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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 THE NATIONAL POSTAL POLICY COUNCIL, THE MAJOR MAILERS ASSOCIATION, AND THE NATIONAL ASSOCIATION OF PRESORT MAILERS

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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 THE NATIONAL POSTAL POLICY COUNCIL, THE MAJOR MAILERS ASSOCIATION, AND THE NATIONAL ASSOCIATION OF PRESORT MAILERS
(March 1, 2018)

The National Postal Policy Council ("NPPC"), the Major Mailers Association ("MMA"), and the National Association of Presort Mailers ("NAPM"), collectively, the "First-Class Business Mailers," hereby respectfully address the proposals set forth by Order No. 4258 ("*NPRM*").[1]

I. INTRODUCTION AND SUMMARY

The First-Class Business Mailers have a vital interest in preserving a strong and viable postal system. Their members are long-term Postal Service partners, regularly preparing and entering large volumes of high quality mail. The importance of the Postal Service --as part of the national communications infrastructure -- to their business operations cannot be overstated. On behalf of

[1] By submitting these comments, NPPC does not waive its concerns about Order No. 4257, for which it has filed a Petition for Review. *National Postal Policy Council v. Postal Regulatory Commission*, Case No. 17-1276 (D.C. Cir. order holding in abeyance Feb. 15, 2018).

[2] One large mailer has informed us that, in response to the higher rates proposed by the *NPRM*, it created a large task force to develop ideas to speed its mail out of the system.

[3] See Order No. 4257, Supplemental Views of Commissioner Nancy E. Langley at 2 ("While I agree with the Commission's decision to include the RHBF payments in its calculation of losses, it is important to note that the Postal Service's accumulated deficit of $59.1 billion includes $54.8 billion in expenses related to prefunding the RHBF").

our members and other mailers, the Postal Service delivers account statements, invoices, return payments, insurance policies, financial documents, utility bills, and countless other types of personalized or confidential business correspondence entered by our members and other mailers that serve to bind the nation together.

Each of our members operates in a competitive market environment. Every single member faces competitors in its line of business; each member, whether a mail owner or service provider, must constantly assess the cost and value of the mail channel. Our members face economic pressures and corporate demands for tight budgets, and – unlike the Postal Service -- do not have captive customers to whom they can readily pass along price increases, but instead absorb at least a portion of all increased costs. Today, there is no “pass-through” of higher postage to our customers.

As the Commission deliberates, it should remain mindful that First-Class business mailers also often begin their budgeting process many months (and some, well more than a year) before a calendar or fiscal year begins. When doing so, they keep a watchful eye not only on current prices and near-term trends in inflation, but also on indicators of future prices. When future postage prices appear likely to be higher (and certainly when they are likely to increase at a rate higher than inflation), the price/value calculation tilts in a direction unfavorable to mail, and triggers efforts to accelerate migration to digital and other communications alternatives.[2] We believe that the unexpected declines in

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[2] One large mailer has informed us that, in response to the higher rates proposed by the *NPRM*, it created a large task force to develop ideas to speed its mail out of the system.

First-Class volume in the past two years are due, in part, to the lingering aftertaste of the exigency surcharge as well as uncertainty regarding this very proceeding.

Finally, we understand that when business is declining, easy measures that do not force real change will not suffice. Restoring profitability requires setting business incentives to drive changed behavior. Approaches that do not link cost reductions or improved efficiency to profitability, or do nothing to encourage product innovation and growth in First-Class Mail, are not business-like solutions to the problem they purport to address. Focusing entirely on price increases in a declining market will not attract new investment; nor will it prove to be a successful model for the Postal Service.

A. The Proposals In The *NPRM* Are Legally Defective And Suffer From Numerous Omissions And Flaws

As the Commission is aware, the Postal Service's financial issues are almost entirely due to the statutory requirement that the Service make substantial transfers to the Treasury to prefund its future retiree health benefit premiums and to meet other obligations, such as supplemental contributions to the FERS fund. The Commission included these obligations in concluding that medium and long-term financial stability have not been achieved. Order No. 4257 at 157-129.

The Commission knows that the Postal Service has had an operating surplus during the price cap era. Order No. 4257 at 164. The Service's negative balance sheet (according to GAAP) and lack of available borrowing authority have been caused not by operations, but primarily by the Postal Service's retiree

health benefit prefunding and related obligations.[3] Those obligations are the responsibility of Congress, which when enacting the Postal Accountability and Enhancement Act ("PAEA") did not anticipate the transformation of the mailing industry and electronic communications that has occurred since 2006.

Neither the RHB prefunding debt nor the Service's other statutory obligations can be altered by the Commission;[4] they require a legislative solution.[5] And, indeed, the Commission, the Postal Service, the postal unions, and the mailing industry together with its suppliers in paper, printing, and more have all urged Congress to take action in recent years, but to no avail.[6]

Congress's failure to act, however, does not empower or even requires the Commission to "fix" the situation unilaterally. The Commission has only a particular set of powers within the statutory structure. One of those powers is to administer a price cap created by Congress to regulate the rates for market dominant products.

That Congress assigned the Commission to administer a price cap for rates for market dominant products, however, does not mean that the Commission can *exceed* that authority in an effort to solve broader problems that

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[3] See Order No. 4257, Supplemental Views of Commissioner Nancy E. Langley at 2 ("While I agree with the Commission's decision to include the RHBF payments in its calculation of losses, it is important to note that the Postal Service's accumulated deficit of $59.1 billion includes $54.8 billion in expenses related to prefunding the RHBF").

[4] The Commission cannot "allow the Postal Service to reamortize unfunded liabilities, administer employee benefits differently, change the frequency of delivery, or deliver profitable items restricted by statute." *NPRM*, Supplemental Views of Vice Chairman Mark Acton.

[5] *See NPRM*, Dissenting Views of Commissioner Tony Hammond.

[6] Were Congress to act, that would constitute a change circumstance requiring the Commission to revisit its proposals or conclusions in this docket.

affect the entire Postal Service. But the *NPRM* has proposed to do just that by offering three different schemes to violate the CPI-U price cap established by Congress.

The First-Class Business Mailers recognize that the Commission has proposed those changes with the best of intentions. Nonetheless, market dominant products are only part (and a declining one at that) of the Postal Service's business, and the regulatory regime for their rates exists to protect them from exploitation. Attempting to use the Commission's power over market dominant mail rates to solve the Postal Service's larger issues beyond the regulator's authority stretches the statute too far.

And there is a real danger that pushing rates ever upward will cause lasting damage to the Postal Service. What the Commission can do, however, is attempt to impose greater pressure for cost control and improving efficiency, areas in which the Service has faltered in recent years. It can also encourage the Postal Service to innovate in an effort to attract new volume or revenue.

It may well be that the Commission simply does not have the power to solve all of the problems it identified in Order No. 4257. Ultimately, Congress will have to enact postal reform. The First-Class Business Mailers urge the Commission to step back from the temptation to do something precipitous now in an effort to fix problems not of its making.[7]

The scope of the Commission's legal authority in this proceeding is a threshold issue. As discussed in Section II below, the Commission does not

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[7] These comments do not address the *NPRM*'s proposals relating to "underwater" products.

have legal authority to authorize the Postal Service to raise rates for market dominant products above the statutory CPI-U cap. Its review authority simply does not encompass the authority to jettison the statutory price cap. The CPI-U price cap is a fundamental hallmark of the system that Congress created by Section 3622, and the Commission's regulations under that section must retain that requirement.

This lack of legal authority affects the proposed 2 percent "supplemental" rate authority and the proposed cumulative 1.0 percent authority for operational efficiency and service standards. It also, and contrary to the interests of the First-Class Business Mailers, affects the Commission's workshare discount proposal to the extent that it would presume pass-throughs in excess of 100 percent of the costs avoided to be lawful.[8]

That should be the end of these comments. But, *arguendo*, the First-Class Business Mailers will also address the merits of the Commission's proposals because they recognize the contingency that the Commission may nonetheless assert authority to abrogate the price cap. In that event, the many problems with the *NPRM* include:

- An incorrect definition of "financial stability" that ignores a decade of successful operation, coupled with a failure to consider substantial real estate assets and other funds owned by the Postal Service;
- An implicit assumption that the entire burden of fixing the Postal Service's purported financial issues must be borne by market dominant mail, a category in decline. Perhaps that is because Section 3622(d)(3) refers

[8] Section 3622(e) establishes four circumstances in which pass-throughs in excess of 100 percent can be lawful. As the First-Class Business Mailers understand the *NPRM*, it does not propose to modify any of those circumstances; instead, they would apply only to pass-throughs that are outside of the proposed permissible bands.

only to market dominant rates, but a provision that is intended to protect mailers from monopolistic exploitation should not be transformed into a piggybank for solving all of the Postal Service's problems;

- Ignoring the steady and lucrative growth and revenue from Competitive products (which now generate more postal revenue than Periodicals and USPS Marketing Mail *combined*), which should help address the problems by at least 30 percent– based on revenue share -- of the $2.7 billion targeted shortfall;
- A failure to link the proposed 2 percent additional cap authority to any cost reduction or efficiency measure, thereby placing Objectives 1, 2, and 5 in conflict by not closely tying revenues, cost reductions, price stability, and service improvements more tightly to extra cap authority, and designing the regime in a way that would grossly over-recover after five years; and
- While commendably placing greater emphasis on Efficient Component Pricing in setting workshare discounts, leaving too much leeway and needlessly postponing the proposal's effect for three years;
- Proposing an incentive based on exceeding a low standard for TFP and not including a penalty for failing to reduce costs that the Postal Service can control or improve efficiency by more than the target; and
- Proposing to give 0.25 percent in extra cap authority for literally doing nothing other than not changing formal service *standards*, while not requiring any improvement in actual service *performance*.

The system for regulating market dominant rates is intended to ensure that market dominant products cover their attributable costs overall and make a reasonable contribution to institutional costs, and as a whole they do. Together with the Postal Service's very successful Competitive products, market dominant mail revenues have paid the operating costs of the Service for the past decade.

But while Orders Nos. 4257 and 4258 draw conclusions based on the overall finances of the Postal Service, including retiree health benefit obligations and related expenses, the *NPRM* looks only to market dominant products for a cure. Without explanation, it does not take into account the fast growing and increasingly profitable Competitive products segment, currently the source of 30

percent of postal revenue and growing, and which generates more revenue than Periodicals and Marketing Mail combined.[9]

Second, the rate proposals in the *NPRM* address Objective 5 but conflict with Objectives 1 and 2, conflicting with the statutory requirement that the Objectives be applied "in conjunction with the others." 39 U.S.C. §3622(b). At no point does the *NPRM* expressly evaluate its proposals against the different Objectives. Had it done so, it might have recognized that its proposals aimed at increasing Postal Service revenues may help Objective 5, but conflict with Objectives 1 and 2, and at the least violate the statutory duty to accord them equal weight. *See* Order No 4257 at 16; *citing Annual Compliance Determination*, Docket No. ACR2008, at 36 (Mar. 30, 2009). Objectives 1 and 5 work in conjunction in a price cap system because successful cost control is an indispensable aspect of net revenue. But the *NPRM* proposals lose that linkage.

In particular, the proposal to raise rates by 2 percent per year above the rate of inflation (which essentially says that Congress erred in setting the statutory price cap at CPI) for five years is not conditioned on the Postal Service reducing, or even controlling, costs. That is a prescription carrying a high risk that the additional revenue will simply be frittered away, leaving us in a similar predicament five years hence. Moreover, that proposal would result, after five years, in rates more than 10 percent in real terms (and even more in the nominal terms that matter more to mailer budgets) above where they would be under the

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[9] Docket No. ACR2017, USPS-FY17-1, Public_FY17CRAReport.xlsx. Competitive mail and services in total account for 30.2 percent of Postal Service revenues, and market dominant products account for 69.8 percent.

current cap, and well above the 5.7 percent higher target that the *NPRM* intended to target, and with no assurance that the additional revenues would be used to chart the Postal Service on a new financial course.

And there is the proposal to confer an additional 0.75 percent rate authority for increasing Total Factor Productivity ("TFP"). TFP has been low in recent years, so relying on recent TFP sets the bar too low to present a meaningful challenge. Yesterday's filing of the FY 2017 figures on Total Factor Productivity -- showing a second year of negative growth and a substantial reduction in the latest 5-year average -- underscores the serious lack of attention to reducing costs and increasing efficiency in the Postal Service.[10]

And finally, there is the proposal to confer an additional 0.25 percent that, as best as we can tell, requires the Postal Service to do literally nothing even if actual service received by mailers and the American public deteriorates. So long as its formal, published service standards remain "high quality," the reality of service would not be a factor in conferring 0.25 percent on the Postal Service each and every year.

Throwing money at the Postal Service without conditioning it on accountability, real cost reductions or improving service is the opposite of maximizing cost reductions and efficiencies and will not succeed. The large majority (two-thirds) of the total proposed extra cap authority (the supplemental 2 percent) is totally unearned; it is not conditioned on cost improvements, efficiency gains, service improvement, or anything else. Absent a plan or controls, it would

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[10] *USPS Annual Tables, FY 2017 TFP (Total Factor Productivity), Table Annual 2017 public (2017 CRA).xlsx, "Tfp-52"* (February 28, 2017).

merely develop a "look backward" cost-of-service approach. Simply giving the Postal Service more revenue to handle less volume will not maximize incentives for cost reduction; if anything, it will discourage using them.[11]

Although the *NPRM* commendably proposes to require greater use of Efficient Component Pricing ("ECP") in setting workshare discounts, which is an important step towards promoting efficiency, it otherwise proposes nothing to stem the erosion of the First-Class Presort Mail that pays the lion's share of the Postal Service's institutional costs. Nowhere does the *NPRM* appear to consider that its rate proposals could harm the long-term attractiveness of the Postal Service as a communications medium and business partner to the mailing industry.[12]

The *NPRM* even admits (at 42-43) that due to expected volume declines its proposals will not even generate the revenues it estimates – a rather startling admission that one would expect to cause the Commission to rethink its entire approach. Nor does it hazard any projection of how much faster volumes in market dominant mail, especially First-Class Mail, would decline if its proposal were adopted. The Commission offers no reason, other than wishful thinking, to expect that these declines will slow, let alone cease or reverse course.

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[11] As the Commission concluded regarding the former cost-of-service system, "[r]ecovery of all estimated costs plus prior year losses and a contingency amount meant that the Postal Service had little incentive to cut costs." Order No. 4257 at 24.

[12] The rate proposals need not even be adopted for harm to begin. Sophisticated mailers, upon seeing the proposals, understand that there is a reasonable likelihood that they will be adopted and will take steps now so as not to be caught by a steep rate increase. *See supra* at 2 & footnote 2.

It is unrealistic to expect volumes will stabilize or improve before real cost reductions and efficiencies are seen – and even in the best of circumstances those results would take some years to materialize. There is no time to wait; if First-Class Mail volume declines are to be stemmed, real cost reductions and efficiencies must be put in place now, not await some future proceeding years down the road. The *NPRM* proposals simply are not enough.

B. Strong, Effective Measures To Maximize The Incentives To Reduce Controllable Costs And Promote Efficiency Are Essential, Because Higher Rates Will Not Solve The Problem

A fundamental purpose of the Postal Accountability and Enhancement Act was to encourage the Postal Service to reduce costs. This is reflected in the very first Objective that Congress established in Section 3622(b)(1): "To maximize incentives to reduce costs and increase efficiency." 39 U.S.C. §3622(b). The primary mechanism Congress enacted to achieve that was a strong price cap that limited price increases to inflation as measured by the Consumer Price Index, and gave the Postal Service an incentive to operate efficiently by allowing it to pocket any "earnings" it could obtain by reducing its costs and operating more efficiently.

In Order No. 4257, the Commission determined, *inter alia*, that the Postal Service has made insufficient gains in cost reductions and operational efficiency under the current rate-making system. *Id*. at 248. This is not to say that the Postal Service costs have not declined at all under the PAEA. Real attributable costs for market dominant mail declined 16 percent, from $0.22 to $0.19, over the PAEA era. Order No. 4257 at 191. However, these reductions were largely

confined to mail processing; in contrast, the Postal Service has yet to achieve real reductions in transportation, delivery, and other costs. *Id*. at 194.[13] During this period, the Postal Service's Total Factor Productivity changes generally were positive, albeit modest. *Id*. at 225.

And while real attributable costs declined, the Commission found that one important factor in reducing those costs were that mailer decisions, as "market dominant mail has shifted to less costly mail classes and products, resulting in reductions in the overall costs." *Id*. at 194-197. Within classes, the mail mix shifted to a greater proportion of workshared mail entered deeper into the system, and away from flats towards letters. This is a reason why pricing reforms, such as the workshare discount proposal in the *NPRM*, which set price signals closer to marginal cost are in the Postal Service's best interest.

As is known, during this period the annual volume of market dominant mail declined by an astonishing 60.8 billion pieces. *Id*. at 200. The Postal Service attempted to respond with several cost reduction initiatives. These included the Retail Access Optimization Initiative, Network Rationalization, the Periodicals Mail study, Standard Mail Load Leveling, and various flats initiatives such as the Flats Sequencing System ("FSS"). Unfortunately, as Order No. 4257 summarizes at some length, there is little reason to believe that the Postal Service has realized the cost savings it had projected.

The Retail Optimization Initiative was not completed; instead, it was replaced by yet another plan, the Post Office Structure Plan. The Postal Service

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[13] This suggests that the Postal Service saw cost reductions when it finally realized the benefits of the letter automation systems, which mostly affected mail processing costs.

itself reduced its own estimate of cost savings from the Network Rationalization Initiative by nearly 25 percent (from $2.1 billion to $1.6 billion), yet the Commission's own review concluded that even the revised estimate was overly optimistic. Docket No. N2012-1, *Advisory Opinion* at 2 & Appendix H. The Commission found that the Load Leveling plan needed more work and lacked even a cost-benefit analysis. Docket No. N2014-1, *Advisory Opinion* at 2. The issues with the FSS are well known.

Sadly, the actual cost savings derived from these initiatives appears unknowable. The Commission has found that "due to the lack of comprehensive data, the Postal Service cannot measure the impact or success of initiatives designed to improve flats cost and service issues." Order No. 4257 at 203 & n. 320, *quoting Annual Compliance Determination FY 2016* at 26.

Nor has the Postal Service been held accountable for its capital investment decisions; there is no systematic Commission process to review or to assure that its capital investments are prudent, or that they even achieve the targeted return on investment presented in the Decision Analysis Reports that underlie the authorization of those investments. And the Commission recently affirmed that it has no interest in evaluating particular capital investments, but rather is focused on "general capital spending levels" and that evaluating whether past investments met their goals "is not necessary to evaluate the Commission's proposals")" Order No. 4397 at 4 (Feb. 6, 2018) (Order Denying Motion for Issuance of Information Request). This is not an approach that will ensure that

extra dollars are invested wisely in encouraging mail growth, improving service, or improving finances.

The Annual Compliance Review process has proven ineffective in forcing more cost reductions or efficiency. The accountability for results consists of public critiques, not enforcement measures to drive compliance. Indeed, in instances where the Commission has questioned the results of an initiative, it has done little more than request an explanation from the Postal Service.[14] Repeated failures to reduce costs by the expected amounts have led to no adverse regulatory consequence to the Postal Service, as there is no penalty or reduction in cap authority.

Given the lack of rigorous tracking of cost savings, of appropriate cost-benefit analyses, or of any regulatory consequence for failing to achieve projected ROI or cost efficiencies, giving the Postal Service increased cap authority without any corresponding additional accountability, oversight, or significant cost reduction pressure would be extremely unlikely to lead to greater cost reductions. Unfortunately, the three cap-related proposals in the *NPRM* do just that:

- The additional 2 percent above CPI for five years, compounded, imposes no conditions on the Postal Service;
- Conditioning the 0.75 percent for exceeding the lowest Total Factor Productivity in years sets an exceptionally low bar; and

. The 0.25 percent for “high quality” service requires only that the Postal Service do literally nothing. It would receive this amount automatically as long as it simply does not change published

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[14] *E.g.*, *Chairman’s Information Request No. 9*, Questions 14 & 15, Docket No. ACR2017, (Jan. 25, 2018).

> service standards or business rules, even if it allows service to deteriorate by "informal" or tacitly approved slowdowns. It is a bonus predicated on mere words, not deeds.

Nothing in these proposals creates a genuine incentive for the Postal Service to find meaningful cost reductions. Instead, the proposals would simply allow the Postal Service to charge higher rates to a reduced number of mailers who are sending a declining number of pieces as they diminish their exposure to the mail. And as a result, we are highly likely to find ourselves five years hence in the same predicament as today, with the Postal Service still in desperate need for more money and confident in the belief that the Commission would once again have no option but to give it still more rate authority.

The proposal to require greater use of ECP will help to improve efficiency, and should be adopted. However, that improvement in *efficiency* will have only indirect effects at best on *cost reductions*.

A better approach would be to tie any performance incentive to real improvements in costs over which the Service has control. The *NPRM*'s TFP proposal applies this principle, but to only a small part of the potential extra rate authority. We believe a better outcome is likely if all extra rate authority were conditioned on cost reductions or productivity improvements.

Although the Postal Service can be expected to claim that it has squeezed as many costs out of the system as possible, as business people we know that this is highly unlikely to be the case for a $70 billion operation. For just one example, the Postal Service recently reported that the number of headquarters staff rose in FY 2018, as well as the number of supervisors in the field even while

the total number of career employees declined.[15] *Annual Report and Comprehensive Statement of Postal Operations,* Docket No. ACR2017, USPS-FY17-17 at 11. Why the Service needed to add more administrative staff and supervisors at a time of declining volume is mystifying. If they were added to manage Competitive Products, the Commission should ensure that their costs were attributed to such products.[16] There is no need for market dominant mailers to be paying for growing overhead at a time that their own volume is in decline. And many other examples abound, as there are other expenses that need not rise at the rates that they have in recent years.

The Postal Service and mailing industry are at a crossroads. It is abundantly clear that the Service's current and future financial health depends upon its controlling its costs and improving its operational efficiency. Rate hikes will not do the trick, because the market simply cannot and will not absorb continuously increasing rates of the level proposed by the *NPRM*.

C. A Way Forward

Below, these comments address serious flaws in the *NPRM*'s three rate proposals in more detail, all of which should preclude their adoption. Instead, if the Commission wants to improve the Postal Service's incentives to reduce costs and maximize efficiency, while addressing balance sheet issues, it must choose between two options.

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[15] Increasing the number of non-career employees at the cost of career employees may make sense, but that does not explain why more headquarters staff and supervisors were needed.

[16] This issue is the subject of Chairman's Information Request No. 8, Questions 2 through 4, in Docket No. ACR2017, to which the Postal Service responded on January 9, 2018.

One option would be to take a more aggressive regulatory approach. The Commission could play a more active role in scrutinizing Postal Service cost reduction proposals (perhaps, for example, ensuring that they actually are undertaken).[17] Given its evident belief that more capital investment would be desirable, the Commission could require the Postal Service to seek prior approval of any capital investment that it would fund with extra cap authority. Doing so might help ensure that any new cost saving or value-added initiatives are implemented in a far better manner than, say, the FSS, Network Rationalization, or Full-Service Intelligent Mail barcoding. To date, however, the Commission has displayed no appetite for assuming a greater oversight role, although many regulatory agencies do so.

The second option would not require the Commission to be a more aggressive regulator. Instead, it would design a regulatory system in which Objectives 1, 2, and 5 would work in conjunction with one another. The goal would be to maximize the incentives for cost reduction and efficiency while giving the Postal Service a realistic opportunity to improve its financial metrics without having to raise rates by the huge amounts proposed in the *NPRM*.

Two alternatives illustrating how this might be done are spelled out in Section VI below. The gist, however, is that any additional rate authority:

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[17] *E.g., Response of the United States Postal Service to Chairman's Information Request No. 5, Question 5*, Docket No. ACR2017 (Jan. 26, 2018) (admitting that the Postal Service made "no specific efforts to reduce the unit cost of Marketing Mail parcels in FY 2017" despite the Commission's stating in the FY 2016 Annual Compliance Determination that it should do so).

(1) must be completely conditioned on actual improvements in what the Postal Service can actually control – in other words, what it calls "controllable income;"[18] and

(2) must contain incentives that are balanced by penalties if the Postal Service fails to improve its controllable income.

Properly implemented, such an approach could improve the Postal Service's financial metrics while raising rates by less than the amounts proposed in the *NPRM*, through a combination of modestly increased rates and modest, but real, cost efficiencies.[19]

The Commission's proposal to require greater use of ECP in setting workshare discounts is, unlike the rate proposals, consistent with both Objective 1 and Objective 5. In Section III below, the First-Class Business Mailers recommend certain changes to ensure that the proposal will achieve its goal.

Finally, we address the Commission's proposed revisions to its rules of procedure, which are based on its inherent rulemaking authority rather than on Section 3622(d)(3). We support two and oppose one of the proposed revisions to the rules of procedure.

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[18] Incentives to encourage performance should target only matters that the regulator and the regulated entity can control. (Otherwise, they are not truly "incentives".) Incentives for the Postal Service should reward or punish only things that the Service can control (*i.e.*, controllable operating income), at most. TFP is a more familiar, if less perfect, alternative to controllable income. In contrast, the Postal Service has no ability to control the interest rates that have such enormous effects on its CSRS, FERS, and worker's compensation obligations.

[19] The First-Class Business Mailers do not, by suggesting this approach, waive their argument that the Commission does not have legal authority to allow rates to rise above the statutory price cap.

II. THE COMMISSION DOES NOT HAVE LEGAL AUTHORITY TO ADOPT THE PROPOSED CHANGES TO THE STATUTORY PRICE CAP

Contrary to the tentative conclusion in the *NPRM*, the Commission's authority under 39 U.S.C. §3622(d)(3) to re-evaluate the "system for regulating rates and classes for market-dominant products" does not encompass the power to rescind or ignore the requirements and limitations established in §§3622(d)(1) and (2). That is so for three mutually reinforcing reasons.

First, Section 3622(d) speaks in mandatory terms. It sets forth several "[r]equirements": A system "shall" incorporate a CPI-based cap; certain limitations "shall" be applicable; and the Commission "shall" conduct a ten-year review. The Commission is no more free to disregard the statutorily mandated price cap than it is to disregard its ten-year-review obligation.

Second, the PAEA's price cap represented the culmination of extensive Congressional deliberations that were informed by Congress' longstanding tradition of setting the benchmark by which postal rates are determined. It would defy logic for Congress to have empowered the Commission to disregard the results of that painstaking process or to have transferred to the Commission a role that Congress has assumed since the Nation's Founding—let alone to have done so *sub silentio*.

Finally, interpreting the statute to enable the Commission to replace the heart of the PAEA would put the statute in conflict with constitutional limitations on the ability of Congress to delegate its legislative function to the executive branch or to administrative agencies. That interpretation should thus be avoided.

A. On Its Face, the Statute Imposes an Unambiguous and Mandatory Cap

Any effort to discern a statute's meaning must start with the language of the statute itself. *Advocate Health Care Network v. Stapleton*, 137 S. Ct. 1652, 1658 (2017); *Caraco Pharm. Labs v. Novo Nordisk*, 131 S. Ct. 1670, 1680 (2012). And when that language is unambiguous, it will carry the day. *See, e.g., Nat'l Ass'n of Mfrs. Dep't of Defense*, __ U.S. __, 2018 WL 491526, at *15 n.9 (2018).

Here, the relevant statutory language is unambiguous:

> (a) Authority Generally.—
>
> The Postal Regulatory Commission shall, within 18 months after the date of enactment of this section, by regulation establish (and may from time to time thereafter by regulation revise) a modern system for regulating rates and classes for market-dominant products.
>
> . . .
>
> (d) Requirements.—
> (1) In general.—The system for regulating rates and classes for market-dominant products shall—
> (A) include an annual limitation . . . that will be equal to the change in the Consumer Price Index for All Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates;
> (B) . . .
> (C) . . .
> (D) establish procedures whereby the Postal Service may adjust rates not in excess of the annual limitations under subparagraph (A); and
> (E) [Exigency exception].
>
> . . .
>
> (3) Review.—
> Ten years after the date of enactment of the Postal Accountability and Enhancement Act and as appropriate thereafter, the Commission shall review the system for regulating rates and classes for market-dominant products established under this section to determine if the system is achieving the objectives in subsection (b), taking into account the factors in subsection (c). If

> the Commission determines, after notice and opportunity for public comment, that the system is not achieving the objectives in subsection (b), taking into account the factors in subsection (c), the Commission may, by regulation, make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.

39 U.S.C. §3622.

This language leaves the Commission without authority to jettison the price cap set forth in 39 U.S.C. §3622(d)(1). By its very terms, the price cap is a "[r]equirement[]" that "shall" apply to any rate regime. Considering the broader statutory context yields the same result: The Commission was tasked in Section 3622(a) with putting flesh on the price cap's bones, and it is that flesh—not the underlying price cap—that is to be reviewed ten years hence.

1. The language of Section 3622(d)(1) requires the Commission to adopt a system that retains the price cap

The statute is straightforward, specifying that the "system for regulating rates and classes for market-dominant products ***shall*** [] include an annual limitation on the percentage changes in rates . . . that will be equal to the change in the Consumer Price Index for All Urban Consumers." 39 U.S.C. §3622(d)(1)(A) (emphasis added). This directive is one of the "[r]equirements" for the rate-setting system. *See* 39 U.S.C. §3622(d).

The word "requirement" speaks for itself.[20] Likewise, the word "'shall' is ordinarily 'the language of command.'" *Alabama v. Bozeman*, 533 U.S. 146, 153 (2001) (citations omitted); *see also Lopez v. Davis*, 531 U.S. 230, 231 (2001)

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[20] Merriam-Webster defines the word as: "something required: something wanted or needed[;] something essential to the existence or occurrence of something else." *See* "Requirement" Definition, https://www.merriam-webster.com/dictionary/requirement.

("Congress used 'shall' to impose discretionless obligations."). The legislature's choice of these words forecloses any claim that the statute makes the price cap merely optional.

The statutory language also forecloses any claim that this "requirement" "shall" apply for the initial 10-year period only. If Congress intended to adopt a sunset provision, it would have said so—by, for example, providing that the price cap applies to the "first system," the "initial system." or the "system preceding the 10-year review." *See* 2A Norman & Shambie Singer, Sutherland Statutes and Statutory Construction § 46:1 (7th ed. 2014) ("Courts may, for example, defend a particular interpretation by arguing that if the legislature had intended otherwise, it would have said so."). In *Sebelius v. Cloer*, 133 S. Ct. 1886, 1893 (2013), the Court invoked this principle to uphold an award of attorneys' fees for good-faith but untimely vaccine-injury-compensation claims, reasoning that "[i]f Congress had intended to limit fee awards to timely petitions, it could easily have done so." So too, here: If Congress had intended to limit the price cap to the initial ten-year period, it could easily have done so. Instead, Congress instructed that the price cap "shall" apply without time limitation, indicating that Congress contemplated that the requirement would apply to any and all rate structures the Commission would create.

The Commission dismissed the word "requirements" on the ground that a statute's title has no power to enlarge the text. *See, e.g., NPRM* at 16. But giving that word its normal definition would not *enlarge* the statutory text; it would *effectuate* it. That text specifies that the "system for regulating rates . . . ***shall*** . . .

include" a CPI-based price cap. That is, the title is *consistent* with the statutory text and there is thus no basis to disregard it.

2. The balance of Section 3622 supports the conclusion that the Commission lacks authority to lift the price cap

Under well-known rules of statutory construction that Congress is deemed to know (*see McNary v. Haitian Refugee Center*, 498 U.S. 479, 496 (1991)), when a particular phrase is used repeatedly in the same enactment, it is customary to give it the same meaning each time it appears. *See, e.g.*, *Ratzlaf* v. *United States,* 510 U.S. 135, 143 (1994). Section 3622(a) directs the Commission to establish a "system"; and Section 3622(d)(3) directs it to review, and potentially revise or replace, that "system" ten years later. If the same word is to be given the same meaning in each instance, Section 3622(d)(3) must call for a review, revision, and replacement of the same system that was established under Section 3622(a).

Indeed, the parallelism of Sections 3622(a) and (d)(3) runs deeper than the word "system" alone. Section 3622(a) requires the Commission to adopt a "system for regulating rates and classes for market-dominant products." That same language is mirrored in the ten-year review provision, which calls for the Commission to review "the system for regulating rates and classes for market-dominant products." 39 U.S.C. §3622(d)(3). That parallel phrasing makes it clear that Section 3622(d)(3) directs the Commission to review the system the *Commission* created, not the provisions *Congress* imposed.

That result is confirmed by Section 3622(d)(3)'s use of the words "established" and "under": "Ten years after the date of enactment of the [PAEA]

and as appropriate thereafter, the Commission shall review the system for regulating rates and classes for market-dominant products ***established under*** this section to determine if the system is achieving the objectives in subsection (b), taking into account the factors in subsection (c)." A form of the word "establish" was likewise used in Section 3622(a) ("the Commission "shall . . . by regulation establish…."), making it clear that the review authority in Section 3622(d)(3) echoes the authority granted in Section 3622(a). Congress's choice of the word "under" (as opposed to "by") further supports that result. If Congress intended the Commission's review authority to allow it to override the mandatory provisions of Section 3622(d)(1), one would expect Congress to have written 39 U.S.C. §3622(d)(3) to authorize the Commission to review the system "***created by*** this section." But that is not what Congress chose to do, and it must be taken to mean what it said.

In interpreting the statute to the contrary, the Commission focused on the ways in which the language of Section 3622(a) differs from the language in Section 3622(d)(3). *NPRM* at 16-18 (noting that the former provision directs the Commission to "establish (and may from time to time thereafter by regulation revise)," while the latter provision directs it to "make such modification or adopt such alternative system"). The Commission emphasized Section 3622(d)(3)'s provision that it "may, by regulation, make such modification *or adopt such alternative system* for regulating rates and classes for market-dominant products as necessary to achieve the objectives." *NPRM* at 14-15 (emphasis added). In the Commission's view, the first option ("modification") connotes moderate

change, while the second option contemplates replacement of the existing system. *NPRM* at 15.

This argument elides an important over-arching statutory premise: In *all* instances (the initial establishment of the system under Section 3622(a), modifications to the system under Section 3622(d)(3), and the adoption of an alternative system under Section 3622(d)(3)), only the "system" (and, in particular, the "system . . . established under" the statute) can be modified or replaced—and that "system" is one for which the price cap is a "requirement."[21]

The Commission cited 39 U.S.C. §3622(c)(4)—in which Congress limited the scope of "alternative means"—as evidence that "Congress knew how to impose express limits on the scope of 'alternative system' but chose not to do so with respect to the Commission's authority under section 3622(d)(3)." *NPRM* at 15.[22] But by the same (and more relevant) token, Congress likewise knew how to impose express limits on the *price cap*; indeed, it imposed some such limits in Section 3622(d)(2) ***without including a limit on the price cap's longevity***.

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[21] Nor does it help to focus on Section 3622(d)(3)'s distinction between "sections" and "subsections," as the Commission did in Order No. 4257:

> The language of section 3622(d)(3) clearly includes the entire section of 3622. This is made evident by the plain meaning of the term "section" and the fact that the same provision expressly differentiates between sections and subsections and does not exclude or limit the review to specific subsections. As the meaning of the phrase "established under this section" is clear and refers to § 3622 in its entirety, in the absence of ambiguity, the inquiry ends at the language of the statute.

Order No. 4257 at 10 (footnotes omitted). Even if "section" in Section 3622(d)(3) refers to Section 3622 as a whole, that does not change a simple fact: 39 U.S.C. §3622(d)(3), by its very terms, limits the Commission's ten-year-review authority to revamping the "system . . . established under" that section, which, for the reasons set forth in the text, refers to the system the Commission established under Section 3622(a) (not the system created by Section 3622(d)).

[22] Congress enacted this language in the Postal Reorganization Act and then moved it into subsection (c) with the passage of the PAEA.

"Where Congress explicitly enumerates certain exceptions to a general prohibition, additional exceptions are not to be implied." *Andrus v. Glover Const. Co.*, 446 U.S. 608, 616-17 (1980) (citing *Continental Casualty Co. v. United States*, 314 U.S. 527, 533 (1942)).

Congress's omission of a time limit on the price cap cannot be dismissed as an oversight. The price cap was "central" and "indispensable" to the statute; indeed, it was "the single most important safeguard for mailers" in the PAEA. Order No. 547 at 10-13; *see also* Order No. 536 at 36 (noting that the quantitative pricing standards are at the top of the statutory hierarchy, above the statute's lists of "objectives" and "factors"); *accord* FY 2010 ACD at 18-19 (Mar. 29, 2011). "Congress . . . does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions." *Whitman v. Am. Trucking Ass'ns*, 531 U.S. 457, 468 (2001). Thus, if Congress intended to place a moratorium on the central feature of the statute, one would expect to see that explicitly stated.

The Postal Service has argued that, under the statutory interpretation we are advocating here, the Commission's role under Section 3622(d)(3) would be reduced to mere "tinker[ing]" that could have been undertaken even without explicit statutory authority. As the Postal Service puts it:

> . . . the Mailers' proposed construction would impart to Section 3622(d)(3) an implausible, impermissible degree of insignificance. . . . Taking the reasoning employed in the White Paper to its logical conclusion, all of the provisions of Section 3622(d)(1)-(2) would be immune from the Commission's review under Section 3622(d)(3), considering that they are, just like the provisions specifically mentioned by the Mailers, all phrased as "requirements" that "shall" be part of the initial system. This would essentially leave the Commission with nothing to do except tinker with the finer points of its implementing regulations, which it can do under the statute regardless of Section 3622(d)(3). The whole purpose of also

> including Section 3622(d)(3) in the PAEA is to empower the Commission to examine and potentially replace the "requirements" of Section 3622(d)(1)-(2) that form the core of the initial regulatory system that Congress established. Therefore, the Mailers' interpretation would convert Section 3622(d)(3) into mere surplusage, which the Commission may not do.

USPS Comments at 4-5 (Mar. 20, 2017) (footnotes omitted) (*referring to Letter from Matthew D. Field to Shoshana Grove*, Oct. 24, 2014). But the Commission's ten-year-review role is no more "insignifican[t]" than its Section 3622(a) role, under which the Commission adopted a system of regulations in rulemakings in 2007 and 2008. *See* 39 C.F.R. §3010.1 *et seq.* (Part 2010) and, indirectly, Part 3020 (Product Lists). If that were a mere formality, why would Congress have felt the need to enact Section 3622(a) at all?

To be sure, the Commission already had the inherent authority to revise the regulations it adopted pursuant to Section 3622(a), but that would not render Section 3622(d)(3) "mere surplusage." *Cf. USPS Comments* at 5. Rather, Section 3622(d)(3) would still have the effect of requiring the Commission to take a fresh look ten years later *even if it might not otherwise have chosen to do so*.[23] And even if the Postal Service is accurate in concluding that this leaves the Commission with an "insignifican[t]" role, the Commission is not free to substitute its judgment that a greater role should lie. *See Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 376 (1986) (holding that only Congress, not judicial or administrative agencies, can rewrite statutes).

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[23] For example, there are numerous actions that the Commission might have proposed in this review, including: using a Passche Index instead of a L'Epeyers; changing how it calculates CPI increases; modify the cap to subtract for periods of deflation; adopt an X-Factor to increase the incentive for cost reduction; modify the rules for below-cost products; define more products and price points within classes and products; or use a quality-of-service adjusted price cap.

B. The History of Postal Reform Indicates That Congress Could Not Have Intended For The Commission To Have The Power To Jettison The Price Cap

The Commission has placed considerable emphasis on a floor statement by Sen. Collins preceding the passage of the PAEA, in which she expressed the view that the Commission's Section 3622(d)(3) review authority would encompass the power to override the price cap. *See NPRM* at 22-23. While the Commission is correct in concluding that this statement supports the result it favors, relying on the statement at all is misguided. Even for those judges who make use of legislative history, legislative history cannot be used to override "clear statutory language." *Milner v. Dep't of Navy*, 562 U.S. 562, 572 (2011). Here, because the provision straightforwardly depicts the price cap as a "[r]equirement[] that "shall" apply to any system, and the balance of the statute unambiguously supports that result, resort to legislative history is improper.

But even if legislative history could otherwise be consulted, Sen. Collins's statement is due to be disregarded because it is the statement of an individual legislator alone—a kind of legislative history that courts have deemed unreliable. *See Garcia v. United States*, 469 US. 70, 76 (1984) ("To the extent that legislative history may be considered, it is the official committee reports that provide the authoritative expression of legislative intent."); *IBEW v. NLRB*, 814 F.2d 697, 715-17 (D.C. Cir. 1987) (Buckley, J., concurring) (noting that floor statements of individual legislators are unreliable because they are larded with remarks that reflect a political rather than a legislative purpose).

Indeed, Sen. Collins's statement bears all the markers of unreliability, as it cannot be squared with the painstaking deliberations that informed the PAEA's passage and with the longstanding role that Congress has played in the management of the postal system, including direct involvement in setting postal rates, ever since the Nation's Founding.

Initially, postal rates were set by Congress as part of the very first postal Act, which was signed into law by President George Washington on February 20, 1792. *See* An Act to Establish the Post-Office and Post Roads within the United States, 2nd Cong., Sess. I, Ch. 7, §§ 9 & 10 (Feb. 20, 1792) (setting rates, at six cents on up, for domestic and international mailings of all kinds) (reprinted at http://njpostalhistory.org/media/pdf/postact1792.pdf). At the time, the Department operated at a loss subsidized by Congress. *See* Order 547 at 7.

In 1970, with the enactment of the PRA, Congress modified this regime by directing that postage rates should be pegged to the costs of providing the relevant postal service. *See* Order 457 at 7; Order 4257 at 2-3, 23-24. But that proved problematic, as over the next several decades the cost-of-service scheme made the system for evaluating proposed rate changes expensive, litigious, unpredictable, and slow. *See, e.g.*, Order No. 457 at 8-9; Order No. 4257 at 3, 25-29. And it gave the Postal Service no incentive to operate efficiently or to control costs. Order No. 4257 at 9-10.

Accordingly, in 2006, Congress supplanting the PRA with the PAEA, which replaced the costs-of-service benchmark (*see* Order No, 547 at 10) with, for market-dominant products, a simplified price cap tied to the rate of inflation.

Order No. 547, at 1 (Sept. 30, 2010). As a result, rate cases became shorter and less formal and mailers could count on a system marked by predictability and stability. *Id*. at 11. In addition, the CPI-based price cap was intended to give the Postal Service an incentive to maximize gains and minimize costs. *See* Order No. 547 at 11-12; Order No. 4257 at 32-33.

The rate-setting regime (costs-for-service with the PRA and CPI-based price cap with the PAEA) at the heart of each statutory scheme was the subject of thorough deliberations. Alternative legislation was introduced, debated, and rejected. Congressional hearings were held, votes taken, and Presidential approval obtained. *See, e.g.*, Order No. 547 at 8-24; Order No. 4258 at 20-23.

In light of that history, it would defy not just the Constitution (see below) but common sense to think that, in enacting the PAEA, Congress would have abdicated its longstanding role as the body that sets the benchmark for postal rates—let alone to think that it would have done so without explicitly saying so. The inclusion of the phrase "as appropriate thereafter" in Section 3622(d)(3) makes that result even more untenable. Under the Commission's interpretation of Section 3622(d)(3), that language would empower the Commission not only to replace the price cap as part of its ten-year review, but to adopt another system later, yet another system thereafter, and so on. That result simply cannot be squared with the time-honored role Congress has performed in this context.

C. Interpreting The Statute To Permit The Commission To Override The Statutory Price Cap Would Place The Statute In Constitutional Jeopardy

"[W]here an otherwise acceptable construction of a statute would raise serious constitutional problems, the Court will construe the statute to avoid such problems unless such construction is plainly contrary to the intent of Congress." *Edward J. DeBartolo Corp. v. Florida Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988). This "cardinal" canon of statutory construction reflects the prudential concern that constitutional issues not be needlessly confronted, but also recognizes that Congress, like the courts, is bound by and swears an oath to uphold the Constitution. *Id.* at 575.

This rule of statutory construction requires the Commission to construe Section 3622(d)(3) as depriving it of authority to override the price cap because a contrary construction would render the statute constitutionally suspect under the Presentment Clause of the Constitution, U.S. Const. Art. 1, § 7, cl. 2, and place it in tension with limits on Congress's delegation of legislative authority to administrative agencies.

1. Interpreting the statute to permit the Commission to override the price cap would render the statute invalid under the Presentment Clause

Under the Presentment Clause, a bill shall not become law without first passing both houses of Congress and being "presented" to the President, who "shall sign it" if he approves it, or "return it," *i.e.*, veto it, if he does not. U.S. Const., Art. 1, §7, cl. 2. This provision deprives the President of authority to unilaterally amend or repeal parts of duly enacted statutes. *See Clinton v. City of*

New York, 524 U.S. 417, 439 (1998). The Commission's proposal to modify the statutory price cap would run afoul of this prohibition.

In *Clinton*, the Court struck down as contrary to the Presentment Clause a provision of the Line Item Veto Act, 2 U.S.C. §691 *et seq*., that authorized the President to veto individual line items of spending legislation. Allowing the President to exercise a line item veto, the Court held, "would authorize the President to create a different law—one whose text was not voted on by either House of Congress or presented to the President for signature." *Id*. at 448–49.

The creation of a "different law" is precisely what the Commission's interpretation of Section 3622(d)(3) would authorize: The Commission would be free to jettison the price cap over which Congress carefully and extensively deliberated, and to replace it with a different scheme. But having the Commission substitute its policy decisions for those of Congress is precisely what the Presentment Clause prohibits.

To be sure, Congress may authorize the executive branch to waive the application of statutory provisions in specified circumstances. *See, e.g., Republic of Iraq v. Beaty*, 556 U.S. 848, 861 (2009) (upholding statute that expressly allowed the President to waive application of certain statutes to Iraq in particular circumstances); *Marshall Field & Co. v. Clark*, 143 U.S. 649 (1892) (upholding statute directing the President to suspend exemptions from import duties on foreign ships upon his determination that a country was imposing unreasonable duties on U.S.-made products).

But two important distinctions separate those cases from this one. First, the authority to jettison the legal requirement was "expressly" stated in those statutes. *Republic of Iraq*, 556 U.S. at 861. Here, in contrast, the statute includes no such express provision; instead, the Commission's authority to jettison the price cap is ambiguous at best (as evidenced by the disagreement on this point in this proceeding).

Second, in those cases, "Congress itself made the decision to suspend or repeal the particular provisions at issue upon the occurrence of particular events subsequent to enactment, and it left only the determination of whether such events occurred up to the President." *Clinton*, 524 U.S. at 445. Thus, those statutes involved a straightforward exercise of executive, not legislative, power: The statutes authorized the President to take particular action in specified circumstances and, in taking that action, the President was simply "enforc[ing] [] the policy established by Congress." *Field*, 143 US. at 693. But here, if the price cap were excised, the statute would not authorize "particular action in specified circumstances"; instead, it would enable the Commission to take indeterminate action in unspecified circumstances.

In the *NPRM*, the Commission distinguished *Clinton* on the ground that the Line Item Veto Act authorized the President to replace Congress's will with a contemporaneous, uncabined, unilateral policy judgment, while the PAEA calls for the executive's input ten years hence and imposes a plethora of "objectives" and "factors" to cabin the executive's discretion. *Id*. at 24-25. But no one would contend that *Clinton* would have come out differently if the Line Item Veto Act

had required the President to wait ten years before undoing statutory text, or if the Act had set forth "objectives" and "factors" for the President to consider before excising provisions of a duly enacted statute. Indeed, the Line Item Veto Act ***did*** direct the President to consider various criteria and ***did*** cabin his discretion. For example, it specified that he could slash line items only after considering a statute's legislative history and purposes, and only if he determined that the excision would "reduce the Federal budget deficit" and "not impair any essential Government functions." *See* 2 U.S.C. § 691(b) (1994 ed. Supp. II) (quoted in *Clinton*, 524 U.S. at 436). That did not save the statute, however, because Congress had neglected to specify the "particular events" that should give rise to a veto. *Clinton*, 524 U.S. at 445.[24]

Neither the procedures set forth in Section 3622(d)(3), nor the "objectives" and factors" set forth in Sections 3622(b) and (c), provide that kind of direction. They require the Commission to take action in ten years, to invite public comment, and to review various policy considerations when they take that action, but they don't cabin the bottom line at all: They don't specify the "particular events" that would call for the Commission to act; or instruct the Commission on

[24] In arguing that the Presentment Clause is not violated here, the Postal Service has relied heavily on *Terran v. Sec'y of HHS*, 195 F.3d 1302, 1307–08, 1312–14 (Fed. Cir. 1999), which upheld the National Childhood Vaccine Injury Act. That statute established an initial Vaccine Table to cover claims for compensation due to injuries caused by vaccines but empowered the Department of Health and Human Services to promulgate revised Vaccine Tables that would apply prospectively to new claims, as updated information was acquired concerning the link between vaccines and injuries. But in that case, *Congress*, not the HHS, established the program's requirements: The statute directed that claimants should be compensated when they showed that they suffered a vaccine-related injury; and that this determination should be made by reference to an injury's appearing on a table or by a claimant's demonstration of a causal link between a vaccine and an injury. *See id.* at 1307. That is, Congress specified the "particular events" that would call for payment; the executive simply performed the more ministerial task of updating the table to reflect medical advances. *Id.* In contrast, under the Commission's interpretation of §3622(d)(3), no "particular events" would cabin its ability to act.

how to act when those events occur. They are simply a set of policy considerations that do not, on their own, come close to providing the level of legislative direction that the Presentment Clause demands.

2. Interpreting the PAEA to permit the Commission to override the price cap would render the statute invalid under the non-delegation doctrine

Wholesale repeal or modification of the heart of PAEA would additionally infringe upon the non-delegation doctrine, under which Congress may not delegate legislative power to administrative agencies. *Whitman v. Am. Trucking Ass'ns, Inc.*, 531 U.S. 457, 472 (2001). Under this doctrine, Congress may confer decision-making authority upon agencies, but it must lay down "an intelligible principle to which the person or body authorized to [act] is directed to conform." *Whitman*, 531 U.S. at 472 (quoting *J.W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394, 409 (1928)).

Pursuant to the non-delegation doctrine, the Court has approved statutes that: instruct the EPA to set "ambient air quality standards the attainment and maintenance of which . . . are requisite to protect the public health" (*Whitman*, 531 U.S. at 465); permit the Attorney General to designate a drug as a controlled substance when "necessary to avoid an imminent hazard to the public safety" (*Tuoby v United States*, 500 U.S. 160, 163 (1991)); require the Occupational Safety and Health Agency to "set the standard which most adequately assures . . . that no employee will suffer any impairment of health" (*Industrial Union Dep., AFL-CIO v. Amer. Petroleum Inst.*, 448 U.S. 607, 646 (1980)); and allow the Securities and Exchange Commission to modify the structure of holding

company systems to ensure that they are not "unduly or unnecessarily complicate[d]" and do not "unfairly or inequitably distribute voting power among security holders" (*American Power & Light Co. v. SEC,* 329 U.S. 90, 104 (1946). In each case, Congress specified the bottom-line principle that should guide administrative action.

On the other hand, the Supreme Court has disapproved a statute that gave the executive the power to "prohibit the transportation in interstate and foreign commerce of petroleum" in excess of state permission. *See Panama Ref. Co. v. Ryan*, 293 U.S. 388, 406 (1935). Congress had specified the objectives of the statute—removing obstructions to the free flow of commerce, encouraging productivity, and conserving natural resources—but "[a]mong the numerous and diverse objectives broadly stated, the President was not required to choose." *Id.* at 418. That is, the statute did not lay down any hard-and-fast rules:

> As to the transportation of oil production in excess of state permission, the Congress has declared no policy, has established no standard, has laid down no rule. There is no requirement, no definition of circumstances and conditions in which the transportation is to be allowed or prohibited.

Id. at 430.

The Court reached a virtually identical result in *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 529-31 (1935), where the Court struck down a statute that authorized the President to approve "codes of fair competition" proposed by trade or industry groups, if the President finds that the codes are not designed "to promote monopolies" and "will tend to effectuate the policy" behind the statute. *Id.* at 521-23. In turn, the policies behind the statute

"embrace[d] a broad range of objectives," including removing obstructions to the free flow of commerce, providing for the general welfare, promoting cooperative action among trade groups, inducing united action of labor and management, eliminating unfair competition, promoting productivity of industries, avoiding undue restrictions on production, increasing the consumption of industrial and agricultural products by increasing purchasing power, reducing unemployment, improving standards of labor, rehabilitating industry, and conserving natural resources. *Id.* at 534-35.

The Court struck down this regime on the ground that it "sets up no standards, aside from the statement of the general aims of rehabilitation, correction, and expansion," which the Court characterized as "a preface of generalities." *Id.* at 537, 541. The Court contrasted the statute at issue with ones in which Congress "declar[es] the rule which shall prevail in the legislative fixing of rates, and then remit[s] the fixing of such rates in accordance with its provisions to a rate-making body." *Id.* at 541 (internal quotation marks omitted).

The Commission's interpretation of §3622(d)(3) would place the PAEA on the impermissible side of the constitutional line. Once the price cap and limitations found in Sections 3622(d)(1) and (2) are removed, there would be "no policy," "no standard," and "no rule." *Panama Ref. Co.*, 293 U.S. at 430. The "objectives" and "factors" set forth in Sections 3622(b) and (c) are nothing more than "general aims" and "a broad range of objectives" (*A.L.A. Schechter*, 295 U.S. at 541, 543); they lay down "numerous and diverse objectives broadly stated,"

amongst which "the [Commission] is not required to choose (*Panama Ref. Co.*, 293 U.S. at 417). In sum, they impose ***no hard-and-fast rules***.

The need for such rules is especially pronounced in this context:

> It is true enough that the degree of agency discretion that is acceptable varies according to the scope of the power congressionally conferred. While Congress need not provide any direction to the EPA regarding the manner in which it is to define "country elevators," which are to be exempt from new-stationary-source regulations governing grain elevators, it must provide substantial guidance on setting air standards that affect the entire national economy.

Whitman, 531 U.S. at 475 (internal citations omitted). Because postal rates for the entire nation are at issue here, Congress should be expected to provide substantial direction to guide administrative action—something that cannot be found in the general objectives and factors alone.

The Commission gave short shrift to the non-delegation doctrine, treating it in a single paragraph stating that the statute simply "leaves a certain degree of discretion to an Executive Branch actor." *NPRM* at 24. In the Commission's view, the statute offers "clear direction," in that "[a]ny modifications or the adoption of an alternative system must be necessary for the system to achieve the objectives" set forth in the statute. *Id.*[25] But those objectives are decidedly vague. They include maximizing incentives to reduce costs and increase efficiency, creating predictability and stability in rates, maintaining high quality service standard, allowing the Postal Service pricing flexibility, assuring adequate revenues, reducing the administrative burden and increasing the transparency of

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[25] *See also USPS Comments* at 12-13 (Mar. 20, 2017) (referring to the statute's objectives and factors as providing "detailed standards").

the ratemaking process, enhancing mail security, deterring terrorism, establishing and maintaining a just and reasonable schedule for rates and classifications, and allocating the total institutional costs of the Postal Service appropriately between market-dominant and competitive products. These are, at best, a "preface of generalities." *A.L.A. Schechter*, 295 U.S. at 537. Indeed, in some respects, these considerations are in tension with one another, giving *competing* direction at best (see below).

These policy objectives are legally indistinguishable from the "broad range of objectives" and "numerous and diverse objectives broadly stated" that failed to save the statutes at issue in *A.L.A. Schechter*, 295 U.S. at 534, and *Panama Ref. Co.*, 293 U.S. at 417. The delegations at issue in those cases did not survive *despite the inclusion of those objectives* because the statutes omitted any bottom-line rules. So, too, here: If the price cap were stripped away, there would be no bottom-line rule to limit the "alternative system" that the Commission could adopt.

For that reason, the price cap should not be excised from the statute. Instead, Section 3622(d)(3) should be construed to require the Commission to work within the mandatory framework imposed by Sections 3622(d)(1) and (2). "A construction of the statute that avoids [an] open-ended grant should certainly be favored." *Indus. Union Dep't v. Am. Petroleum Inst.*, 448 U.S. 607, 646 (1980) (plurality opinion); *see also Nat'l Cable Television Ass'n, Inc. v. United States*, 415 U.S. 336, 342 (1974) (construing statute to avoid non-delegation question). "In recent years, [the Supreme Court's] application of the

nondelegation doctrine principally has [largely consisted of] giving narrow constructions to statutory delegations that might otherwise be thought to be unconstitutional." *Mistretta*, 488 U.S. at 373 n.7. The doctrine should be applied here consistently with that tradition.

In sum, under the interpretation of the statute that comports with the statutory text, Congress's historic role in postal rate-setting, and relevant canons of statutory construction, Section 3622(d)(3) does not authorize the Commission to disregard the price cap and related limitations created by Sections 3622(d)(1) and (2).

* * *

The Commission's lack of legal authority to disregard the requirements in Section 3522(d)(1) and (2) should end this matter. It does not have the authority to:

- Authorize "supplemental" price cap authority of 2 percent annually for each of the first five calendar years following the effective date of the new rules.
- Authorize 0.75 percent additional price cap authority annually for improvements to operational efficiency, as measured by Total Factor Productivity ("TFP"); or
- Authorize 0.25 percent additional price cap authority annually for maintaining current published delivery standards and business rules.

The First-Class Business Mailers recognize that this analysis could affect the Commission's legal authority to presume the general lawfulness of workshare discounts that passthrough more than 100 percent of the costs avoided. In any

case, however, the Commission clearly would have authority to require the use of ECP up to 100 percent pass-throughs.

III. THE PROPOSAL TO PROMOTE EFFICIENCY BY REQUIRING THE POSTAL SERVICE TO SET WORKSHARING DISCOUNT PASSTHROUGHS WITHIN EFFICIENT BOUNDS SHOULD BE ADOPTED WITH MODIFICATIONS

Although the Commission lacks legal authority to allow the Postal Service to exceed the price cap as proposed, it does have the authority to require the use of Efficient Component Pricing for workshare discounts. The *NPRM* proposal to do so should be adopted, with modifications.

The *NPRM* proposes to require workshare discount pass-throughs in First-Class and Marketing Mail to be set within a range of 85 to 115 percent of the costs avoided. *NPRM* at 93. In the case of pass-throughs that are outside of those bounds, it proposes a three-year grace period to come into compliance. *Id*. at 95. Similarly, it proposes to allow the Postal Service three years to bring within the band new discounts established in the future. *Id*.

The Commission is well within its legal authority to improve the pricing of workshare discounts. It is to be commended for moving towards ECP in setting discounts, an important step towards more efficient pricing policy as required by Objective 1. It also is consistent with Objectives 5 and 8, and Factors 4, 5, and 6.

The Commission should adopt this the proposal with two improvements. First, the presumptive range should be tightened, and second, there should not be a phase-in period.

A. The Presumptive Range Should Be Tightened To 95-105 Percent

The First-Class Business Mailers support the concept of setting a range with upper and lower limits within which workshare discount pass-throughs would be deemed compliant. However, the proposed 30 percent range for the band is too broad. Instead, for First-Class and Marketing Mail, a range more consistent with maximizing the incentives for pricing efficiency would be between 95 and 105 percent. A narrower range would also minimize the chance of excessive pass-throughs. (If the Commission is persuaded that it lacks authority to establish a presumption that pass-throughs from 101 to 105 percent are lawful, the appropriate range should be 95 to 100 percent.)[26]

The Postal Service's history over the course of the PAEA era of reducing workshare pass-throughs demonstrates the need for a more narrow range than proposed. The *NPRM* notes that in Docket No. R2008-1, 46 of 69 pass-throughs were within the proposed range, but by Docket No. R2017-1 only 20 of 75 pass-throughs were. *NPRM* at 94. And the volume of mail covered by a particular passthrough also matters, because the consequences of inefficient pricing are greater the larger the affected volume.

The Postal Service has continued to set pass-throughs at inefficient levels in recent years. In each of the last two rate adjustments, the Postal Service has set the vitally important discount at the 5-Digit Automation tier (which accounts

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[26] Narrowing the band still leaves the Postal Service with far more flexibility than it allows mailers. We note, for example, that the Postal Service will demand 0.5 percent tolerance for Move Update compliance, one of many quality measurements that it uses to evaluate and penalize mailers with additional postage assessments for non-compliance.

for the majority of First-Class Letter Presort Mail) at less than 90 percent.[27] Also in Docket No. R2018-1, the Postal Service shrank the Automation Letter pass-through from 100 percent in Docket No. R2017-1 to 83 percent [28] The story of the pass-through from the Metered Mail benchmark to the Nonautomation Presort Letter rate is even more dismal – a meager pass-through of 16.3 percent in Docket No. R2017-1 and of 16.9 percent in Docket No. R2018-1.[29]

These uneconomic pricing signals have discouraged the mailing industry from performing work that it could do more efficiently than the Postal Service. Setting all pass-throughs at more efficient levels would reduce the Postal Service's incentive to "price to capacity" rather than price to maximize efficiency as the PAEA requires. Order No. 4257 correctly observed (at 216) that "workshare discounts set substantially below avoided costs may cause the Postal Service to maintain a larger network or retain more processing operations than necessary."

The narrower the range of the band, the more efficient and cost-effective the price signals will be. If discounts are set properly, there should be less concern about rate fluctuations arising from changes in avoided costs.

Accordingly, the First-Class Business Mailers recommend that the Commission modify proposed rule § 3010.261(c) so that it reads:

(c) 95 percent to 105 percent for all other classes.

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27 *See* Docket No. R2017-1, USPS-LR-R2017-1/1, CAPCALC-FCM-R2017-1 Rev. 11-1-16.xlsx (Tab Passthrus FCM Bulk Letters, Cards) (83.3 percent) & Docket No. R2018-1, USPS-LR-R2018-1/1, CAPCALC-FCM-R2018-1 Rev. 10_19.xlsx (FCM Worksharing) (88.2 percent).

28 *Id*.

29 *Id*.

B. The Presumptive Range Should Take Effect Immediately Without A Three-Year Phase-In Period

The First-Class Business Mailers disagree with the proposal to phase-in the new workshare discount bands over three years. There is no need for a transition period. Instead, the band requirement should take effect the first time the Postal Service proposes to use any additional or price cap authority created by this proceeding. Mail currently within the band should remain within the band, and all workshare discounts outside of the band should move within the band.

Delaying the band requirement for three years would be harmful. Authorizing above-inflation rate increases without simultaneously requiring efficient discounts is a policy mishmash that will not "maximize the incentives for cost reduction and efficiency" as required by Objective 1. The Commission's *NPRM* implicitly recognizes that postal management has used problematic judgment in setting inefficient workshare pass-throughs. There is no reason to allow the Postal Service three more years to do so.

Nor would immediate implementation of the new rule impede rate design. Efficient workshare discount prices benefit the Postal Service, as finely prepared pieces contribute more per piece than less-workshared pieces. Postal rates should be set to send efficient signals, and the sizes of the workshare discounts are trivial compared to the billion-dollar overall rate increases proposed elsewhere in the *NPRM*.

That a change might be large is not necessarily a problem. The Commission saw no need for a phase-in when the Postal Service reduced the

pass-through for Automation 5-Digit Flats in Docket No. R2018-1 from 115.7 percent to 100 percent, shrinking the discount from $0.184 to $0.119 with a corresponding hike in the final rate. Order No. 4215, at 12 (Nov. 9, 2017). Implementing the band requirement without delay should also pose no material risk of rate shock. In cases in which rate shock remains a concern, the Postal Service would retain the ability to invoke the statutory exceptions in Section 3622(e).

Nor should there be a three-year phase-in period for new worksharing discounts. There is no *a priori* reason why a new workshare discount should not be set at or near the best estimate of avoided costs. The experimental and market test rules should give the Postal Service an opportunity to test a new discount and obtain reasonable data before setting a new permanent workshare discount.

Accordingly, proposed rule Section 3010.262 should not be adopted.

IV. THE PROPOSED 2 PERCENT "SUPPLEMENTAL" RATE AUTHORITY ABOVE THE STATUTORY CPI CAP WOULD PLACE THE ENTIRE BURDEN ON MARKET DOMINANT MAILERS AND WOULD RESULT IN RATE INCREASES MUCH LARGER THAN STATED

The *NPRM* proposes to grant the Postal Service "supplemental" price cap authority of 2 percent above CPI annually for each of the first five calendar years following the effective date of the new rules. *NPRM* at 38. This is intended to address what the Commission has referred to as "medium-term" financial stability. *Id*. These increases, which would compound, would remain in the base rates

after the fifth year. This increase would not be conditioned on any cost savings or productivity improvements.

The Commission based its 2 percent supplemental authority proposal on the FY 2017 net loss of $2.7 billion, or about 5.7 percent of the Postal Service's FY 2017 market dominant revenue. *NPRM* at 40-41. Instead of raising rates by 5.7 percent at once, the *NPRM* proposes to phase in this increase over five years "to allow mailers to plan their operations and budgets over this period." *Id*. at 42. The Commission set the supplemental authority at 2 percent because it:

> in addition to the CPI-U price cap for 5 years produces estimated revenues with a net present value equal to that of a one-time rate increase of 5.7 percent above CPI-U followed by 4 years of inflation-only increases.

Id. at 42.

To estimate future revenue due to this proposal, the *NPRM* applied the higher rates to current volumes. Because volumes are declining and the mail mix is shifting to lower priced mail, the *NPRM* acknowledges that this method overestimates the amount of revenue that the proposed 2 percent would generate, stating that it "intends for the Postal Service to achieve cost reductions and operational efficiency gains sufficient to close the gap between total revenue and total costs." *Id*. at 42-43. After five years, the Commission intends to review the Postal Service's financial performance.

Even assuming *arguendo* that the Commission has legal authority to jettison the statutory price cap, this proposal has many flaws. It is premised on a grossly overstatement of the amount of money that the Postal Service may need, or must collect from market dominant mailers. It ignores both the contributions

from Competitive products, and the Postal Service's extensive funds and real estate assets. Furthermore, the proposed 2 percent supplemental authority suffers from a design flaw that results in rates in years 5 through 10 (and beyond) $2 billion higher than even the $2.7 billion that the Commission intends. Finally, it lacks any incentive to reduce costs.

Market dominant mailers – and especially First-Class Business Mailers – already bear the heaviest burden of the Service's overhead. The Commission should look at all options first, before increasing that burden still more. The Commission should consider refocusing on cash flow, how the Postal Service might monetize its considerable assets, take into account Competitive product profitability, and improving service performance before looking at the cap, and then at only the lowest possible increase.

A. The Proposed Two Percent Supplemental Authority Is Based On An Unsound Legal Standard, Ignores Competitive Products, And Fails To Take Into Account Other Postal Assets

The negative balance sheet of such concern to the Commission is not the fault of market dominant mail – which has easily covered its attributable costs and paid the vast majority of institutional costs every year that the PAEA has been in effect. Against this background, the proposal to raise market dominant rates by two percent above CPI for five years – which would do nothing to encourage cost reduction or efficiency – is based on an incorrect standard, should be reduced to take into account Competitive products, and would result in rates higher than targeted after five years.

1. The Commission used the incorrect legal standard, which inflated the perceived "shortfall"

Order No. 4257 and the *NPRM* employ a definition of the Objective 5 term "financial stability" that is untethered to any statutory language. The Commission's approach relies on concepts of its own making regarding short-term, medium-term, and long-term financial stability, while rejecting the only language in Section 3622 that indicates what Congress meant by "financial stability."

Section 3622(d)(1), the exigency provision, authorizes the Commission to approve above-cap rate adjustments due to extraordinary or exceptional circumstances where:

> Such adjustment is reasonable and equitable and necessary to enable 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.

39 U.S.C. §3622(d)(1)(E). Both the Commission and the Court of Appeals have called the exigency provision a "safety value" that allows the Postal Service to "compensate[s] for the net adverse financial impact of the exigent circumstances." Order No. 864, Docket No. R2010-4R, at 25 (Sept. 20, 2011); *Alliance of Nonprofit Mailers v. Postal Regulatory Commission*, 790 F.3d 186, 189 (D.C. Cir. 2015).[30] Because the exigency provision is intended to offset

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[30] *Accord* Order No. 1926, Docket No. R2013-11, at 17-19 (Dec. 24, 2013) (noting need to quantify the "net financial impact" of the exigent circumstance); *aff'd United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263, 1268 (D.C. Cir. 2011) ("the adjustments must match the amount of the revenue lost as a result of the exigent circumstances").

adverse financial effects of an exigent circumstance, the standard defined in the exigency provision should be regarded as the normal financial condition.

Accordingly, a PAEA-based definition of "financial stability" is that which allows 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." *See* Order No. 1926, Docket No. R2013-11, at 115 (Dec. 24, 2013). Under the PAEA-based definition, the most appropriate metric is whether the system of rate regulation has generated sufficient funds to maintain and develop postal services adapted to the needs of the nation, consistent with best practices of honest, efficient, and economical management. Neither Order No. 4257 nor the *NPRM*, which relies entirely on the former, examined that question.[31]

In Order No. 4257 (at 154), the Commission rejected the Section 3622(d)(1) definition based "because it does not adequately address the Objective 5 mandate for the Postal Service to generate retained earnings as part of financial stability." That reasoning is unpersuasive. First, it is based on the erroneous assumption that the Postal Service is "entitled" to retained earnings. As discussed below, that is simply a misreading of the statute.

Second, neither Order No. 4257 nor the *NPRM* offers any explanation of how the (d)(1) definition fails to "adequately address" retained earnings. Nothing in the (d)(1) standard precludes the Postal Service from developing postal

[31] Whether postal management has met this "best" standard is not addressed by the *NPRM*. The First-Class Business Mailers believe that postal management does a good job, but there is certainly room for them to do better.

services; and, indeed, the very purpose of the exigency provision is to preserve the Service's financial stability during extraordinary or exceptional circumstances.

The First-Class Business Mailers urge the Commission to apply a statute-driven definition of financial stability. If it were to apply the correct definition, it would have to conclude that the Postal Service is financially stable. The Service has, in fact, "maintained and developed" postal services designed for the needs of the nation, although whether it has always exercised the "best practices" of economical or efficient management in doing so is debatable. The mail has been delivered, to more delivery points than ever before, and the Postal Service has introduced pricing innovations, invested in new equipment, and redesigned its network to support the volumes anticipated in the future.

To the extent that it has fallen short of the Section 3622(d)(1) standard, it has done so by failing to meet the "economical" and "efficient" elements of the test. And to the extent that these shortcomings exist, they should be addressed in the context of improving the achievement of Objective 1, not by raising rates.

2. Order No. 4257 and the *NPRM* mistakenly assume that the Postal Service is "entitled" to retained earnings

Section 3622(b)(5) provides that the market dominant rate regulatory system shall assure that the Postal Service has "adequate revenues, including retained earnings, to maintain financial stability." 39 U.S.C. 3622(b)(5). The Commission reads this "plain language" of Objective 5 as "requiring" that the Postal Service generate, or an entitlement to, retained earnings. Order No. 4257 at 154 & 158; *NPRM* at 33-34. This premise serves as part of the justification

offered by the *NPRM* for proposing to authorize the Postal Service to raise market dominant rates by more than the CPI.

The Commission's treatment of retained earnings reflects an apparent misunderstanding of the Objective 5. Congress included the term "retained earnings" in the PAEA to make clear that the "breakeven" requirement in the former law was no more. Former 39 U.S.C. §3621 had provided, in relevant part: "Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service."

By eliminating this former "breakeven" requirement, Congress authorized the Postal Service to earn positive net revenue without fear of having to disgorge it in a subsequent cost-of-service rate case. Allowing the Postal Service to keep any operating net income was intended, hand-in-hand with the price cap, to provide an incentive for it to reduce costs and increase efficiencies.

That the law since 2006 has *authorized* the Postal Service to retain positive earnings is hardly the same as that it somehow is "entitled" to them. Retained earnings, as the name implies, are to be earned through cost controls and encouraging volume growth. The price cap placed a ceiling on revenues; under that ceiling, the Service was allowed and expected to cut costs and could pocket any resulting net revenue. That is quite different from an entitlement.

That the Postal Service did not have positive net income since enactment of the PAEA, and thus no retained earnings, means only that the Service failed to

cut costs sufficiently in response to declining volume. Had it done so, it would have been able to retain any positive earnings that it generated.

Indeed, if the Postal Service were legally "entitled" to retained earnings, then the price cap established by Congress would have been illusory. Instead, market dominant rate regulation would be a form of cost-of-service with a guaranteed rate of return and deferred revenue collection. Congress certainly did not say that if the Postal Service failed to cut costs sufficiently to generate retained earnings, then the price cap – which the Commission has repeatedly acknowledged was fundamental to the PAEA reforms – could freely be disregarded.[32]

Finally, if the Postal Service believes that the Commission will allow it to raise rates sufficiently above the CPI cap to ensure that it has positive net income and retained earnings, then the Service will have little incentive to reduce costs or attempt to increase market dominant volumes going forward. As the Commission has noted regarding the former breakeven requirement, the Service's knowledge that it was entitled to recover all estimated costs plus prior years losses and a contingency amount gave it little incentive to cut costs. Order No. 4257 at 24. *Raising* the cap is hardly, in this situation, the correct response.

Retained earnings were contemplated by the PAEA as an opportunity, not an entitlement. Nowhere in the PAEA did Congress say that the term "retained

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[32] In the private sector, only a business with a monopoly – or one that is engaged in price fixing --- can raise prices willy-nilly. But monopolies and price-fixers come under antitrust or similar scrutiny, as recently demonstrated by the Turing and Valient Pharmaceuticals companies. Here, Congress has granted the Postal Service a monopoly and assigned this Commission the role of preventing predatory behavior that the Sherman and Clayton Acts establish for private firms. It is the responsibility of the Commission to ensure that the Postal Service earns its surpluses, not simply raises rates high enough to create them.

earnings" in Objective 5 was intended to outweigh Section 3622(d)(1). Discarding the CPI cap in order to force retained earnings would eviscerate the purpose of the Act, and divert management's attention from cost reduction, improved efficiency, technology innovation, and increasing market dominant volumes.

3. The *NPRM* ignores the revenue from competitive products while proposing to require market dominant products to fund all of the Postal Service's financial shortfalls

Section 3622 concerns the system for regulating the prices for market dominant postal products. The Commission does not contend – nor could it -- that market dominant products as a group do not cover their attributable costs or make a significant contribution to institutional costs. On the contrary, every Annual Compliance Determination since enactment of the PAEA has concluded that they do.[33] The price cap has also provided an incentive to postal management to price Competitive products in a profit-maximizing manner, because it prevents monopoly mail rates from being raised to cover Competitive product shortfalls.

Despite this success, the *NPRM* would abrogate the system governing the pricing of market dominant products to "fix" the Postal Service's *overall* financial problems. Literally, the Commission proposes to address the Postal Service's *comprehensive* issue by holding market dominant mailers liable for recovering the *entire* $2.7 billion deficit target that the 2 percent supplemental authority

[33] Market dominant products have done so as a group every year, although, unlike Competitive Products, the law does not require all market dominant products to cover their costs.

seeks to recover. This is clear from Order No. 4257, which stated (at 169): "the total revenue generated by the market dominant ratemaking system was not sufficient to cover total costs" without explaining why it should be.

This *NPRM* proposal is perplexing because in 2017 market dominant products ***provided only 70 percent of the Postal Service's revenues***, and that proportion will likely decline in years to come. Despite the growth trends in Competitive Product volumes, revenues, and profitability, the Commission proposes to recover the entire "supplemental" $2.7 billion annual target from market dominant products. It assumed that Competitive products merely would "maintain the current level of contribution to institutional costs." *NPRM*, at 41 n.58.

As an initial matter, it merits noting that the Commission has already pulled the rug out from under this assumption.[34] Furthermore, there is no reason to disregard Competitive products when calculating what additional sums to extract from market dominant mailers. The Section 3633(a)(3) "appropriate share" provision demonstrates that Congress expected Competitive Products to share in covering overhead costs. Congress did not say that once an appropriate share is set, any subsequent shortfalls in institutional costs are to be recovered from market dominant mailers.

Accordingly, it would be reasonable to reduce the portion of the targeted "shortfall" to be recovered from market dominant mailers by 30 percent to reflect

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[34] *See* Order No. 4402, Docket No. RM2017-1 (Feb. 8, 2018) (proposing new method of determining "appropriate share" that, using current results, would materially increase the share assigned to Competitive products).

the share of postal revenues generated from Competitive products. In FY 2017 dollars, the Year 1 increase would be 2 percent of $47.788 billion, or about $956 million; 30 percent of that (or $286 million) should come from Competitive products and only $670 million from market dominant mail). As an alternative route to the same result, the $2.7 billion reference point upon which the *NPRM* relies in fashioning the proposed 2 percent above-CPI annual increase for five years could be reduced by 30 percent.

Each subsequent annual increase also should be reduced by at least the same proportion to ensure that Competitive products continue to share the burden. As the Postal Service's growth in Competitive product volumes, revenues, and profits is expected to continue in the coming years, the Commission should also monitor the relevant revenue shares of market dominant and Competitive Products going forward and adjust the targeted revenue accordingly.

4. The Commission has ignored the Postal Service's substantial real estate and retirement funds

The Postal Service has substantial real estate assets that appear on its balance sheet only at net depreciated value. The net value of its property and equipment as of September 30, 2017, was $14.981 billion. *USPS 2017 Form 10-K* at 46. That figure, which includes equipment, is indisputably far below the true market value of those properties. Although the Postal Service has not provided the market value of its real estate, its Inspector General has estimated that the

market value of Postal Service real estate could be as high as $85 billion.[35] The Postal Service also has more than $335 billion in its FERS, CSRS, and RHB funds. *USPS FY18 Integrated Financial Plan* at 5.

The Commission disregarded these assets in both Order No. 4257 and the *NPRM*. In Order No. 4257, the Commission refused to consider the considerable market value of the Postal Service's real estate on the grounds that Generally Accepted Accounting Principles do not usually allow real estate to be restated at market value. *Id*. at 155. While that is accurate as to GAAP, that approach does not consider the actual value of the Postal Service's assets.

Nor did the Commission consider how the Postal Service could use the market value of its depreciated real estate to satisfy liabilities or raise capital for new investment. Instead, it appears to have misunderstood the issue by stating: "in order for the Postal Service to realize the full value of its real estate, it would have to dispose of those assets and either curtail operations or replace the real estate with new assets, presumably purchased at market value." *Id*.

No one is suggesting that the Postal Service sell off its real estate and then provide service through phantom facilities. However, the Postal Service is expected to apply the best practices of efficient and economical management. Private businesses routinely engage in sale/lease back arrangements in which they sell physical assets to third parties and lease them back. Properly done, this enables those businesses to convert the market value of their real estate (which is carried on the balance sheet at net depreciated value) into capital

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[35] *Considerations in Structuring Estimated Liabilities*, Office of the Inspector General, Report Number FT-WP-15-003, at 3 (citing an estimate from June 2012) (Jan. 23, 2015).

available for, among other things, investments in new vehicles and technology, the development of new products, or payment of debts. The sale/lease back arrangement would also allow the Postal Service to manage the restructuring of its network over time, as it is better able to shed leases when it is time to close a facility, or to lease a new facility when appropriate.

The failure of the *NPRM* to consider the Postal Service's ability to raise capital in this manner while continuing to operate within the statutory price cap is a failure to consider a reasonable alternative. The Commission should require the Postal Service to provide the market value of its real estate and a reasonable plan for monetizing them before attempting to authorize rate increases above CPI.

In addition, the more than $335 billion that the Postal Service holds in its retiree funds almost certainly exceeds the market value of its real estate. These assets, together with the market value of the real estate, also should be considered when determining the Postal Service's actual financial condition and how much extra, if any, it needs for its financial stability. Indeed, it is surprising that an entity that is to be run according to best business practices and efficient and economical management has not offered some options along these lines to the Commission.

In Order No. 4257, the Commission insisted that it must "consider the statutory obligations of the Postal Service (such as the RHBF) in its overall

financial stability analysis." *Id*. at 158.[36] Yet while the Commission did so in assessing the Service's "long-term" financial condition, it ignored the sizeable sums held by the Postal Service in the funds to which it makes those payments and which can cover its future liabilities for quite a while.

Even the smallest fund, the RHB, holds nearly $50 billion, which is nearly 50 percent of the actuarial liability, and as of 2017, the annuitant premium payments for the RHB are drawn from the fund (even if the Postal Service skips its payment of the normal costs of retiree health benefits attributable to current employees). *USPS FY18 Integrated Financial Plan* at 4; *USPS 2017 Form 10-K* at 31-32. The FERS and CSRS funds are even more fully funded.[37] Thus, Postal Service retiree health benefit premiums will be funded for a considerable period of time even if the Service were to never to contribute a penny more.

Taking into account these considerable assets and that RHB premium payments are fully covered for many years should reduce the need for revenue from the reference point used by the *NPRM*. There is no need to rush this proceeding; the Commission should take the time to ensure that any revenue target is reduced appropriately to reflect ***all*** of the Postal Service's assets, not merely market dominant mail.

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[36] These statutory obligations also include supplemental contributions to the Federal Employees Retirement System and contributions to meet adjustments to the worker's compensation liabilities.

[37] The Postal Service's CSRS and FERS' fund balances are both greater than 91 percent of their respective actuarial liability. *USPS FY2017 10-K*, at 28. And the Office of Personnel Management has announced its intention to use Postal-Service specific demographics (but not salary growth assumptions) in calculating CSRS and FERS retirement benefits, which is expected to reduce the size of those obligations. *Id.* at 29.

5. The proposed 2-percent supplemental cap authority would grossly over recover after five years

The *NPRM*'s proposed 2 percent "supplemental" price cap authority in each of the next five years is intended to produce "estimated revenues with a net present value equal to that of a one-time rate increase of 5.7 percent above CPI-U followed by 4 years of inflation-only increases." *NPRM* at 41-42. This is based on the FY 2017 net loss of $2.7 billion, or 5.7 percent of total Postal Service market dominant revenues in that year. The Commission states that phasing in the increase is this manner would be a more "smooth and steady" way to proceed than an immediate one-time 5.7 percent increase in the first year.

The Commission attempts to illustrate this in Figure III-1. *NPRM* at 44. However, that chart shows that the two approaches are anything but equivalent, other than that they collect the same amount of money over the first few years. The Commission's approach would result in a much larger increase in market dominant rates after five years than merely 5.7 percent. That is evident from Figure III-1 itself:

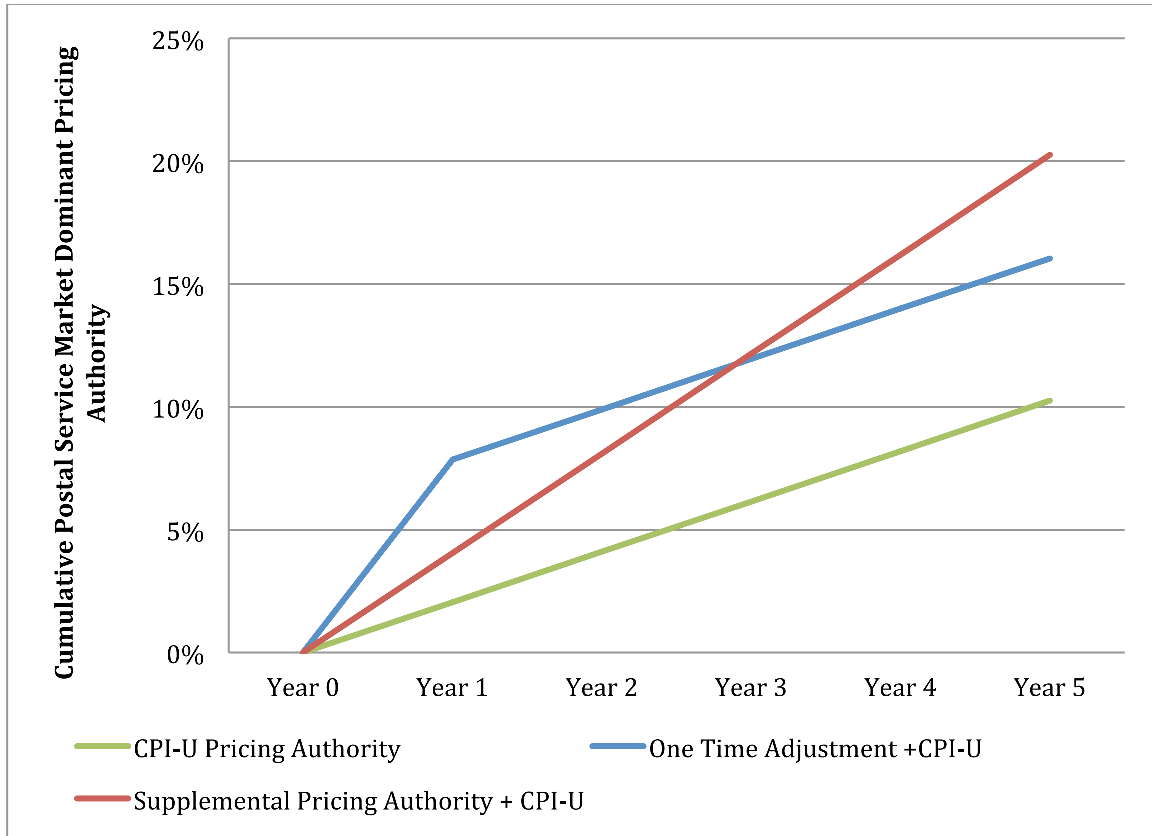

Figure III-1, source LR- PRC-LR-RM2017-3/2 (Tab Figure).

Figure III-1 is intended to show that raising rates by 2 percent annually in each of the next five years (the red line) would produce the same amount of revenue as a 5.7 percent rate increase in Year 1, followed by no increase (other than inflation (the blue line) – which Figure III-1 assumes to be 2.05 percent annually. *See* PRC-LR-RM2017-3/2 (Tab PC Auth Calc).[38]

But Figure III-1 also shows is that, by the fifth year, the base rate facing market dominant mailers from the 2 percent supplemental increase would substantially exceed a 5.7 percent increase (plus inflation). Instead, it would be

[38] The Commission's assumption that inflation will remain at 2.05 percent for the next five years is looking dubious. Inflation appears likely to tick up by more and the Federal Reserve may raise interest rates by more than financial markets have been assuming.

at 10 percent, rather than 5.7 percent (not including the compounding effect), a difference that works out to about $2 billion a year.

That is 4.3 percent more than would result from the 5.7 percent one-time increase that the Commission deemed unacceptably large (*NPRM* at 44-45) and almost exactly double the rate increase that the current CPI-U cap would allow. The value of that 4.3 percent difference, using FY 2017 market dominant revenues, is about $2.0 billion from the market dominant mailers whom rate regulation is supposed to protect. Adding an inflation rate of 2.05 percent, which is the assumption in the *NPRM*, to the five 2-percent increases results in a cumulative rate increase after five years of 20.25 percent under the proposal. *Id*.

Nowhere does the *NPRM* acknowledge that rates after five years would be 10+ percent higher than under current law – *even were inflation zero*. The Commission can hardly be unaware of that fact because Figure III-1 illustrates it quite plainly. The NPRM does not come to grips with the fact that the cumulative increase after five years would exceed 20 percent even if inflation remains at 2 percent. And because mailers pay nominal, unadjusted rates, that is the increase that they would perceive.[39] It is important to bear in mind that the use of real (inflation-adjusted) numbers in the analysis does not really reflect the real-world effects.

Thus, after five years market dominant rates would be more than 20 percent higher than today (assuming inflation holds steady at 2 percent). The

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[39] Private businesses setting budgets do so on the basis of unadjusted numbers, because they lack the power to raise rates hand-in-hand with inflation. When the Commission considers the cumulative effect of the various increases, the totals unadjusted for inflation are the most relevant when considering the effects on mailers.

NPRM does not propose that this increase would automatically revert after five years to the level that a one-time 5.7 percent increase would have reached. Nor is there a proposed "throttle" if inflation were to soar in the next few years. Instead, the *NPRM* merely anticipates a review of the matter after five years.

But unless the rates are reset at the lower target, the Postal Service would substantially over-recover the $2.7 billion reference point starting in year 6 by $2.05 billion annually, an annuitized value of over $40 billion at a 5 percent interest. Presumably the Service would continue to charge those 20 percent higher rates throughout the pendency of any review that might occur. The Commission can be confident that the Postal Service would resist strenuously any reduction at that point, just as it did in the exigency case.

Even if the target sum were reduced to account for Competitive products, as it should be for the reasons stated above, the very design of the mechanism proposed in the *NPRM* essentially guarantees that the Postal Service will over-recover. Accordingly, if the Commission were to allow cap authority above the CPI-U, then it must modify the formula.

One option would be to moderate the annual increase to spread it over more than five years. Another would be for rates to revert to the 5.7 percent level after the fifth year. Still another, as discussed in more detail in Section VI below, would be to abandon such arbitrary increases and instead link any extra rate authority to true cost reductions in either Controllable Income or, as a simpler (and perhaps temporary) alternative, on significant improvements in Total Factor Productivity.

B. The Cumulative 10+ Percent Increase Over Five Years Would Lead To Ever-Spiraling Downward Volumes And Ever-Spiraling Upward Rates

The Commission assumes constant volumes when calculating the revenue that would be generated over five years by the proposed supplemental 2 percent above inflation annual increase. *NPRM* at 42. At the same time, it recognizes that because market dominant product volumes have been declining and shifting toward lower-priced products and rates, that assumption means that its revenue estimates are "higher than the revenues that the proposed rate adjustment authority would actually generate." *Id*. at 42-43. In other words, the *NPRM* admits that the proposed 2 percent supplemental rate authority will not do what it says that it will do – which makes it appear capricious, not reasoned.

The Postal Service anticipates First-Class Mail volume will decline in FY 2018 by 2.5 billion pieces, a 4.2 percent decline on top of the similar precipitous decline in FY 2017. *USPS FY18 Integrated Financial Plan* at 6.[40] It expects a comparable decline in Marketing Mail of 2.3 billion pieces, or 2.9 percent of that larger volume product. *Id*. In all, the Postal Service anticipates a total volume decline of 4.6 billion pieces, or 3.1 percent, even when included expected growth in Competitive Product volumes. *Id*. at 5-6. The prospect of above-inflation rates from the *NPRM* may accelerate volume departures. Nonetheless, the *NPRM* assumes that the Postal Service will continue to receive revenue from every one of these 4.6 billion pieces in each of the next five years.

[40] First quarter FY 2018 performance was in line with this prediction. Market dominant mail volumes fell by 5.2 percent. First-Class Mail volume fell by 4.4 percent, with Presort Letters failing by 3.4 percent. *See Preliminary RPW Report for Quarter 1, FY 2018* (filed Feb. 9, 2018). However, Marketing Mail volume fell by 5.9 percent.

The *NPRM* also concedes that it is difficult to predict the effects of rate increases "outside the industry's experience under the PAEA system of ratemaking." *Id*. at 45. That experience is narrow; because rate increases under the PAEA have, overall, been capped at inflation (excluding the exigency years), real price changes over the past decade have been close to zero. Calculating a reliable estimate of price elasticity over a period in which real price changes have effectively been zero is very challenging.

Postal Service volume forecasting models generate price elasticity estimates that reasonably are valid only within a limited range of price increases. But the increases being proposed by the *NPRM* are well beyond the range of the models over the past decade, making their price elasticity estimates uncertain at best. That means that one cannot truly know the amount by which the proposed supplemental rate authority will fall short of the revenue that the *NPRM* assumes. But if volumes of First-Class and Marketing Mail continue to decline by 4 percent annually, the shortfall will be large.

Unfortunately, the size of this unknown shortfall is very relevant to whether the *NPRM*'s proposal should be adopted. This is because the Commission expects the Postal Service to close whatever gap is left through cost reductions and achieving efficiencies. But this is little more than wishful thinking because the Commission has no way to know the size of that "gap" and it proposes no new oversight or accountability to ensure that those savings are realized. *NPRM* at 43. If the amount of the gap is unknown, there can be no reasonable basis to

expect that cost reductions will cover the gap. Certainly the Postal Service has not proposed any plans as to how it will cut costs to do so.

And because the Postal Service knows that the Commission intends to revisit this issue in five years,[41] it will not have strong incentives to make difficult decisions to reduce costs and to make sure that dollars are invested wisely during the next five years. The *NPRM* in this proceeding already gives the Postal Service good reason to expect that the Commission would give it yet another rate increase at that time, regardless of the consequences to the mailing industry. The “logic of [the *NPRM*] would require ever-increasing prices, even if that would drive away mail volume at a rate that could put the Postal Service out of business.”[42] Still more rate increases will beget still more volume losses, and the cycle would continue on.

A pattern of ever diminishing volume coupled with ever-spiraling rate hikes and no cost reductions is frighteningly foreseeable, despite being disastrous for the Service, the public, and the mailing industry. A different approach is needed, one that will create real incentives for the Postal Service to reduce costs and invest prudently, while maintaining predictability and stability. Such an approach is outlined in Section VI.

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[41] Order No. 4258 at 54-55.

[42] Dissenting Views of Commissioner Tony Hammond.

V. THE PROPOSED 0.75 PERCENT INCENTIVE FOR IMPROVING OPERATIONAL EFFICIENCY DEMANDS LITTLE FROM THE POSTAL SERVICE AND DOES NOT IMPROVE ACCOUNTABILITY

The *NPRM* proposes to award the Postal Service 0.75 percent additional cap authority (about $358 million based on FY 2017 market dominant revenue) if the average improvement in Total Factor Productivity over the most recent five-year period exceeds 0.606 percent. *Id* at 62.[43] The extra cap authority would expire if unused within a year. *NPRM* at 120. If TFP improved by less than the moving average (say by only 0.5 percent) or turned negative, the Service would receive no extra authority, but would also not be penalized. The *NPRM* does not propose a sunset for this proposal.

Although this proposal provides an incentive for the Postal Service to shed costs and gain efficiencies, it sets the hurdle for improvement at an insufficient level and is not balanced.

The Lowry and Wolff monograph on performance-based regulation cited in the *NPRM* states:

> Financial rewards and penalties need to strike the right balance: low enough to mitigate regulatory risk, but strong enough to incentivize correct utility behavior. This balance can sometimes be difficult to achieve.

Lowry & Woolf, *Performance-Based Regulation In A High Distributed Energy Resources Future*, Berkeley Lab Report No. 3, at 3 (January 2016). That is the case here as well.

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[43] A TFP improvement of 0.606 percent would equate to cost savings or efficiencies of approximately $420 million using FY 2017 market dominant revenue. This five-year average would be a rolling one, updated each year after the Postal Service files its annual TFP estimate with the earliest year rolling off. *See* Proposed Rule § 3010.181.

As noted above, a fundamental problem with the proposal is that it sets the TFP target too low. The proposed 0.606 benchmark is based on the average growth in TFP over the five recent Fiscal Years before issuance of the *NPRM*, *i.e.*, Fiscal Years 2011 to 2016. That was a period in which the Postal Service experienced poor operational productivity and its cost reductions and efficiency gains were less than under prior law.[44] During the entire PAEA era, TFP averaged 0.65 percent. Order No. 4257 at 225-226, *citing* Figure II-24.[45] TFP growth in FY 2015 was only 0.1 percent, and TFP actually declined in FY 2016 and, it now appears, ***again*** in FY 2017.[46] *Id*. at 220-221.

Given that the past five years have experienced admittedly unsatisfactory performance, it is strange that this period would provide the hurdle to be achieved. Instead, a performance incentive based on TFP-based performance incentive must, in the words of Lowry and Wolff, be strong enough to encourage proper behavior. Rather than the meager 0.606 from FY 2011 to FY 2016 under the PAEA (*NPRM* at 62), an approach such as that proposed in the *NPRM*

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44 The Postal Service did comparatively little for years to encourage use of the Intelligent Mail barcode or leverage its capabilities beyond a small 0.3 cent incentive. One of the most notable and costly efforts, the FSS, fizzled and has caused significant flats processing problems. And Network Rationalization underachieved its anticipated cost savings, harmed service standards by eliminating most "overnight" First-Class Mail, and may have harmed productivity by moving more processing to larger facilities that proved to be less efficient.

45 The average annual TFP growth during the last ten years of cost-of- service regulation was 1.03 percent. Order No. 4257 at 225-26, citing Figure II-24. That TFP improved more during a period of cost-of-service regulation than over a period of price cap regulation is counter-intuitive. But the late 1990's was a period of major innovation in postal operations. Perhaps the single most important innovation was automated processing of letters and the widening deployment of barcodes.

46 *See Responses of The United States Postal Service to Questions 1-19 of Chairman's Information Request No. 2,* Docket No. ACR2017. That continued poor performance would convert the rolling 5-year average to a mere 0.28 percent, an extremely low target.

should use a TFP threshold around 1.25 (near what was achieved under the prior law when operational efficiency was improving).

Second, the 0.75 percent "performance-based incentive" (about $358 million in FY 2017 dollars) is notably smaller than the $950 million from the "supplemental" 2 percent. The Postal Service could receive the great majority of extra revenue without having to tackle the hard steps necessary to improve TFP to reduce costs or improve productivity.

Third, the Postal Service would receive the entire benefit upon hitting the TFP target. A 1.607 percent TFP gain would earn it no more extra rate authority than a 0.607 percent gain.

Fourth, given the Postal Service's recent low -– and even negative -– TFP in recent years, it is possible that the rolling five-year average could become negative. If that were to occur, it would also be possible that even a negative change in TFP could still be higher than a negative 5-five rolling average, thus earning a bonus, so long as it were less bad than previous years. From any perspective, awarding the Postal Service any performance incentive for a negative TFP is simply unacceptable. A better proposal would require that, to earn any performance incentive, TFP must not only exceed a benchmark that would represent actual improved performance, but must also be positive.

Fifth, unlike the 2 percent supplemental rate authority, the *NPRM* does not propose that this authority would terminate. There is no reason why this "operational performance" extra should be indefinite. Any such authority should be sunset as well, subject to a future evaluation.

Sixth, the proposal is unbalanced -- it ratchets only upwards. The Postal Service would gain rate authority when it exceeds the benchmark, but there is no corresponding reduction if the benchmark is not met. A balanced proposal should also penalize the Service if it were to fail to meet the threshold. This should take the form of a reduction in rate authority -– equal to the additional rate authority the Postal Service could earn -- for each year that the target is not met. For example, using the *NPRM* proposal, if the Postal Service were to fail to exceed a 0.606 (or 0.28) TFP improvement, it would lose 0.75 percent rate authority.

Finally, TFP is an imperfect measure, because the way it measures efficiency allows TFP to increase without costs decreasing if there is excessive inflation in factor input prices. Measuring operational improvements by TFP would give the Postal Service a direct incentive to shift postal costs onto mailers without offering workshare or other incentives.[47] Seamless Acceptance is a recent example of such a move. The Commission would need to monitor the Postal Service carefully to ensure that it does not push unrecompensed costs on to mailers in order to get the 0.75 percent increase. For reference, compared to the incentive that the *NPRM* offers the Postal Service, the $.003 and $0.001 incentives for using Full Service IMb that Postal Service gives mailers is far smaller than the costs they incur.

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[47] For an analysis of the problem of the Postal Service shifting costs to mailers through the imposition of mailing requirements, see *Effects of Compliance Rules on Mailers*, Office of the Inspector General Audit Report (Aug. 24, 2011).

VI. ALTERNATIVE APPROACHES THAT ALIGN OBJECTIVES 1 AND 5 BY LINKING RATES TO COST AND PRODUCTIVITY IMPROVEMENTS COULD IMPROVE NET INCOME AT LOWER RATES

Section 3622(b) directs the Commission to consider the nine Objectives "in conjunction with the others." 39 U.S.C. §3622(b). The *NPRM* did not evaluate its various proposals against the different Objectives. Had it done so, it might have recognized that its proposals aimed at increasing Postal Service revenues may advance Objective 5, but conflict with Objectives 1 and 2, and at the least, violate the statutory duty to accord them equal weight. *See* Order No 4257 at 16; *citing Annual Compliance Determination*, Docket No. ACR2008, at 36 (Mar. 30, 2009). Successful cost control is an indispensable aspect of net revenue improvement under a price cap system. That is how Objectives 1 and 5 work together, and together enable the predictable price changes of Objective 2.

A better approach would tie *all* revenue increases to real cost reductions. Discussed in this section, and presented in more detail in the Appendix attached hereto and in the accompanying spreadsheets, are alternative approaches that would align Objectives 1 and 5 more closely. Assuming *arguendo* the Commission has authority to do so, these alternative approaches would completely replace the *NPRM*'s proposed 2 percent supplemental authority and 0.75 percent productivity incentive. These would not be perpetually; under either approach, the Commission should re-evaluate them in no later than five years.

A. Linkage To Controllable Cost

The most direct way to link earned additional cap authority to cost reductions would be to base the size of any above-cap price increase on savings in controllable costs. Under such an approach, if the Postal Service were to reduce controllable expenses, it could receive additional cap space in return. This is the same conceptual approach as in the *NPRM*'s 0.75 percent TFP proposal. If the Postal Service were able to reduce costs in Year One, it would earn additional cap authority in Year Two. As in the case of the *NPRM*'s TFP proposal, the Postal Service's balance sheet would benefit from both cost reductions and revenue improvements.

The Postal Service has in recent years presented a financial concept it has called "controllable" costs. Although the Commission has not formally adopted that term via a regulatory definition, our understanding is that it measures the costs that postal management has some power to control.

Properly designed, linking cap authority to "controllable costs" could create an incentive for both changes in the *efficiency* of postal operations and changes in the *prices* of the different factor inputs. This is desirable because both efficiency and input prices affect cost levels. This linkage to input prices (in addition to efficiency) is appropriate because the Postal Service has some ability to affect its input prices through careful management. In addition, the constraints of the regulatory regime also indirectly affect the collective-bargaining process by setting the larger financial context for negotiation, so encouraging careful management of input prices in the price levels should constrain wage growth.

Using assumptions based on FY 2017 actuals for input price inflation, annual volume change, and cost-elasticity with respect to volume, Figure 1 shows how rates, costs, and net income would change if this approach were in effect for five years. The five year period is used because the Commission says that it will review the system in five years.

Figure 1: Controllable Cost Alternative: Year-to-Year Changes

	2018	2019	2020	2021	2022	2023	5-Year Total
Operating revenue	$ 70.0	$ 68.6	$ 67.2	$ 65.8	$ 64.5	$ 63.2	$ 399.3
Controllable operating costs	$ 70.0	$ 67.4	$ 64.9	$ 62.4	$ 60.1	$ 57.9	$ 382.7
Volume	150.0	145.5	141.1	136.9	132.8	128.8	
Cost change due to volume change		$ (1.2)	$ (1.1)	$ (1.1)	$ (1.0)	$ (1.0)	
Revenue change due to volume change		$ (2.1)	$ (2.1)	$ (2.0)	$ (2.0)	$ (1.9)	
Net balance sheet improvement	$ -	$ 1.2	$ 2.3	$ 3.4	$ 4.4	$ 5.3	$ 16.7
Unit price	$ 0.47	$ 0.47	$ 0.48	$ 0.48	$ 0.49	$ 0.49	
Unit price real annual change		1.0%	1.0%	1.0%	1.0%	1.0%	5.1%

Source: Appendix at 7 & Linking Rate and Cost Changes, Tab Scenario 1.

The most notable results are that the Controllable Cost alternative:

(1) results in rates that are 5.1 percent higher than inflation after 5 years, compared to the *NPRM* proposal's rates that are 14.5 percent higher than inflation (combining the *NPRM*'s 2 percent and 0.75 percent proposals);

(2) shows a balance sheet improvement of $16.7 billion compared to the *NPRM* proposal's $14.8 billion (both treating the entire revenue structure under the market dominant framework); and

(3) produces controllable operating costs of $57.9 billion compared to $64.0 billion in 2023 (in 2018 dollars) under the *NPRM* proposal.

B. Linkage To TFP

As noted, the Commission has not developed and placed into operation an appropriate measure of controllable costs. As a result, there might be a delay before such an approach could be introduced. Therefore, as a less perfect but perhaps more practical interim alternative, the Commission might consider linking

above-cap authority to efficiency alone, using as the efficiency measure the growth in TFP that the *NPRM* has itself proposed to use.

As noted above, we recognize that TFP has some shortcomings, primarily because it fails to account directly for changes in factor input prices and therefore runs the risk of uncontrolled factor input prices, including wages. It also may give the Postal Service incentive to shift costs to mailers. However, it might serve on an interim basis until an approach based on controllable cost can be developed.

This TFP alternative differs from the *NPRM* proposal in three ways. One, it uses TFP (assuming controllable costs are not yet available) as the basis for *all* extra cap authority (other than service performance); in contrast, the *NPRM* uses TFP only as the condition for receiving the extra price authority of 0.75 percent above CPI, and not for the supplemental 2 percent authority.

Two, the alternative would improve upon the *NPRM* proposal by rewarding the Postal Service with greater rate authority the more it exceeds the target TFP growth rate, ensuring that at every level of TFP growth there remains an incentive to do better.

Third, if the Postal Service experiences TFP growth below the target (the same rolling average as in the *NPRM*), as a penalty cap authority would be reduced. This is fair because reduced TFP means that mailers would be receiving less efficient service for their money.

Figure 2 presents calculations of how rates, costs, and net income could change if this approach were in effect for five years. It assumes that the Postal Service would receive in extra rate authority half of the dollar equivalent of

percentage improvements in TFP. Its assumptions are based on FY 2017 actuals for input price inflation, annual volume change, and cost-elasticity with respect to volume. As in the *NPRM*, the targeted TFP growth rate would be a five-year rolling average.

Figure 2: TFP Alternative: Year-to-Year Changes

	2018	2019	2020	2021	2022	2023	5-Year Total
	[d]	[e]	[f]	[g]	[h]	[i]	[j]
Operating revenue	$ 70.0	$ 68.3	$ 66.5	$ 64.9	$ 63.3	$ 61.7	$ 394.6
Controllable operating costs	$ 70.0	$ 68.1	$ 66.2	$ 64.3	$ 62.6	$ 60.8	$ 392.0
Volume	150.0	145.5	141.1	136.9	132.8	128.8	
Cost change due to volume change		$ (1.2)	$ (1.1)	$ (1.1)	$ (1.1)	$ (1.1)	
Revenue change due to volume change		$ (2.1)	$ (2.0)	$ (2.0)	$ (1.9)	$ (1.9)	
Net balance sheet improvement	$ -	$ 0.2	$ 0.4	$ 0.5	$ 0.7	$ 0.8	$ 2.6
Unit price	$ 0.47	$ 0.47	$ 0.47	$ 0.47	$ 0.48	$ 0.48	
Unit price real annual change		0.5%	0.5%	0.5%	0.5%	0.5%	2.6%

Source: Appendix at 7 & Linking Rate and Cost Changes, Tab Scenario 1.

The most notable differences between the TFP alternative and the *NPRM* proposal are:

(1) the TFP alternative results in rates that are 2.6 percent higher than inflation after 5 years, compared to 14.5 percent under the *NPRM* proposal;

(2) the TFP alternative shows a balance sheet improvement of $2.6 billion compared to $14.8 billion under the *NPRM* model (both treating the entire revenue structure under the market dominant framework); and

(3) controllable operating costs would be $60.8 billion under the TFP alternative compared to $64.0 billion in 2023 (in 2018 dollars) under the NPRM proposal.

C. Comparing The Different Approaches

If linking price increases to greater efficiency gains can produce modest annual cost savings, the cumulative effect on the net balance would be larger than what can be achieved with price increases alone. At the same time, price

increases would not need to run nearly so far above inflation as in the Commission's proposal.

The following Figure 3 presents the baseline results from the *NPRM* 2 percent and 0.75 percent proposals and the two alternative substitute approaches:

Figure 3: Baseline Model Results

Rules for Above-CPI Price Increases	Net Balance Sheet Improvement Over 5 Years	Real Price Increase Over 5 Years
NPRM Proposals	$14.8 billion	14.5%
Controllable Cost Alternative	$16.7 billion	5.1%
TFP Alternative	$2.6 billion	2.6%

Source: Appendix at 7 & Linking Rate and Cost Changes, Tab Scenario 1.

Figure 3 shows that approaches that directly tie above-cap price authority to cost reduction incentives could improve the Postal Service's balance sheet in a manner comparable to the *NPRM* proposal but with much lower rate increases and better cost control. Either of these alternatives would better align Objective 5 with Objective 1 than the *NPRM*'s 2 percent proposal and its 0.75 percent proposal.[48]

The Postal Service is sure to claim, of course, that it has cut every dollar possible and can find no more. The First-Class Business Mailers regard this as an overstatement. It is inconceivable that in any $70 billion enterprise there are

[48] Obviously, the Commission must be mindful of the total rate consequences of whatever policies it adopts, on both a single year and multiyear cumulative basis. That is, the 2 percent proposal in the *NPRM*, if adopted unchanged, certainly should *not* be combined with the Controllable Cost model with a higher bonus.

not hundreds of millions of dollars in cost reductions available, if management has the incentive to find them. And it is obvious that the Service can easily overpay for many factor inputs simply through lack of attention and effort.

Just as importantly, a failure to create such an incentive now would, in all likelihood, mean that we would be back in this situation five or more years hence, with few cost reductions and the Service asking for still more revenue. That is not an outcome that would be in the interest of anyone.

VII. THE PROPOSED 0.25 PERCENT CAP AUTHORIZATION FOR MAINTAINING HIGH QUALITY "SERVICE STANDARDS" DOES NOT ENSURE HIGH QUALITY SERVICE AND REWARDS THE POSTAL SERVICE FOR LITERALLY DOING NOTHING

Objective 3 provides that the regulatory system shall be designed:

> To maintain high quality service standards established under section 3691.

39 U.S.C. §3622(b)(3). In Order No. 4257, the Commission stated: "A system achieving Objective 3 is designed to encourage the maintenance of high quality service standards established pursuant to 39 U.S.C. §3693, *and to hold the Postal Service accountable for consistently achieving those standards*." *Id*. at 261 (emphasis added).[49] The Commission found that the Postal Service had reduced the high quality service standards originally set in 2007, and concluded therefore the regulatory system had not achieved Objective 3. *Id*. at 273.

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[49] The Advance Notice of Proposed Rulemaking that commenced this docket had proposed to evaluate that the regulatory system had achieved Objective 3 -– *i.e.*, that the system has maintained high quality service standards -– if it were designed for the Postal Service "to consistently *achieve*, for each class of mail, stated days to delivery at a desired target rate." Order No. 3673 at 5 (emphasis added). However, in the *NPRM* the Commission discarded this focus on actual service, instead couching the test as whether "high quality service standards have been maintained, as contemplated in Objective 3." Order No. 4257 at 249. That change is contrary to the PAEA, because it ignores Factors 1 and 4, which emphasize actual service.

Unfortunately, the remedy proposed in the *NPRM* would not satisfy even the test newly announced in Order No. 4257. The *NPRM* would allow the Postal Service 0.25 percentage points of extra rate cap authority:

> for each class of mail if the Commission finds in the appropriate ACD that all of the Postal Service's service standards (including applicable business rules) for that class during the applicable year met or exceeded the service standards in place during the prior fiscal year on a nationwide or substantially nationwide basis. This test examines the service standards and the business rules. *It does not examine actual service performance such as time-to-delivery.*

NPRM at 120-121 (emphasis added).[50] Not only does the Commission lack the legal authority to exceed the CPI cap in this instance, as explained in Section II above, but it is evident from the last two sentences of the quotation that the proposal does not attempt to "hold the Postal Service accountable for consistently achieving" the service standards. On the contrary, it contains *absolutely no requirement* that the Service exceed those standards. All that the Postal Service would need to do to acquire an additional 0.25 percent in extra cap authority (worth $115 million at FY 2017 market dominant revenue, excluding Ancillary and Special Services) is *literally* to do nothing.

That is because the proposal would award the extra 0.25 cap authority so long as the Postal Service does not alter its formal service standards, as it did in

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[50] The Commission has shown interest in a mechanism of this nature since at least 2011. *See Section 701 Report,* at 40 (Sept. 22, 2011) (noting "there are no direct financial incentives for the Postal Service to increase the service performance of its products and services"). That is the case with the *NPRM* proposal as well. The Commission reiterated its interest in its 2016 report. *Section 701 Report* (Nov. 14, 2016) at 25 (noting that the relationship between service performance and price cap authority has not been fully explored").

the 2012 Network Rationalization and Load Leveling proceedings,[51] or the related business rules. Whether service *performance* actually exceeds those standards would be irrelevant to whether the extra cap credit would be awarded.[52]

Nothing in the *NPRM* would prevent the Postal Service from reducing the actual quality of service mailers receive in any number of ways. Even if the Postal Service were to suffer from mismanagement or incompetence, or to deliberately engage in a pattern of slowing processing or transportation, so long as it were careful not to alter the published business rules and to avoid filing a case with the Commission, it would receive its cap authority.

The Commission says that it would monitor actual service quality through the Annual Compliance Review process. *NPRM* at 71. But the ACR process has been ineffective in forcing the Postal Service to meet even the reduced service standards. Instead, the typical course is for the Commission to express concern in an ACD about poor performance and to encourage the Postal Service to do better in the ensuing year. That approach has *yet* to yield service performance that meets all of the standards.

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[51] In that case, the Postal Service sought an advisory opinion from the Commission regarding changes in the level of service of all market dominant classes. *See Advisory Opinion,* Docket No. N2012-1 (Sept. 28, 2012); *see also Service Standards for Destination Sectional Center Facility Rate Standard Mail*, 70 Fed. Reg. 12390 (Mar. 5, 2014) ("*Load Leveling*").

[52] The *NPRM* contemplates that the Postal Service would include in the ACR whether it had changed any service standards, or to certify that it had not. The Commission would issue a preliminary determination of compliance when it issues the ACD. Challenges to that preliminary determination would be "limited to changes in the service standards, including the business rules, that occur on a national or substantially national basis." *NPRM* at 71. The Commission would rule on the challenges within 60 days. *Id*. But 60 days is not enough time to determine whether the Postal Service has, in fact, reduced service standards *sub silentio* without formally going through the Section 3691 process – an action that could cost mailers $125 million each year.

A "reward" for service should not be based on simply refraining from changing published standards and business rules that the Postal Service is under no legal obligation to meet and that in practice it can effectively rescind or let deteriorate. While high quality service standards and business rules are desirable, more important to mailers is that the Postal Service's actual performance meets or exceeds standards. As the Commission has recognized, Factors 1 and 4 highlight that a decline in service *performance* is "tantamount to a decline in the overall value of the mail as a service" -– a factor affecting rates. Order No. 4257 at 256.

Although the amount of money at stake here (about $120 million at FY 2017 market dominant revenues) is relatively small in the overall context of the Postal Service, the point is that if the rate regulatory system is to be used as an incentive for service quality, it must be designed to incentivize the Postal Service to *exceed* its service standards. Any award must be for *exceeding* the service standard. Merely *meeting* the standard is simply doing what it is supposed to do, and deserves no extra reward. And, to be balanced, a penalty in the same percentage amount should apply to any failure on the part of the Postal Service to meet or achieve the service standards.

Furthermore, the proposed extra cap authority scheme would be indefinite. The *NPRM* offers no reason why it should be so. Any such authority should, as in the case of the 2 percent authority, sunset after five years and be subject to a new Commission review.

Finally, there is timing issue because this extra cap authority would be granted when an ACD is issued, which occurs in late March, and take effect as of the following January 1. By then, the time period upon which the authority is awarded would be a Fiscal Year 27 to 15 months in the past. To prevent mailers from paying higher rates while service worsens, the Postal Service must be prohibited from reducing service at any time between the end of a Fiscal Year in which such extra authority is earned until after it is implemented.

VIII. THE *NPRM*'S PROPOSED REVISIONS TO PROCEDURAL RULES

The *NPRM* proposes a set of revisions to the Commission's rules of procedure. The First-Class Business Mailers will address only a few of them here.

A. The Proposal To Require The Postal Service Annually To File A Schedule Of Planned Rate Adjustments Over The Next Three Years Would Be A Modest Improvement Over Current Regulations

Current law requires the Postal Service to maintain a schedule of predictable rate adjustments, which it is free to modify. The NPRM proposes to require the Postal Service annually to file a schedule of plans to adjust rates over the next three years, including estimated filing and implementation dates (month and year) and, by class, the amounts of planned rate adjustments.

The First-Class Business Mailers support this proposal because it may provide additional guidance as to the timing and size of rate adjustments within the near to medium future. On the other hand, the proposal appears to lack teeth because the Postal Service can modify the schedule if it provides a reason for

doing so, while the *NPRM* is silent on whether there would be any consequences if the Commission found the explanation unsatisfactory. It is difficult to imagine what the consequences could be, because the Governors have the ultimate say as to when rate adjustments take effect.

Finally, under this regime, it is reasonable to expect that the Postal Service would always file a schedule that contemplates the maximum adjustments. It is unclear whether doing so would be helpful to mailers, or merely cause some to exert more effort to leave the mailstream.

B. The Revision Of Rules To Require 90-Day Notice Of Rate Adjustments Should Be Adopted

The NPRM proposes to require the Postal Service to give 90-day notice of adjustments to market dominant rates. This modification would conform to current practice, give the minimum notice that mailers need to conform their mailing systems, and should be adopted.

The 90-day proposal is a good step. However, if the Commission were to authorize an above-CPI increase as proposed in the *NPRM*, mailers may need more time in order to determine the impacts. It would be desirable for large business mailers to have a good grasp in the May-to-June period preceding a January increase, so they can forecast for the following year's budget. Ninety days will not provide sufficient time to have predictable above-CPI rate increases.

IX. CONCLUSION

Successful businesses do not dig themselves out of difficulties by raising rates for products facing steadily declining demand. Nor does the Commission

have legal authority to allow the Postal Service to do so by exceeding the cap. Even if it did, burdening market dominant mailers with higher rates should be the last resort, not the starting point. The Commission should first consider all other options for revenue, including the Postal Service's substantial real estate assets and growing Competitive products, and refocus on improving cost reductions and productivity, service performance, and encouraging mail growth.

Separately, the Commission should adopt its workshare discounts proposal as modified, and the two procedural revisions addressed herein.

For the foregoing reasons, the First-Class Business Mailers respectfully urge the Commission to take these comments into consideration.

Respectfully submitted,

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TECHNICAL APPENDIX:

Alternative Approaches to Above-Cap Price Increases

This Appendix explores alternatives to achieving the larger goals of the PAEA with respect to the joint objectives of achieving low costs and adequate revenues together with price stability. Together, these are critical to achieving the objective of financial stability for the Postal Service. These important relevant objectives are called out in three of the nine objectives of the PAEA: objective 1, which addresses cost reduction and efficiency; objective 5, which addresses adequate revenues, retained earnings and financial stability; and objective 2, which addresses price stability.

Fundamentally, the regulatory structure governing the Postal Service's market dominant price levels must address both costs and revenues to achieve financial stability. Financial stability depends on having revenues greater than costs and so by definition is affected by both. It is the difference between revenues and costs that determines profitability, improvement in which is necessary for achieving both medium term and longer term financial stability as defined by the Postal Regulatory Commission. Consequently, a focus on only revenues or costs alone can, and very likely will, fail to improve the income statement or the balance sheet. In particular, an approach that seeks to achieve financial stability only through increased revenues will completely fail if the revenue increases are entirely or mostly absorbed by increased costs.

It is understood that the Service is not in complete control of all determinants of revenues and costs. For example, interest rates affect costs and trends in postal volumes affect revenues, and the Service has little ability to influence either one of these determinants. In other ways, however, the Service does have meaningful ability to influence both costs and revenues, with consequences that affect the Service's financial stability.

The PRC has proposed an approach to address concerns about the Service's long-term financial stability that relies almost entirely on increased revenues. The NPRM proposals rely primarily on an annual price increase of 2% above CPI, with no linkage to cost reduction or efficiency improvement, other than for a non-cap related proposal to set workshare discounts closer to avoided costs. Although the proposals do include an additional 0.75% price increase above CPI that is linked to

achieving a target growth in total factor productivity (TFP), that incentive is not well designed.

The incentive effect of the NPRM TFP proposal is poorly designed for at least three reasons: 1) only a small part of the above-CPI price increase received by the Service is linked to improvements over the current level of TFP, so most of the increased revenue can be obtained with no improvement in productivity; 2) the Service receives the effect of the price increase incentive only for TFP improvements in the neighborhood of the target – once the incentive target is reached, higher values of TFP above the target have no further effect; and 3) the TFP linkage runs the risk that efficiency will increase without costs decreasing because of the possibility of excess inflation in factor input prices, including wages.

In essence, the NPRM proposals focus almost exclusively on the revenue side of financial stability in objective 5. There is far too little attention to the demands of objective 1 to "maximize incentives to reduce costs… ", which addresses the necessary cost side of financial stability. And there is no attention to the demands of objective 2 to consider price stability.

This Appendix presents two high level conceptual alternatives to the PRC approach that have a more balanced focus on both revenues and costs. These alternatives pursue objectives 1 and 5 at the same time by tying revenue increases closely to cost reductions, and they also pursue objective 2 by considering price stability. They also illustrate the significant importance of cost reductions in generating positive net income.

The strongest alternative approach would address all three of the weaknesses in the NPRM proposals (other than the service incentive): 1) the high proportion of above-CPI increases given without any incentive, 2) the limited range of TFP values where improvements result in an incentive, and 3) the possibility of excess inflation in factor input prices. To do this, an alternative could be based solely on a measure of controllable costs, giving the Service the incentive of above-CPI price increases for demonstrated decreases in controllable costs.

The proposed estimate of controllable costs would factor out the effects of changes in interest rates and mail volumes. However, in recognition of the strong role management can and must play in restraining factor input prices, the estimate would reflect both changes in the *efficiency* of postal operations and changes in the *prices* of the different factor inputs.

It is important for such a regulatory approach to reflect factor input prices (in addition to efficiency) because the Postal Service has the ability to affect its input prices through careful management.

Furthermore, with respect to the often-cited constraints of the collective bargaining process, it is important to recognize that the regulatory regime also indirectly affects the outcome of the collective bargaining process by defining the larger financial context for negotiation. As a result, an incentive rule for financial stability that emphasizes cost control and thereby reflects factor input prices would be an important factor in constraining wage growth indirectly.

Despite the benefits of basing an incentive on both efficiency and prices, one potential downside of doing so is the lack of a regulation clearly defining the term "controllable costs." As a result, there might be a delay before such a rule could be introduced while an appropriate measure of controllable costs is developed.

Because of this, it is useful to consider a second alternative that would avoid the delay necessary to develop an appropriate measure of controllable costs. This approach would be based on efficiency alone, using the measure of growth in total factor productivity (TFP) that the PRC itself has already proposed.[1] While this measure is inferior because it fails to account for changes in factor input prices – and therefore runs the risk of excessive inflation in factor input prices, including wages – it has the virtue of using a measure that the Postal Service already reports, is readily available, and has already been proposed by the PRC for defining above-cap price increases. Accordingly, it could be used until the PRC adopts a definition of "controllable" costs and establishes a system using that approach.

The TFP alternative described herein would fix the first two shortcomings of the PRC's proposal: 1) the high proportion of above-CPI increases given without any incentive, and 2) the limited range of TFP values where improvements result in an incentive. In the proposed TFP alternative, all of the above-CPI increases would be linked to TFP. In addition, the incentive relationship would be continuous, providing above-CPI price increases that are proportional to whatever cost changes result from TFP changes above past levels.

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[1]As a rough estimate, growth in TFP of 1% for total costs of $70 billion would produce a savings of $700 million if there are no increases in factor input prices. Christensen Associates, 2017, Total Factor Productivity as a Measure of Operational Efficiency at 6.

To illustrate the effect of these two alternatives to the PRC's proposal – the controllable cost alternative rule and the TFP alternative rule – a spreadsheet ("Linking Rate and Cost Changes") has been developed to explore their cumulative effect over 5 years – the length of time before the PRC intends to review its actions in this proceeding. The spreadsheet simplifies many details, including treating all revenues and costs in the market dominant framework and ignoring the NPRM service incentive.

However, the benefit of this simplified analysis is that it provides a transparent and readily-understandable illustration of the larger relationships that would be affected by these three different approaches: (1) NPRM; (2) controllable costs; and (3) TFP. For each, the spreadsheet shows how the approach (using the given parameter assumptions) translates into 5-year changes to the Service's net balance sheet and to real prices. Note that the spreadsheet's parameters (noted in orange) can be changed to explore the effects of different assumptions.

The spreadsheet demonstrates the importance and value of cost control. If linking price increases to successful cost control or TFP growth can produce annual cost savings, the cumulative effect on the net balance could exceed what can be achieved with price increases alone. At the same time, price increases would not need to run so far above inflation as in the NPRM proposal, which results in unstable prices and, in the absence of price elasticities calibrated for major increases, entails considerably greater risk of substantial additional volume decline. As a result, a unified approach that focuses on both costs and revenues promises to be a much more successful route to obtaining long-term financial stability for the Service.

Detailed Spreadsheet Description

This section describes the structure of the spreadsheet that illustrates the alternative conceptual systems and the initial parameter assumptions that they use.

All the models in the spreadsheet calculate yearly changes using plausible values for declining volume, its effect on costs and the cost increases likely to occur without an incentive savings. The declining volume is initially set at 3% per year, consistent with the rate of decline from FY 2016 to FY 2017 and the Service's projection for FY 2018.[2] The effect of volume decline on costs is modeled with a cost elasticity of 0.56, consistent with the Service's FY 2017 estimate of the portion of costs that are

[2] U.S. Postal Service Fiscal Year 2019 Congressional Budget Submission at 2; USPS Fiscal Year 2018 Integrated Financial Plan at 5.

volume variable.[3] The cost increases likely to occur without an incentive savings are assumed to be 0.5% above CPI, using an economy-wide measure of employment cost as the Service's most important input price.[4]

All of these assumptions can be changed on the spreadsheet. In addition, all of the models are carried out using real values, effectively setting CPI at 0, for ease of understanding.[5]

The default model of the NPRM proposals uses a 2% annual price increase above CPI over the entire 5-year period. However, the parameters can be adjusted to vary this assumption by year. The model of the NPRM proposals also assumes annual TFP growth of 0.6%, setting this as the 5-year average value for the target. The value of 0.6% is set using the geometric average TFP growth over the most recent 5-year period (FY 2012 – FY 2016)[6]. The model then provides an extra 0.75% annual price increase above CPI for each year that the TFP target is met; the baseline version of the model assumes that this target TFP growth rate is met every year.

In the controllable cost alternative, all above-CPI price increases depend on decreasing controllable costs. In the model, the above-CPI price increases starting in FY 2019 are calculated from the difference in controllable costs resulting from last-year's level of TFP growth above the baseline (the recent 5-year average, as proposed in the NPRM, currently 0.6) and any reduction in the inflation of factor input prices.[7] This calculation implicitly removes any cost change due to declining volume, economy-wide levels of factor price inflation, and baseline TFP growth from the measure of controllable cost reduction. The size of the decrease in controllable costs is determined in the model by two parameters, one describing how much the

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[3] Docket No. ACR2017, USPS-FY17-1, Public_FY17CRAReport.xlsx, "Cost 3", cell H26 divided by cell F35.

[4] For comparison, in the 10 years from December 2007 to December 2017, the Employment Cost Index for total compensation increased by 4.8% above CPI (from 100.0 to 104.8), an annual rate of increase of 0.47%. Employment Cost Index Historical Listing – Volume IV, Constant Dollar, January 2018, Table 4 at 3. Available at www.bls.gov/ect.

[5] This simplicity for the purposes of modeling transparency has no effect on real outcomes. It would be straightforward to convert the model to nominal values with assumptions about a non-zero level of inflation. The real results of the model would be exactly the same, but it would be harder to understand.

[6] USPS Annual Tables, FY 2016 TFP, Public Version, February 3, 2017.

[7] Specifically, the reduction in controllable costs is calculated by multiplying the value of last year's controllable costs by the percentage-point increase in TFP growth over baseline and the percentage point reductions in the factor price inflation compared to the economy-wide level.

Service can further increase TFP growth with an incentive and the other describing how much the Service can slow the inflation of input prices. The incentive in this model operates by providing an above-CPI price increase based on the size of the cost difference resulting from additional TFP growth and reduced factor price inflation, at a rate defined by a rate bonus parameter. The incentive is applied symmetrically if controllable costs increase rather than decrease; as a result, if TFP falls below the baseline or the inflation of factor input prices is above the economy-wide average, then the allowable price increase would be less than CPI.

Like the controllable cost alternative, all above-CPI price increases in the TFP alternative depend on decreasing costs/increasing productivity, though in this alternative only the cost reductions reflected in additional TFP growth are rewarded. In the model, the above-CPI price increases starting in FY 2019 depend on cost changes resulting from additional TFP growth the previous year beyond the recent 5-year average of 0.6%. The parameters of the TFP alternative differ from those of the controllable cost alternative in assuming there is no incentive to restrain input price inflation. The incentive of the TFP alternative operates by providing an above-CPI price increase based on the size of the cost difference resulting from additional TFP growth, at a rate defined by a rate bonus parameter. As in the controllable cost alternative, the incentive is applied symmetrically so that if TFP falls below the baseline (5-year average of , currently, 0.6%) the allowable price increase would be less than CPI.

Four Scenarios to Compare the PRC Proposals with the Two Alternatives

This section describes the results of four scenarios that show the results of a baseline version of each rule and then three contrasts using slightly different parameter assumptions. These comparisons illustrate the fundamental point that it is possible to produce similar improvement in the balance sheet as the NPRM proposals with a lower level of prices if there are incentives for cost reduction. In addition, the contrast in all scenarios between the Controllable Cost and TFP alternatives demonstrates the importance of including an incentive to restrain factor price inflation in addition to an incentive to increase efficiency.

Scenario 1: Baseline Models

The baseline models use the default assumptions described above. For both alternative rules, the extra TFP growth resulting from the incentive is set at 1.0 percentage point, which means that the total average 5-year TFP growth is assumed to be 1.6%. This level of 5-year average TFP growth is higher than was achieved for

any 5-year period over the past 14 years (5-year averages ending in FY 2007 through FY 2016), when the highest 5-year average was only 1.4%. However, this rate was achieved for the 5-year period ending in FY 2004, so it is not unreasonable to expect that it would be possible to achieve with appropriate incentives.[8]

In addition, the baseline model for the controllable cost approach assumes that the incentive reduces input price inflation by 1.0 percentage points. Since the default assumption is that input prices increase by 0.5% above CPI, the controllable cost rule assumes that input prices will decrease compared to CPI, at a rate of -0.5%. This assumption regarding the potential for significant reduction in input price inflation over multiple years reflects the reality that input price contracts over multiple years have been set with essentially no incentive or pressure to contain costs. As a result, it is likely that there is substantial scope for lowered input prices with appropriate incentives. To cite one example of a major Service input price, it has been found that the Service pays a compensation premium superior to those typically available in the private sector.[9]

Finally, the baseline model assumes a bonus rate of 50% for the two alternatives. This means that an above-CPI increase in prices is allowed that equals 50% of the total cost savings from produced from either controllable cost savings or additional TFP growth. This above-CPI increase provides the incentive for the additional cost savings.

Table 1 shows the results for the three rules for the cumulative net balance improvement and the price increase above CPI over 5 years.

Table 1: Scenario 1: Baseline Model Results

Rules for Above-CPI Price Increases	Net Balance Sheet Improvement Over 5 Years	Real Price Increase Over 5 Years
PRC Proposal	$14.8 billion	14.5%
Controllable Cost Alternative	$16.7 billion	5.1%
TFP Alternative	$2.6 billion	2.6%

[8] USPS Annual Tables, FY 2016 TFP (Total Factor Productivity), Table Annual 2016 public (2016 CRA).xlsx, “Tfp-52” (March 2, 2017).

[9] Interest Arbitration Decision and Award, United States Postal Service and American Postal Workers Union, AFL-CIO, at 11 (July 8, 2016).

Source: "Linking Rate and Cost Changes," Scenario 1.

The results of Table 1 show that with incentives for improvement on the cost side, it is possible to reach a greater improvement in the net balance sheet with a substantially lower increase in real prices. In this scenario, the results of the Controllable Cost alternative are better than the NPRM proposals in both balance sheet improvement and more moderate postal price increases. Although the TFP alternative does not do as well – since it has no incentives to reduce factor price inflation – it is still able to improve the balance sheet with much lower increases in postal prices than in the NPRM proposals.

Scenario 2: Smaller Incentive Effect on TFP Growth

In this scenario, the incentive effect on increasing TFP growth is only half as large as in the baseline, an annual increase of only 0.5 percentage points rather than 1.0 percentage points. As a result, the two alternative models assume a total average 5-year TFP growth rate of 1.1%. This level of 5-year average TFP growth was achieved most recently for the 5 years ending in FY 2014 and over the past 50 years has been achieved 7 times, so the historical record shows that it is quite feasible.[10]

Table 2: Scenario 2: Smaller Incentive Effect on TFP Growth

Rules for Above-CPI Price Increases	Net Balance Sheet Improvement Over 5 Years	Real Price Increase Over 5 Years
PRC Proposal	$14.8 billion	14.5%
Controllable Cost Alternative	$9.6 billion	3.8%
TFP Alternative	$-4.6 billion	1.3%

Source: "Linking Rate and Cost Changes," Scenario 2.

Table 2 shows that it is possible for the Controllable Cost alternative to come close to the results of the NPRM proposals even if the incentive has a smaller effect on TFP growth. Again, the increase of postal prices in the alternative rules is much lower than under the NPRM proposals.

[10] USPS Annual Tables, FY 2016 TFP (Total Factor Productivity), Table Annual 2016 public (2016 CRA).xlsx, "Tfp-52" (March 2, 2017).

Scenario 3: Smaller Incentive Effect on Restraining Input Price Inflation
In this scenario, the incentive effect on restraining price inflation is only half as large as in the baseline, an annual restraint of -0.5 percentage points rather than -1.0 percentage points.

Table 3: Scenario 3: Smaller Incentive Effect on Restraining Input Price Inflation

Rules for Above-CPI Price Increases	Net Balance Sheet Improvement Over 5 Years	Real Price Increase Over 5 Years
PRC Proposal	$14.8 billion	14.5%
Controllable Cost Alternative	$9.7 billion	3.8%
TFP Alternative	$2.6 billion	2.6%

Source: "Linking Rate and Cost Changes," Scenario 3.

Table 3 again shows that it is possible for the alternatives to produce substantial improvement in the net balance sheet with much smaller increases in postal prices if there are incentives to reduce costs.

Scenario 4: Larger Bonus Rate
In this scenario, the bonus rate in the alternatives for the above-CPI price increases is set at 75% rather than 50%, giving the Service a higher incentive for cost savings and increased TFP growth.

Table 4: Scenario 4: Larger Bonus Rate

Rules for Above-CPI Price Increases	Net Balance Sheet Improvement Over 5 Years	Real Price Increase Over 5 Years
PRC Proposal	$14.8 billion	14.5%
Controllable Cost Alternative	$21.5 billion	7.6%
TFP Alternative	$5.0 billion	3.9%

Source: "Linking Rate and Cost Changes," Scenario 4.

Table 4 shows that a larger bonus rate produces substantially higher net balance sheet improvement than the Controllable Cost alternative compared to the NPRM proposals, again with much lower increases in postal prices.