis of United States Postal Service Financial Results and 10-K Statement FY2013* at ii (April 10, 2014).

[26] Ibid.

[27] Annual Compliance Determination FY2012 (Revised) at 7 (May 7, 2013).

[28] *Annual Compliance Determination FY2011* at 21 (March 28, 2012).

- "Declining mail volumes, especially in First-Class, and the PAEA mandated pre-funding requirements for the retiree health benefits fund, as currently structured, could impede the Postal Service's ability to meet these requirements of title 39."[29]

- "The Postal Service lost $5.1 billion in FY 2007, $2.8 billion in FY 2008, and $3.8 billion in FY 2009. The financial results for FY 2009 reflected the steepest decline in postal volumes since the Great Depression."[30]

- "While postal service remained at levels that were consistent with that mandate in FY 2009, the financial results for that year left a legacy of great risk that the mandates of sections 101 and 3622(b)(5) will not be met as early as the end of the current fiscal year."[31]

- "By the end of the fiscal year, total mail volumes had declined by 4.6 percent, or more than 9.5 billion pieces. Postal Service revenues also declined within the second half of the year, as the CPI-capped rate increase of 2.9 percent, implemented in May 2008, could not overcome the accelerating volume decline."[32]

- "If a downturn in the economy or other circumstance should further stress the Postal Service's cash flow, it risks not being able to pay some of its bills and could, in a worst case scenario, run out of cash."[33]

---

[29] *Annual Compliance Determination FY2010* at 21 (March 29, 2011).

[30] *Annual Compliance Determination FY2009* at 9 (March 29, 2010).

[31] Ibid.

[32] *Annual Compliance Determination FY2008* at 9 (March 30, 2008).

[33] Chairman Taub Congressional Testimony: *Accomplishing Postal Reform in the 115th Congress – H.R. 756, The Postal Service Reform Act of 2017* at 10 (February 7, 2017).

- "In summary, the Postal Service still faces significant financial obstacles for the future. The exigent surcharge was removed on April 10, 2016, because the Postal Service had collected all of the allowable $4.6 billion. With the growing liability of retiree health benefits, the inability to borrow for needed capital investments, and the continued loss of high margin First-Class Mail revenues, the important task of improving the financial condition of the Postal Service is daunting."[34]

- "Aside from the financial pressure of generating sufficient funds to remain solvent, the Postal Service must also be concerned about how to fund this $4 billion in universal service obligations. This obligation is in addition to those monies required to keep the mail moving, undertake capital investments, and pay other multibillion dollar obligations such as retiree costs."[35]

Several of the Commission's comments recognize that the major issue facing the Postal Service today was not anticipated in 2006 when the Price Cap was set. Falling mail volume (which was especially severe during the Great Recession of 2007-2009) combined with an expanding network of delivery points has led to overall less density in the system. This means that as mail volume declines and delivery points grow, each mail piece needs to pick up more of the cost of an expanding network. The current Price Cap on First Class mail does not provide sufficient flexibility for that to happen.[36] The Postal Service Office of Inspector General's 2013 study of the Price Cap describes the problem succinctly, noting that:

---

[34] Id. at 21.

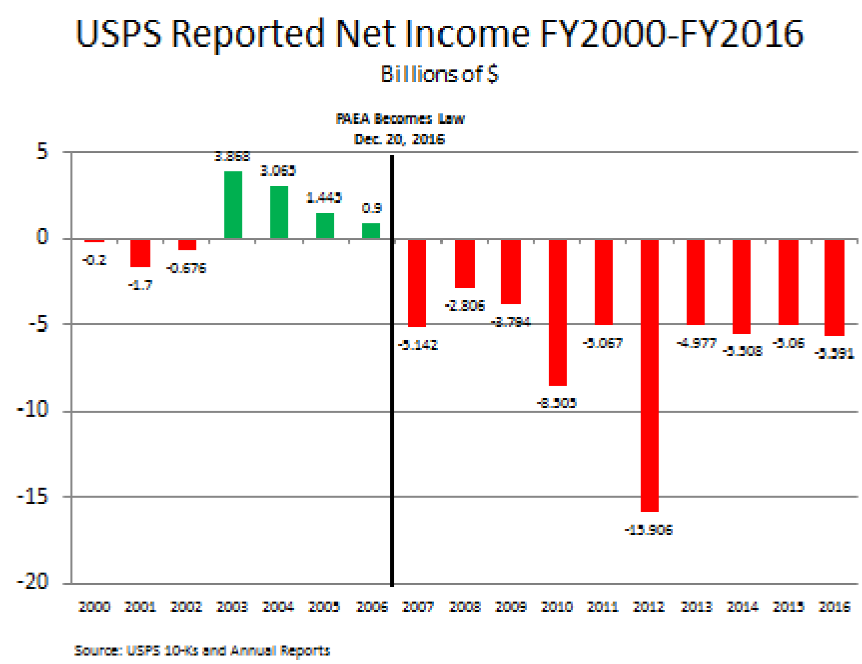
[35] Id. at 22.

[36] Objective Four envisions that a modern rate system would allow the Postal Service pricing flexibility. The current CPI Price Cap restricts needed flexibility. The changes in mail volume, mail mix, and density were likely not anticipated by Congress when it included a Price Cap in the PAEA.

> The present price cap formula was not designed for an environment of falling mail volumes. An unstated assumption under a traditional price cap is that volume will remain stable or preferably grow. Growth in the output of products is likely needed to cover costs, particularly in the case of the Postal Service where the network of delivery points is expanding. In addition, financial models indicate that a financial failure is likely in the medium to long term under the price cap as it is presently structured, even if Congress provides substantial short-term assistance and the Postal Service makes significant gains in efficiency.[37]

Financial sustainability under the Price Cap succumbs to these changes in demand which, even in the event they remain static, guarantees both short- and long-term financial struggles.

This difficult scenario where Postal Service revenue is artificially constrained by the Price Cap shows up in the basic financial metrics of the Postal Service as short-falls



in reported net income, maximum debt levels, and reduced capital spending. The

---

[37] *Revisiting the CPI-Only Price Cap Formula* (April 12, 2013).

Postal Service's negative net income numbers have been widely reported. While some of this red-ink has been the result of booked, but not paid, pre-funding payments to the Postal Service Retiree Health Benefits Fund in recent years, the Postal Service's controllable net income does not reflect a vibrant financial situation. More importantly, the Postal Service used all of its borrowing authority in FY2012 to pay the amortization payments that Congress saddled it with in the PAEA. Consequently, over the past four fiscal years, the Postal Service's resources for capital investments have been severely restricted to only its self-generated cashflow. As a result, the Postal Service's capital commitments have been quite small.

To illustrate, the Postal Service owned over 227,000 vehicles in FY2016. Of its 200,000 vehicle delivery fleet, approximately 145,000 vehicles or 72% are at least twenty years old. These aged vehicles keep the Postal Service's gas and maintenance costs high. In 2014, the Government Accounting Office reported that the Postal Service had been prepared to replace a large proportion of its fleet, but because of a lack of financial resources had to defer those replacements.[38] The OIG's 2014 report on the subject stated that the "Postal Service developed a short-term plan to maintain operations until it can implement its long-term plan, beginning in FY 2017, to replace its aging fleet with the next generation of collection and delivery vehicles. But it lacks the financial resources to fully develop or fund these plans."[39] Chairman Taub very recently

---

[38] GAO, *U.S. Postal Service Actions Needed to Strengthen the Capital Investment Process* (January 2014).

[39] USPS OIG Delivery Vehicle Fleet Replacement, Report DR-MA-14-005 (June 10, 2014).

noted a similar conclusion, testifying before Congress that

> These low liquidity levels in recent years have impeded the Postal Service's ability to make capital investments in infrastructure and hindered the growth and productivity enhancements in key assets required for primary postal operations. As the Postal Service noted in the FY 2016 Form 10-K statement, it now operates an aging vehicle fleet, increasing the need, and consequently the cost, for maintenance and repair. Also unmet is the need to invest in sorting and handling equipment to fully capitalize on business opportunities in the growing package delivery markets.[40]

The OIG's analysis showed that the Postal Service has enough vehicles to sustain delivery operations in the short term, but it could experience delivery vehicle shortfalls if there is an unexpected decrease in vehicle inventory or increase in motorized vehicle routes." Even now, the Postal Service will only begin taking delivery of prototypes of new vehicles as FY2017 winds down. A complete investment remains far off in the future.

Clearly, the PAEA revenue system is failing to produce the funds to allow for these and other vitally needed investments to be made in the Postal Service's infrastructure. In a 2016 report, the OIG noted that "the Postal Service must now compete against the private sector, which uses the latest technologies for parcel mail volume to keep its average cost per piece low."[41] The Postal Service's ability to use its information network to resolve bottlenecks and provide end-to-end visibility of the mail depends on continued investments in its IT network to provide data to customers and employees in real time and to provide digital enhancements of hard copy mail (e.g.,

---

[40] Chairman Taub Congressional Testimony: *Accomplishing Postal Reform in the 115th Congress – H.R. 756, The Postal Service Reform Act of 2017* at 8 (February 7, 2017).

[41] USPS OIG, *Peeling the Onion: The Real Cost of Mail,* Report Number RARC-WP-16-009 (April 18, 2016).

Informed Delivery). The investments needed to maintain the system and make even minor innovations simply cannot happen under the restrictions of the current revenue system driven principally by the Price Cap on market dominant mail.

Objective One –
Maximize Incentives to Reduce Costs and Increase Efficiency

We turn now to another Objective which, although not as critical as Objectives Three and Five, is important to the Commission's review. Objective One is a central objective in any business, but it can only be taken so far without damaging the core service. While the Price Cap has been successful in forcing cost reductions, it has failed to incentivize efficiency while maintaining the quality of the underlying core service provided by the Postal Service. As discussed earlier, because of limits on revenue, the Postal Service is struggling to meet current service standards, which it has adjusted down several times since 2006. The Postal Service has had to make other cuts in service that are not necessarily captured in the service standards, such as cutting the hours at thousands of post offices, plant closures and consolidations, and removing blue mailboxes.

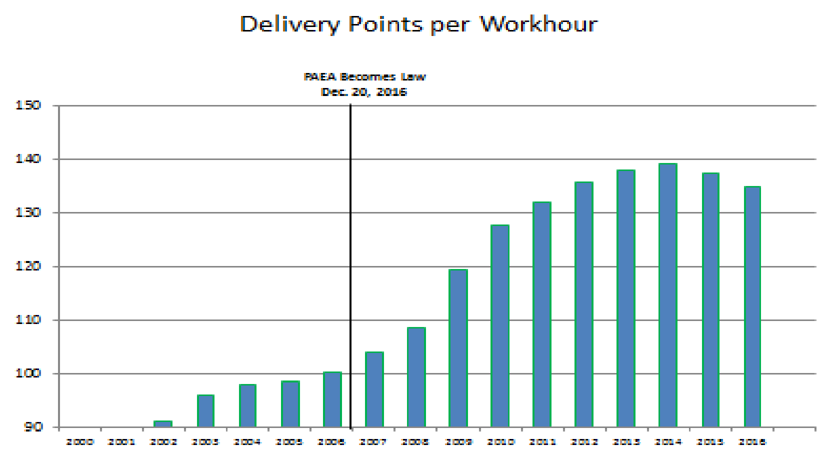
Yet Total Factor Productivity has continued to grow despite the loss of volume during the recession of 2007-2009. The Postal Service cut 350,000 workhours out of the system between 2006 and 2014 (the most recent low point for workhours), a 24% decrease. That came, however, at the cost of service; it also came at a cost to the communities that lost their Postal facilities during network rationalization.[42] Since 2014, workhours have increased about 4.5% as the Postal Service deals with a change in mail

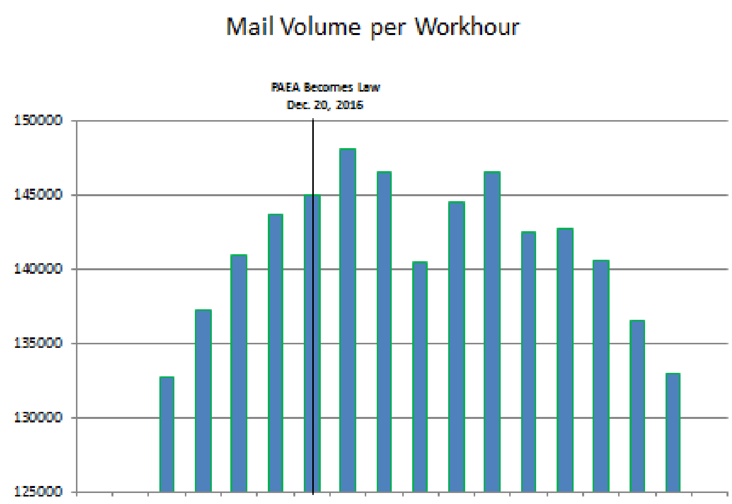
---

[42] *See* Fiscal Policy Institute, *The Economic and Community Impact of Downsizing Postal Sorting Operations in Youngstown, Ohio; The Economic and Community Impact of Downsizing Postal Sorting Operations in Tucson, Arizona; The Economic and Community Impact of Downsizing Postal Sorting Operations in Newburgh, New York; The Economic and Community Impact of Downsizing Postal Sorting Operations in New Orleans, Louisiana; and The Economic and Community Impact of Downsizing Postal Sorting Operations in Huron, South Dakota* (November 2014) (available at www.apwu.org).

mix that requires more labor input and the recognition that improving service requires more resources.

The output measure used in calculating Total Factor Productivity attempts to capture both mail volume and delivery point expansion. The combination of weaker





volumes and expanding delivery points produces two very different metrics when considering efficiency, delivery points served per workhour, and volume per workhour.

As shown earlier, the number of delivery points served per workhour has increased dramatically, but the lower density per delivery point shows up in the mail volume per workhour measure. The Postal Service is serving more delivery points per workhour, but at the same time handling less mail per workhour. Eliminating the Price Cap will not make the Postal Service less efficient. Especially given the lack of capital, there are not enough productivity improvements possible to offset the decrease in mail volume and the growing network. Therefore, any metric used to judge Objective One's success must be considered against the lack of success for Objective Three and Objective Five.

PART III: The Solution – Eliminate the Price Cap

The Price Cap is the barrier to achieving a public postal system that satisfies the Universal Service Obligation and meets all of the Objectives set out by Congress. The priority of the Commission coming out of this review should be to reform the rate system by eliminating the Price Cap.

As shown, the Postal Service is locked in a cycle of financial unsustainability that is the product of the Price Cap. The combination of the artificial limits of the Price Cap and the significant contribution Market Dominant Products make to postal revenue means that addressing the Price Cap is critical. When Congress compromised on a Price Cap, it did so without foreseeing the changes and market forces that have shaped the Postal Service's operations and revenue over the past decade. Congress did not anticipate a decrease in mail volume, an increase if delivery points, a recession, and change in mail mix. To be sustainable and to provide quality universal service, it is necessary for the Postal Service to be able to respond to varied and unexpected changes with a rate system that is more flexible than permitted under a CPI Price Cap. If the Postal Service has the freedom to set rates based on demand, infrastructure needs, and market forces while always adhering to its mission and Universal Service Obligation, it will be able to better assure future sustainability to meet the needs of all mailers.

The critical action the Commission can and should take is to eliminate the Price Cap. Any other changes to the rate system simply will not have the level of impact to make them meaningful or constructive. There are other regulatory mechanisms and schemes that can be used to provide oversight and rate control and encourage efficiency that do not require the rigid and formulaic approach of a price cap. An alternative rate-making system without a Price Cap can be designed to meet statutory Objectives and still serve the Postal Service and the Commission obligations to maintain predictability and regularity. Eliminating the Price Cap does not have to eliminate the due process and predictability with which the Postal Service is obligated to operate. Accordingly, the APWU strongly recommends that the Commission eliminate the Price Cap and modify the rate-making system to maintain a transparent system that meets the statutory Objectives and Factors and the Postal Service's mission.

In addition to eliminating the Price Cap, the Commission should allow the Postal Service the opportunity to file for a rate "true up" for market dominant products without being subject to the constraints of any old or new rate-making system. Under any reasonable view of the Postal Service's financial condition, it is evident that laboring under the Price Cap for the past decade has put the Postal Service in a difficult financial situation. Consistent with the PAEA system itself which provided for an initial rate-setting proceeding outside of the Price Cap,[43] a similar opportunity following this ten-year review is appropriate. Allowing the Postal Service to regain lost ground and re-establish rates at levels that will better permit it to cover its real costs and provide capital and retained earnings for future investment is consistent with the PAEA and the purpose of the Commission's review.

---

[43] 39 U.S.C. § 3622 (f).

In conclusion, it is evident that the Price Cap prevents the Postal Service from achieving its statutory Objectives and mission. Particularly in meeting Objectives to maintain quality service and achieve adequate revenue for financial sustainability, the Postal Service is unable to satisfy Congress' goals because of the restraint on revenue the Price Cap on market dominant product imposes. As a result, the Postal Service fails not only to meet the statutory Objectives but its statutory mandate and mission to "bind the Nation together" through "prompt, reliable, and efficient services to patrons in all areas and…all communities." The Commission should eliminate the Price Cap and grant the Postal Service the opportunity to pursue a "true up" rate increase outside of the restrictions of any old or new rate-making system.

Respectfully submitted,

MURPHY ANDERSON, PLLC

Melinda K. Holmes
mholmes@murphypllc.com

Michael T. Anderson
manderson@murphypllc.com

Jason R. Veny
jveny@murphypllc.com

1401 K Street, N.W., Suite 300
Washington, D.C. 20005
(202) 223-2620
Fax (202) 296-9600

Counsel to the
AMERICAN POSTAL WORKERS UNION, AFL-CIO

Mark Dimondstein
President

Debby Szeredy
Executive Vice President

Elizabeth Powell
Secretary-Treasurer