Postal Regulatory Commission
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POSTAL REGULATORY COMMISSION

ANNUAL REPORT

TO THE PRESIDENT AND CONGRESS

FISCAL YEAR 2017

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COVER PHOTO BY M DOGAN

Acronyms

ACD | *Annual Compliance Determination*

ACR | *Annual Compliance Report*

C.F.R. | Code of Federal Regulations

CAG | Cost Ascertainment Group

CHIR | Chairman's Information Requests

CIR | Commission Information Request

CPI | consumer price index

CY | Calendar Year

EXFC | External First-Class Measurement

FERS | Federal Employees Retirement System

FY | Fiscal Year

GEPS | Global Expedited Package Service

NPR | non-published rates

MCS | *Mail Classification Schedule*

NPR | Notice of Proposed Rulemaking

NSA | negotiated service agreement

PAEA | Postal Accountability and Enhancement Act

RHBF | Retiree Health Benefits Fund

RRM | Return Receipt for Merchandise

TFP | total factor productivity

U.S.C. | United States Code

UPU | Universal Postal Union

USO | Universal Service Obligation

PRC | Mission, Vision, and Guiding Principles

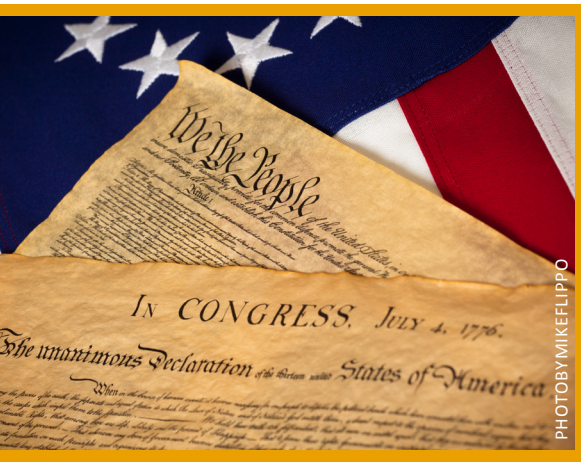

PHOTO BY MIKE FLIPPO


PHOTO BY ROB CRANDALL

Mission Statement

Ensure transparency and accountability of the United States Postal Service and foster a vital and efficient universal mail system.

Vision Statement

To be an independent regulator respected for effectively engaging postal stakeholders to promote a robust universal mail system through objective, accurate, and timely regulatory analyses and decisions.

We will look to achieve our vision by:

- Taking a multi-disciplinary and integrated approach to work
- Monitoring the environment and anticipating changes to enhance agility
- Utilizing rigorous evaluative methods
- Optimizing stakeholder engagement through an appropriate and clearly-defined public involvement process
- Developing staff expertise to ensure that the Commission is a center for excellence in postal regulatory matters
- Ensuring that the Commission is an employer of choice
- Ensuring efficient stewardship of resources

Guiding Principles

The Commission is committed to and operates by the principles of:

Openness

Public participation

Integrity

Fairness and impartiality

Timely and rigorous analysis

Merit

Commitment to excellence

Collegiality and multi-disciplinary approaches

Adaptability

Proactive response to the rapidly changing postal environment


PHOTO BY KAMRAN

Chairman's Letter

JANUARY 2018

On behalf of the Postal Regulatory Commission, I am pleased to submit the Commission's Fiscal Year 2017 *Annual Report to the President and Congress*. This report summarizes the Commission's key accomplishments and activities over the past year. It also provides information required under the Postal Accountability and Enhancement Act of 2006 (PAEA) on the operations of the Commission, including the extent to which regulations are achieving the law's objectives.

The Commission worked hard to complete one of its critical responsibilities mandated by the PAEA – a 10-year review of the system for regulating rates and classes for Market Dominant products. At a Commission public meeting on September 1, 2016, plans were outlined for a review that would allow full and open opportunities for public participation, while balancing the aim of completing the Commission findings and beginning any necessary rulemaking in an efficient and effective manner. We delivered on those plans. On December 20, 2016, exactly 10 years from the 2006 law's date of enactment, the Commission began its review. Following a 90-day comment period, which ended in the Spring of 2017, the Commission issued its findings and proposed rules in late Fall 2017.

In addition, the Commission continued its work on other matters with an ambitious schedule that included rulemakings, reviewing and approving postal rates, adjudicating formal and informal complaints, examining proposals for new products and services, and ensuring Postal Service compliance with the law. Also, by implementing the Commission's 5-year *Strategic Plan* for 2017-2022, the Commission moved forward with continual improvement in operational quality and efficiency.

The Commission is efficient and effective in carrying out its mission as measured by budget savings and timeliness of work. The Commission employees' satisfaction and engagement is strong, as evidenced by the Federal Employee Viewpoint Survey results. The Commission remains a frequently sought resource for postal expertise. I want to thank the entire staff of the Commission, and my fellow colleagues, for a highly productive year. It is a privilege to lead the work of this talented team of professionals, so dedicated to fulfilling our mission of ensuring transparency and accountability of the Postal Service, and fostering a vital and efficient universal mail system.

With best wishes, I am

Sincerely yours,

Robert G. Taub

CHAIRMAN

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CHAPTER I | Fiscal Year 2017 in Review

PHOTOS BY ORHAN CAM

The Postal Regulatory Commission (Commission) achieved the following significant accomplishments in Fiscal Year (FY) 2017 that support its mission to ensure transparency and accountability of Postal Service operations and foster a vital and efficient universal mail system.

Top left: US Capitol Building
Top right: Thomas Jefferson Memorial

1. The Commission published five major reports in FY 2017:
   - *The Annual Report to the President and Congress* (Annual Report) described the Commission's accomplishments and activities as the regulator of the Postal Service.
   - The *Annual Compliance Determination* (ACD) reviewed the Postal Service's compliance with statutory pricing and service requirements.
   - The *Financial Analysis of United States Postal Service Financial Results and 10-K Statement Fiscal Year 2016* provided an in-depth analysis of the Postal Service's financial condition.
   - The *Analysis of the Postal Service's FY 2016 Annual Performance Report* and *FY 2017 Annual Performance Plan* evaluated whether the Postal Service met its performance goals as required under 39 U.S.C. § 3653(d).
   - *Section 701 Report: Analysis of the Postal Accountability and Enhancement Act of 2006* (PAEA) recommended to the President and Congress legislation and other ways to improve the effectiveness and efficiency of the United States' postal laws.

2. Throughout the fiscal year, the Commission dedicated a majority of its resources to the statutorily mandated review of the system for regulating rates and classes for Market Dominant products that was first established in 2006 by the PAEA (Current System) as required by 39 U.S.C. § 3622(d)(3). In early FY 2018, the Commission issued Order No. 4257 finding that the Current System as a whole has not achieved the objectives of the PAEA. See Chapter 3, infra. That same day, the Commission issued a Notice of Proposed Rulemaking (NPR) proposing changes to the Current System that would address the issues identified by the Commission in its review. This rulemaking is currently pending before the Commission.

3. The Commission presided over several other rulemaking proceedings in FY 2017. The Commission:
   - Issued a revised NPR that would require the Postal Service to publish all mail preparation changes in a publicly-available single source and affirmatively designate whether a mail preparation change requires compliance with Commission price cap rules.
   - Initiated a rulemaking to evaluate the institutional cost contribution requirement for Competitive products.
   - Issued two sets of proposed and final rules on Commission ethics and supplemental standards of ethical conduct applicable to Commission employees.
   - Considered 12 proposals by the Postal Service to change various accepted analytical principles. Final orders were issued for 10 of the proposals. The remaining two proposals are currently pending before the Commission.

4. The Commission reviewed the Postal Service's proposed rate changes for Market Dominant and Competitive products in FY 2017

   Highlights include:
   - Issuing an order addressing issues on remand concerning the Postal Service's request to transfer First-Class Mail Parcels from the Market Dominant product list to the Competitive product list. The Commission conditionally approved the Postal Service's request and later approved related rate and Mail Classification Schedule (MCS) changes.
   - Approving rates of general applicability for First-Class Mail, USPS Marketing Mail (formerly called Standard Mail), Periodicals, Package Services, and Special Services.
   - Approving rates of general applicability for several domestic and international Competitive products.
   - Approving 316 Competitive negotiated service agreements (NSA) (208 domestic, 108 international).

5. In other proceedings, the Commission considered two public inquiry dockets relating to city carrier costs and service performance, adjudicated two post office closing appeals, and conducted activities with respect to its international postal policy responsibilities.

6. Other Commission activities included:
   - Testifying before the U.S. House Oversight and Government Reform Committee
   - Processing more than 3,866 inquiries, questions, suggestions, and comments from the general public which primarily involved undelivered, delayed, misdelivered, and missing mail
   - Hosting several open public meetings providing transparency of Commission activities

CHAPTER II | About the Commission

Pictured left to right:
Vice Chairman Mark Acton,
Chairman Robert Taub,
Commissioner Nanci Langley,
Commissioner Tony Hammond

The Commission is an independent establishment of the Executive Branch of the United States Government. It has exercised regulatory oversight over the Postal Service since its creation by the Postal Reorganization Act of 1970, with expanded responsibilities under the PAEA. It has five commissioners, each appointed by the president, by and with the advice and consent of the Senate, for a term of 6 years. A commissioner may continue to serve after the expiration of his or her term until a successor is confirmed, except that a commissioner may not continue to serve for more than 1 year after the date on which his or her term would have otherwise expired. Not more than three of the commissioners may be adherents of the same political party.

Commission Leadership

Robert G. Taub | CHAIRMAN

Chairman Robert G. Taub is serving a second term on the Commission, having been twice confirmed by the United States Senate, following his respective nominations by the president. His current term expires on October 14, 2022. Before his designation by the president as chairman, he was acting chairman from December 2014 to December 2016, and vice chairman for 2013. Chairman Taub has more than 30 years of experience in public service. When first appointed as a commissioner in October 2011, Mr. Taub was the Special Assistant to Secretary of the Army John M. McHugh. As an Army senior executive, he was one of the principal civilian advisors to Secretary McHugh, helping him lead a workforce of more than 1.2 million people, and manage an annual budget exceeding $200 billion. He was awarded the Army's Decoration for Distinguished Civilian Service. His previous public service include chief of staff to U.S. Representative John McHugh (R-NY); 12 years in senior positions on the House of Representative's Committee on Oversight and Government Reform, including staff director of its former Postal Service Subcommittee; senior policy analyst with the U.S. Government Accountability Office; and staff member for three members of Congress, a member of the British Parliament, and state and county officials in upstate New York. He is a Fellow of the National Academy of Public Administration.

Mark Acton | VICE CHAIRMAN

Commissioner Mark Acton was reappointed to the Postal Regulatory Commission by President Barack H. Obama on December 12, 2016 for a third term of continued public service extending until October 14, 2022. Commissioner Acton was confirmed by the United States Senate on December 10, 2016. Commissioner Acton was nominated by President Barack H. Obama on May 12, 2011 for a second term of office through October 14, 2016. Commissioner Acton was confirmed by the United States Senate for his second term of office on September 26, 2011. President George W. Bush first nominated Mr. Acton as a Postal Rate Commissioner on November 7, 2005, and he was confirmed by the Senate on August 3, 2006. Prior to that appointment, Mr. Acton served as Special Assistant to the Chairman of the Postal Rate Commission and assisted in managing all aspects of agency operations.

Tony Hammond | COMMISSIONER

Mr. Hammond was reappointed as a commissioner on December 10, 2014, and has been elected to three separate terms as vice chairman during his tenure. His term expires October 14, 2018. Commissioner Hammond served on the Postal Regulatory Commission and its predecessor agency, the Postal Rate Commission, from 2002 to 2011, as an appointee of President George W. Bush. He was reappointed by President Barack Obama for an additional term from 2012 to 2013. Before joining the Commission, Mr. Hammond was the owner and managing member of T. Hammond Company, LLC; senior consultant to Forbes 2000, Incorporated; senior vice president of FL&S, a direct marketing firm; director of campaign operations for the Republican National Committee; executive director and finance director of the Missouri Republican Party; and served 10 years on the staff of former U.S. Representative Gene Taylor (R-MO).

Nanci E. Langley | COMMISSIONER

Ms. Langley was reappointed as a commissioner on December 10, 2014. Her term expires November 22, 2018. She was first appointed as a commissioner on June 6, 2008; that term expired on November 22, 2013. She also served as the Commission's vice chairman from October 2008 to October 2009, January to December 2012, and January to December 2016. Her previous positions include director of the Office of Public Affairs and Government Relations at the Commission; 17 years as a senior adviser to U.S. Senator Daniel K. Akaka (D-HI), including 9 years as a deputy staff director on the U.S. Senate Committee on Homeland Security and Governmental Affairs Subcommittee on Oversight of Government Management, the Federal Workforce, and the District of Columbia; and communications director to U.S. Senator Spark M. Matsunaga (D-HI). She was elected as a fellow of the National Academy of Public Administration in 2009.

Staff and Office Structure

Commission staff has expertise in law, economics, finance, statistics, and cost accounting.

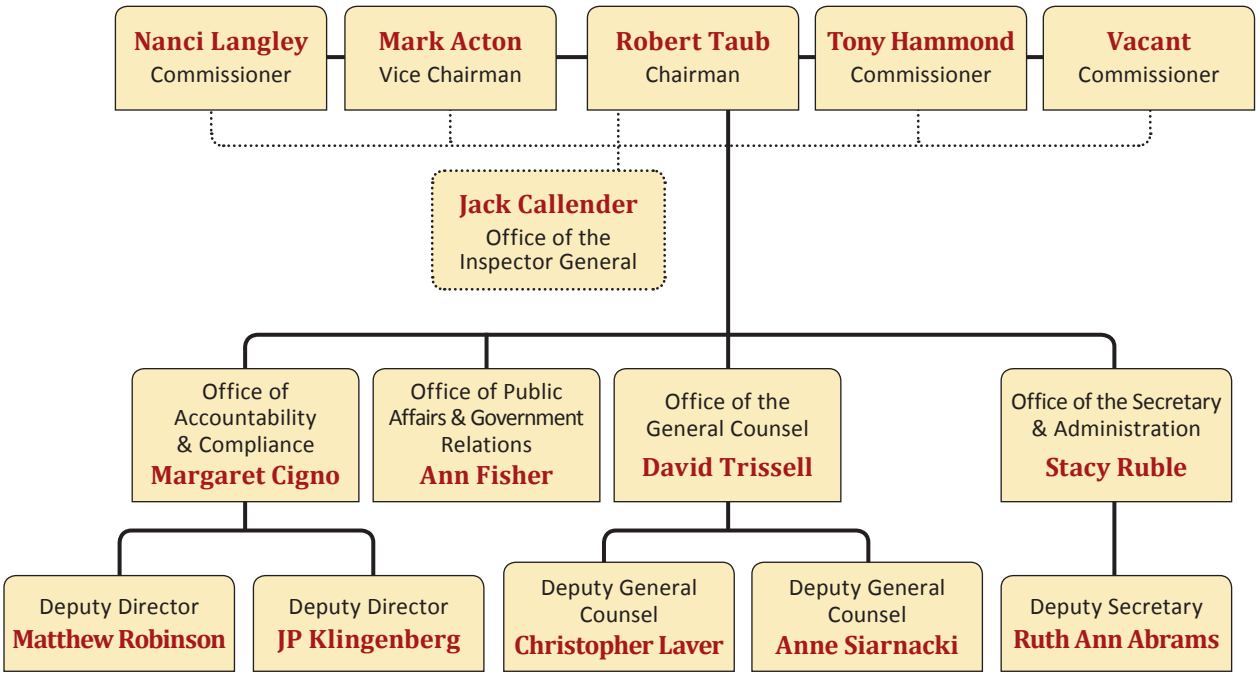
The Commission is organized into four operating offices:

- **Accountability and Compliance.** The Office of Accountability and Compliance is responsible for technical analysis and formulating policy recommendations for the Commission on domestic and international matters.
- **General Counsel.** The Office of the General Counsel ensures the Commission fulfills its statutory and regulatory obligations by providing legal guidance on matters involving the Commission's responsibilities.
- **Public Affairs and Government Relations.**The Office of Public Affairs and Government Relations facilitates prompt and responsive communications with the public, Congress, Federal agencies, the Postal Service, and media.
- **Secretary and Administration.** The Office of the Secretary and Administration records the Commission's official actions; manages the Commission's records, human resources, budget and accounting, and information technology; and provides other support services.

The Commission maintains an independent Office of the Inspector General. It conducts, supervises, and coordinates audits and investigations relating to Commission programs and operations, and identifies and reports fraud and abuse in these programs and operations.

Figure II-1 displays the Commission's FY 2017 organizational structure.

Figure II-1: Commission's FY 2017 Organizational Structure



Commission *Strategic Plan*

The Commission began implementation of its *Strategic Plan* (Plan) for fiscal years 2017 through 2022. The Plan outlines the Commission's core Mission and Vision over the next 5 years, the key strategic goals to help the Commission fulfill its Mission and Vision, and the strategies to meet the statutory requirements of the PAEA. These strategies implemented will help to ensure transparency and accountability of the Postal Service and foster a vital and efficient universal mail system,

Over the next 5 years, the Commission will focus its activities on the following four strategic goals:

Goal 1: Deliver accurate and objective analyses and decisions to ensure transparency and accountability of the Postal Service.

Goal 2: Actively engage with Congress and stakeholders in support of a dynamic postal system.

Goal 3: Provide an optimal internal infrastructure to support management of priorities, workload, and emerging requirements.

Goal 4: Recruit, develop, and retain a diverse, high-performing workforce.

The Plan can be viewed or downloaded from the Commission's website, **www.prc.gov**.

PHOTO BY SEAN PAVONE

Interior of the Library of Congress in Washington, DC.

Office of Public Affairs and Government Relations

The Commission's Office of Public Affairs and Government Relations (PAGR) is a significant resource in support of public outreach and education, complaint processing, media relations, and liaison with the U. S. Congress, the Administration, the Postal Service and other government agencies. This office informs and advises Commissioners and Commission staff on legislative issues and policies related to the Commission and the Postal Service in addition to coordinating the preparation of both congressional testimony and responses to congressional inquiries concerning Commission policies and activities. PAGR is the primary office assisting the general public.

Congressional Testimony

On February 7, 2017, Chairman Taub testified before the U.S. House Oversight & Government Reform Committee at a hearing entitled "Accomplishing Postal Reform in the 115th Congress – H.R. 756, The Postal Service Reform Act of 2017." The hearing was the result of bipartisan legislation introduced by then-Chairman Chaffetz, Ranking Member Cummings, Subcommittee Chairman Meadows and Ranking Member Connolly, and Representatives Ross and Lynch. Discussions included "the significance and potential implications of the Commission's review of the Market Dominant rate system." Chairman Taub's testimony primarily emphasized the significant financial obstacles facing the Postal Service, an overview of the Commission's 701 Report, and the structure of the 10-year Market Dominant rate review.

Open Public Meetings

The Commission held a series of open public meetings in FY 2017 to keep postal stakeholders and the public abreast of Commission operations, activities, and decisions. In accordance with the Sunshine Act, the date, timing, and agenda items for each public meeting were noticed in the Federal Register and posted on the Commission's website, **www.prc.gov**.

Consumer Relations - Comments and Inquiries

INQUIRIES BY SOURCE

During FY 2017, PAGR received 3,866 inquiries, questions, suggestions, and comments. Approximately 72 percent of consumer inquiries were submitted online through "Contact PRC" on the Commission website. Of the remaining inquiries, 19 percent were submitted by phone and 7 percent by mail.

Commission Order No. 195 directs the Postal Service to respond to rate and service inquiries forwarded to its Office of the Consumer Advocate within 45 days. In FY 2017, the Commission forwarded 368 such inquiries. The order also requires the Postal Service to file a monthly report summarizing the general nature of these inquiries. The reports are available on the Commission's website.

INQUIRIES BY ISSUE

As in past years, the predominant types of inquiries the Commission received from business owners were undelivered mail (mail not being delivered), and delayed mail (outgoing mail not being picked up by the carrier, or mail being delivered late in the day or after the close of business).

Service continues to be the highest inquiry category. The Commission received 3,120 inquiries regarding delivery service.

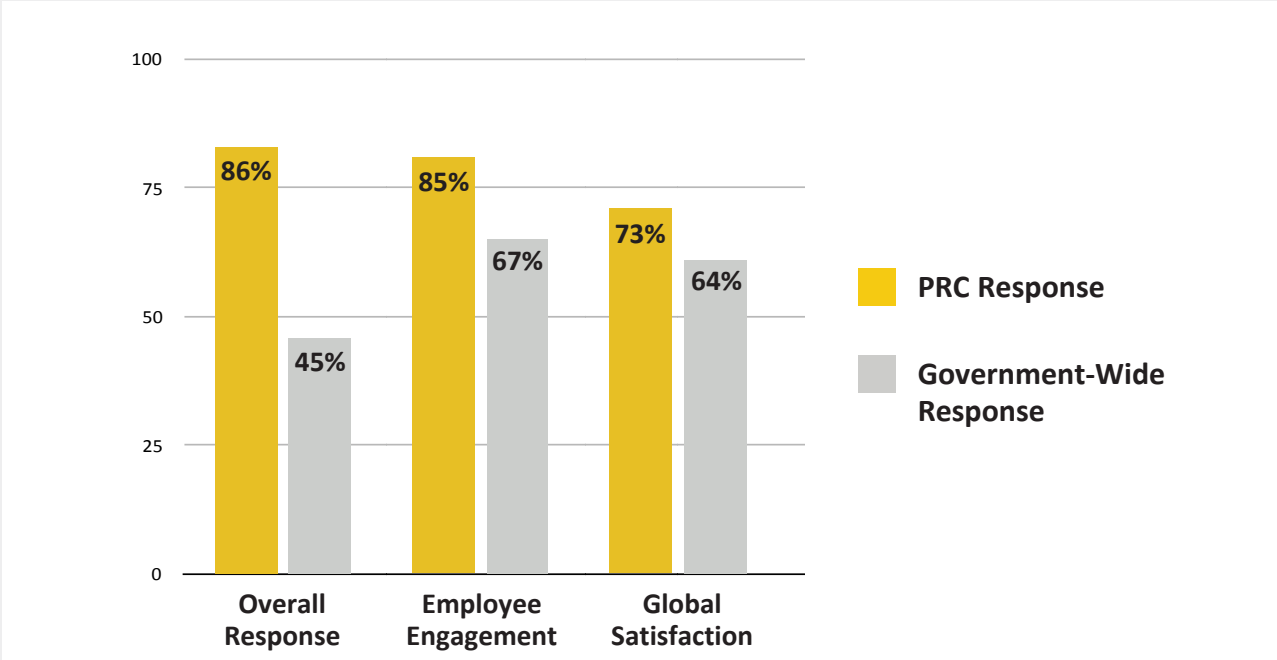
Office of the Secretary and Administration

The Office of the Secretary and Administration (OSA) provides management and staff support to the Commission's operational offices (including the Office of the Inspector General), the Commission's Strategic Plan, and various initiatives of the Executive Branch. OSA ensures that the Commission has the physical, financial, technological, and human capital infrastructure needed to accomplish its mission. Responsibilities include financial management, records management, administrative and organizational support, human resources management, workforce planning, and information technology management.

Employee Engagement and Training

The Commission is committed to enhancing a system that fosters recruitment, development, and retention of a talented, skilled, diverse, and adaptable workforce as part of its Human Capital in the Strategic Plan. In FY 2017, the Commission participated in the annual Federal Employee Viewpoint Survey (FEVS). The agency's FY 2017 response rate of 83 percent was higher than the FY 2016 response rate, and significantly higher than the government-wide rate of 45 percent. Figure II-1 shows an overview of key Commission FEVS ratings on the Office of Personnel Management (OPM) indices when compared with the Federal Government as a whole.

Figure II-2: Overview of FEVS Results, FY 2017



OPM has aggregated the results of the FEVS into two indices. "Employee Engagement" ranks employees' perceptions of the leadership within their agency, their supervisors, and the overall work experience; "Global Satisfaction" measures employees' satisfaction with four aspects related to work: job, pay, organization, and whether they would recommend their organization as a good place to work. Compared to responses with Federal employees government-wide, Commission staff had a higher degree of satisfaction with their work and office environment: 85 percent positive rating in "Employee Engagement" versus the government-wide positive rating of 67 percent, and a 73 percent positive rating in "Global Satisfaction" versus the government-wide rating of 64 percent. The Commission is committed to developing actionable plans based on the confidential feedback received from employees through this survey.

To further address employees' work-life balance, this year the Commission revised and expanded its policy on the Flexible Work Program, which includes alternate work schedules (AWS) and telework opportunities. Telework is an integral part of the Commission's continuity of operations plan, particularly situational or ad-hoc telework, to ensure the Commission's continued operations during government closure or delay. During FY 2017, 69 percent of Commission staff participated in situational telework, compared to 70 percent in FY 2016. Almost half (49 percent) of employees are teleworking on a regularly scheduled basis. In 2017, the Commission continued to offer extended telework to eligible employees and 4 percent of the workforce used this increased flexibility to telework more than three days per week. Thirty percent of Commission staff participated in the AWS program in FY 2017.

The Commission's investment in its employees remains a top priority. In FY 2017, the Commission offered training and professional development opportunities designed to increase employee knowledge, engagement and retention. The Commission also ensured that employees were in compliance with mandatory training requirements in all areas including cybersecurity, ethics, and records management. All employees attended at least one optional training, 47 percent of employees chose to participate in off-site training, and 39 percent attended in-house professional development training.

Equal Employment Opportunity and Diversity

In FY 2017, the Commission continued its commitment to equal employment opportunity (EEO) in its initiatives to recruit, develop, and retain a skilled, high-achieving, and diverse workforce. Women and minorities accounted for 59 percent and 31 percent, respectively, of the workforce. Women filled 40 percent of the agency's executive positions; minorities filled 10 percent. Over the course of FY 2017, the Commission had no EEO complaints filed.

The Commission provides internship opportunities to aid in the recruitment and development of professionals with diverse backgrounds. The Commission will continue to monitor and offer opportunities to increase diversity, including the use of formal recruitment channels such as local universities, veterans' groups, and other comparable organizations and groups that target under-represented populations. To further address this issue, during FY 2017 the Commission revised and updated its reasonable accommodation policy.

Transparency and Open Government

The Commission is committed to transparency, accountability, and open government. In compliance with the Freedom of Information Act (FOIA), the Commission completed all FY 2017 requests within statutory limits. The Commission expects to receive a favorable review in the Department of Justice's FY 2017 Assessment of Agency Progress.

The Commission continued to provide live audio webcasts of hearings, technical conferences, and public meetings, and expanded these capabilities to provide for video webcasting of public meetings and technical conferences. Recordings of the webcasts are available on the Commission's website, **www.prc.gov**.

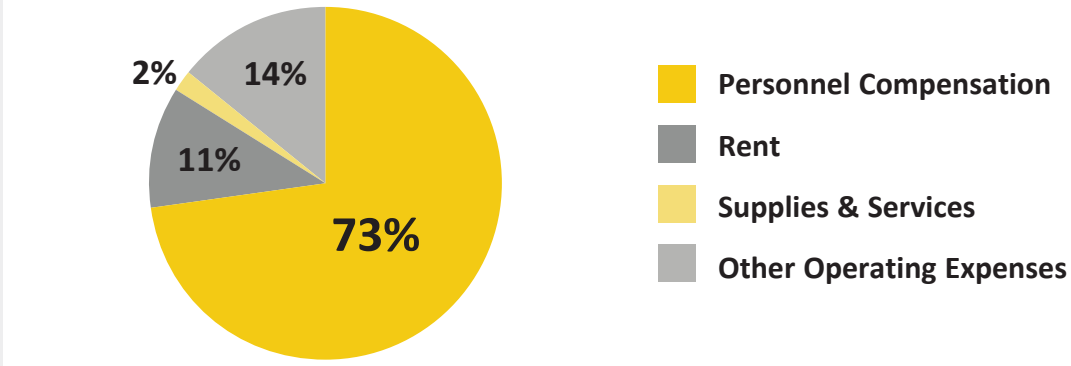
Budget and Finance

The Commission's Total Obligation Authority for FY 2017 was $16,200,000. These funds were used to maintain staffing levels of 75 full-time employees and for operating expenses. Salaries and benefits accounted for $11,761,544 (73 percent) of the Commission expenditures, the remaining $4,438,456 was allocated for operating expenses.

Figure II-3 displays the Commission's actual expenditures for FY 2017: "Rent" goes toward the agency's commercial office and storage space, and "Other Operating Expenses" includes information technology, training, and consulting. The Commission is also implementing a revised budget formulation and forecasting process to further enhance budget development. The Commission also successfully partnered with women and minority-owned business for a total of 21 percent of all Commission contracts.

The Commission continues to work within its budget and improve accounting and contracting processes making them more cost-effective and efficient. In response to the 2009 presidential memorandum regarding government contracting, and in line with Executive Order 13576, "Delivering an Efficient, Effective, and Accountable Government" (2011), the Commission continued to improve its contracting policy and standard operating procedures, resulting in increased accountability and cost savings.

Figure II-3: FY 2017 Actual Expenditures



Information Technology (IT)

In FY 2017, the Commission had zero incidents to report to the Department of Homeland Security (DHS) United States Computer Emergency Readiness Team (US-CERT), and did not experience any breaches of personally identifiable information.

During this past year, the Commission took several steps to improve the overall security and performance of its IT infrastructure, increase Federal Information Security Management Act (FISMA) compliance, and sharpen the emphasis on cybersecurity cross-agency priority goals. The primary focus for FY 2017 was the modernization and optimization of the entire IT infrastructure and legacy applications. The Commission also completed its Managed Trusted Internet Protocol Service (MTIPS) implementation. The time and resources invested in system testing, readiness, and cybersecurity training during FY 2017 is a testament to the Commission's commitment to a secure and reliable IT presence.

Records Management

In FY 2017, the Commission began developing a new Electronic Document and Records Management System (EDRMS). The EDRMS will manage the agency's entire records life-cycle by providing all current electronic records repositories with a shared common interface. Notably, this system will include the electronic transfer of the Commission's records to the National Archives and Records Administration, creating a more streamlined and efficient recordkeeping system. The Commission aims to have EDRMS in place by the end of FY 2018.

CHAPTER III | FY 2017 Proceedings

PHOTO BY ERIKA CROSS

The Commission is required by the PAEA[1] to submit an annual report to the president and the Congress that includes an analysis of the extent to which regulations are achieving the objectives under section 3622 of title 39 of the U.S. Code.[2] In FY 2017 and early FY 2018, the Commission reviewed the system of ratemaking for Market Dominant products that was developed pursuant to section 3622 to determine if it achieved the objectives established by Congress during the 10 years following the enactment of the PAEA (PAEA era). The Commission's review is discussed in detail under the Statutory Review of Market Dominant Rate System section. As a result of that review, the Commission determined that the Current System as a whole has not achieved the objectives of the PAEA.

James A. Farley post office building in New York City.

In accordance with 39 U.S.C. § 3622(d)(3), if the Commission determines that the Current System has not achieved the objectives of the PAEA, the Commission may, by regulation, make modifications or adopt an alternative system as necessary to achieve the objectives. As a result, the Commission also issued an NPR that included proposed changes to the Current System.[3] The proposed changes to the regulations are discussed in detail under the Notice of Proposed Rulemaking section. The Commission anticipates that future Annual Reports will provide in-depth analysis of how well the system in place, after completion of the final rules, is achieving the objectives of section 3622.

In addition to the analysis of the extent to which regulations are achieving the objectives under 39 U.S.C. § 3622, the Commission is required by 39 U.S.C. § 3651(a) to analyze the extent to which its regulations are achieving the objectives of section 3633 of title 39 of the U.S. Code. The Commission's regulations in 39 C.F.R. part 3015 support the requirements under 39 U.S.C. § 3633, which are discussed below under the Rate Changes - Competitive Products section. This chapter also describes the Commission's major orders, reports, and proceedings during FY 2017.

[1] Postal Accountability and Enhancement Act, Pub. L. 109-435, 120 Stat. 3198 (2006).
[2] 39 U.S.C. § 3651(a).
[3] Docket No. RM2017-3, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, December 1, 2017 (Order No. 4258).

Statutory Review of Market Dominant Rate System

When enacting the PAEA, Congress intended that the Current System achieve the nine objectives in 39 U.S.C. § 3622(b):

1. Maximize incentives to reduce costs and increase efficiency.
2. Create predictability and stability in rates.
3. Maintain high quality service standards established under 39 U.S.C. § 3691.
4. Allow the Postal Service pricing flexibility.
5. Assure adequate revenues, including retained earnings, to maintain financial stability.
6. Reduce the administrative burden and increase the transparency of the ratemaking process.
7. Enhance mail security and deter terrorism.
8. Establish and maintain a just and reasonable schedule for rates and classifications without prohibiting the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.
9. Allocate the total institutional costs of the Postal Service appropriately between Market Dominant and Competitive products.

Congress also required the Commission to review the Current System 10 years after the PAEA was enacted "to determine if the [Current System] is achieving the objectives in [39 U.S.C. § 3622] (b), taking into account the factors in [39 U.S.C. § 3622] (c)."[4] In accordance with this statutory mandate, the Commission initiated its review of the Current System by establishing Docket No. RM2017-3 and issuing an Advance Notice of Proposed Rulemaking on December 20, 2016, to establish a framework for its review of the Current System and provide notice and an opportunity for comments. In response, the Commission received 82 sets of comments[5] from interested persons.

After considering comments received, the Commission issued Order No. 4257 containing its findings and determination of its review of the Current System.[6] First, the Commission clarified the scope and framework of its review and interpreted relevant statutory language in 39 U.S.C. § 3622.[7] It determined that all aspects of the Current System outlined in section 3622, including workshare discounts, are appropriately incorporated into the review.[8]

Second, the Commission discussed the evolution to the Current System from the former ratemaking system under the Postal Reorganization Act.[9] The Commission stated that when enacting the PAEA, Congress anticipated that the consumer price index for all urban consumers (CPI-U) price cap would enable the Postal Service to achieve sufficient revenues to cover all of its operating costs and statutorily mandated obligations while simultaneously motivating the Postal Service to cut costs, increase efficiency, and fund network expansion and necessary capital improvements.[10]

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[4] 39 U.S.C. § 3622(d)(3).

[5] Docket No. RM2017-3, Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products, December 20, 2016 (Order No. 3673).

[6] Docket No. RM2017-3, Order on the Findings and Determination of the 39 U.S.C. § 3622 Review, December 1, 2017 (Order No. 4257).

[7] Order No. 4257 at 8-23. The Commission stated that it resolved the Postal Service's petition "to clarify the scope of the statutory review" in Order No. 3673. See id. at 11 n.15 (citing Order No. 3673 at 2 n.4; Docket No. RM2016-9, Petition of the United States Postal Service for the Initiation of a Proceeding to Clarify the Scope of the Review of the System for Regulating Market-Dominant Rates and Classes, April 7, 2016).

[8] Order No. 4257 at 12.

[9] Postal Reorganization Act, Pub. L. 91-375, 84 Stat. 719 (1970).

[10] Order No. 4257 at 32, 37.

However, the Commission explained that the Great Recession occurred shortly after the PAEA was enacted, which, in concert with emergent technological trends, had a substantial negative impact on Postal Service volumes and revenues.[11] The Commission concluded that these quick and dramatic changes to the operating environment on which the PAEA was designed made it challenging for the Current System to achieve the PAEA's goals as intended.[12]

Third, the Commission found that the nine objectives in 39 U.S.C. § 3622(b) reflect the PAEA's goals "to create a flexible, stable, predictable, and streamlined ratemaking system that ensures the Postal Service's financial health (in significant part through rate adjustments, cost reductions, and increased efficiency) and maintains high quality service standards and performance."[13] The Commission identified three principal areas of the Current System that encapsulate the nine objectives: (1) the structure of the ratemaking system, (2) the Postal Service's financial health, and (3) service.[14] The Commission applied each objective "in conjunction with the others" as required by section 3622(b) by evaluating each principal area to determine whether the PAEA's goals were achieved during the PAEA era.[15]

In its review of the structure of the ratemaking system, the Commission found that the Current System was largely successful in achieving the PAEA's goals by creating rate adjustments that were just, predictable, and stable. The Commission also found that the Current System achieved a streamlined ratemaking process that reduced the administrative burden, increased transparency, and provided the Postal Service pricing flexibility. However, the Commission concluded that the Current System has not resulted in increased pricing efficiency during the PAEA era.[16]

In its review of the Postal Service's finances, the Commission found that the Current System has not maintained the financial health of the Postal Service as intended by the PAEA.[17] The Commission explained that while the Postal Service has generally achieved short-term financial stability, both medium- and long-term financial stability measures have not been achieved because total revenues were not sufficient to cover total costs, and the Postal Service was unable to generate retained earnings.[18] The Commission also found that while some cost reductions and efficiency gains occurred during the PAEA era, the incentives were not maximized in a way that allowed the Postal Service to achieve financial stability.[19] The Commission concluded that although the Current System contained a mechanism to appropriately allocate institutional costs and provided sufficient funds to maintain safeguards to protect the mail system and deter terrorism, there was not an adequate

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11 *Id.* at 38.
12 *Id*. at 45.
13 *Id*. at 17.
14 *Id*.
15 *Id*. at 21-22.
16 *Id*. at 48, 142-46.
17 *Id*. at 148, 249.
18 *Id*. at 165-72.
19 *Id*. at 248.

mechanism to maintain reasonable rates because some products and classes failed to cover their attributable costs, further threatening the financial health of the Postal Service.[20]

When reviewing service, the Commission determined that high quality service standards have not been maintained during the PAEA era. The Commission concluded that while the ACD has been and continues to be the proper vehicle for addressing issues related to service performance, the Current System did not effectively encourage the maintenance of high quality service standards as intended by the PAEA.[21]

Taken together, the Commission's analysis of each of the three principal areas of the PAEA led it to conclude that some aspects of the Current System have worked as intended.[22] However, based on its review of the objectives in section 3622(b), taking into account the factors in section 3622(c), the Commission found that the Current System as a whole has not achieved the objectives of the PAEA.[23]

Notice of Proposed Rulemaking

As a result of the Commission finding that the Current System as a whole has not achieved the objectives, the Commission issued an NPR concurrently with Order No. 4257 to address the issues identified by the Commission in its review.[24]

First, the Commission discussed its legal authority to promulgate new regulations under 39 U.S.C. § 3622(d)(3). The Commission found that the PAEA provides the Commission broad authority to promulgate regulations that modify or replace the Current System as necessary to achieve the PAEA's objectives.[25]

Second, the Commission proposed changes that would address key issues with the Current System. In Order No. 4257, the Commission found that the Current System has not achieved medium- and long-term financial stability.[26] To address this issue, the Commission found that additional pricing authority is necessary to achieve the PAEA's objectives.[27] The Commission proposed a two-pronged solution that would complement, rather than replace, the CPI-U price cap by providing discrete, clearly-defined amounts of additional rate authority to put the Postal Service on the path toward generating positive net income and retained earnings.[28] To put the Postal Service on a path to medium-term financial stability, the proposed rules would provide the Postal Service supplemental rate authority to generate additional revenue to cover the Postal Service's obligations.[29] Under the proposed rules, the Postal Service would receive an additional 2 percentage points of rate authority per mail class each calendar year (CY) during each of the first five full CYs after the effective date of these rules, after which this additional rate authority would expire.[30]

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[20] *Id*. at 248-49, 274-275.
[21] *Id.* at 250, 273.
[22] *Id.* at 5.
[23] *Id.* at 5, 275.
[24] *See* Order No. 4258.
[25] *Id*. at 19.
[26] Order No. 4257 at 172, 178, 247.
[27] Order No. 4258 at 34.
[28] *Id*.
[29] *Id*. at 38.
[30] *Id.* at 26, 38, 42, 45.

To put the Postal Service on a path to long-term financial stability, the proposed rules would provide the Postal Service performance-based rate authority to generate retained earnings and fund adequate levels of capital investment while providing meaningful incentives to increase operational efficiency and maintain high quality service standards.[31] Under the proposed rules, the Postal Service would receive up to 1 percentage point of performance-based rate authority per mail class each CY as long as the Postal Service meets or exceeds an operational efficiency-based standard and adheres to service standard quality criteria.[32] Of this rate authority, 0.75 percentage points would be allocated for meeting or exceeding an operational efficiency-based standard (total factor productivity (TFP)) and 0.25 percentage points would be allocated for meeting or exceeding service standard quality criteria.[33]

In Order No. 4257, the Commission found that non-compensatory products are not reasonably or efficiently priced and threaten the Postal Service's financial integrity.[34] Revenues for non-compensatory products and classes do not cover their attributable costs. To address these issues, the proposed rules would prohibit reducing rates for non-compensatory products and would require price increases to improve cost coverage.[35] For non-compensatory products that are part of compensatory classes, the proposed rules would require the Postal Service to increase rates for any non-compensatory product by a minimum of 2 percentage points above the percentage increase for the class.[36] Moreover, to address a non-compensatory class, which occurs if the attributable cost for an entire class exceeds the revenue for the class, the proposed rules would provide the Postal Service with an additional 2 percentage points of rate authority each CY for the non-compensatory class.[37] The proposed rules would not mandate immediate full cost coverage for non-compensatory products and classes, but rather seek to narrow the coverage gap and move prices toward full cost coverage over time to achieve reasonable and efficient rates as the PAEA envisioned.[38]

Workshare discounts are rate discounts the Postal Service provides to mailers for presorting, prebarcoding, handling, or transporting mail.[39] In Order No. 4257, the Commission found that the Current System has not increased pricing efficiency because the Postal Service failed to set most workshare discounts as close as practicable to avoided costs despite the Postal Service's ability to do so under the price cap.[40] To increase pricing efficiency, the proposed rules would establish two bands—ranges with upper and lower limits—for workshare discount passthroughs: between 75 percent and 125 percent for Periodicals, and between 85 and 115 percent for all other classes.[41] All workshare discount passthroughs that fall outside of the applicable band would be noncompliant, subject to a 3-year grace period.[42]

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[31] *Id.* at 38-39, 53.
[32] *Id.* at 26, 39, 55-57.
[33] *Id.* at 26, 61, 64, 70-71, 73.
[34] Order No. 4257 at 139-42, 234-35.
[35] Order No. 4258 at 76-77, 85.
[36] *Id.* at 77, 80.
[37] *Id.* at 84.
[38] *Id.* at 78, 80-81, 87.
[39] 39 U.S.C. § 3622(e)(1).
[40] Order No. 4257 at 145.
[41] Order No. 4258 at 93. Passthroughs represent the relationship between the amount of the workshare discount and the avoided cost as a percentage. *Id.* at 89 n.91.
[42] *Id.* at 95-96.

The NPR also proposes other changes to the rate adjustment process that would increase visibility into future planned rate adjustments.[43] Proposed changes would include enhancing requirements for the schedule for regular and predictable rate adjustments and extending the notification period for planned rate adjustments from 45 days to 90 days.[44] The proposed regulations would also restructure the Market Dominant regulations in 39 C.F.R. part 3010 to promote readability and simplicity.[45]

This rulemaking is currently pending before the Commission. Before any rule changes may be finalized, the public will have the opportunity to submit comments by March 1, 2018, and reply comments by March 30, 2018.[46]

Other Rulemakings

The Commission considered several other rulemaking proceedings during FY 2017.

Rulemakings Amending Commission Regulations

MAIL PREPARATION CHANGES AND THE PRICE CAP

On January 22, 2016, the Commission issued Order No. 3047, which articulated a standard for determining when mail preparation changes have rate effects that implicate the price cap rules.[47] That same day, the Commission initiated an NPR proposing procedural rules that required the Postal Service to properly account for the rate effects of mail preparation changes in accordance with Order No. 3047.[48] The proposed rules allowed interested parties to file a motion with the Commission if the Postal Service failed to recognize or account for a mail preparation change that affected the price cap rules.[49]

The Postal Service appealed Order No. 3047 and a related order to the U.S. Court of Appeals for the District of Columbia (D.C. Circuit).[50] On March 27, 2017, after considering comments received, the Commission issued a revised NPR.[51] The Commission revised the proposed rules to require the Postal Service to publish all mail preparation changes in a publicly-available single source and affirmatively designate whether a mail preparation change requires compliance with the Commission's price cap rules.[52]

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[43] *Id*. at 27.
[44] *Id.* at 98-99, 104.
[45] *Id.* at 107-110.
[46] *Id.* at 130, 13.
[47] *See* Docket No. R2013-10R, Order Resolving Issues on Remand, January 22, 2016 (Order No. 3047).
[48] Docket No. RM2016-6, Notice of Proposed Rulemaking on Motions Concerning Mail Preparation Changes, January 22, 2016, at 1-2 (Order No. 3048).
[49] Order No. 3048 at 3, 7.
[50] *See* n. 197, *infra*.
[51] Docket No. RM2016-6, Revised Notice of Proposed Rulemaking, March 27, 2017, at 2 (Order No. 3827).
[52] Order No. 3827 at 2, 13-14.

On April 11, 2017, the Postal Service moved to suspend the rulemaking until the D.C. Circuit resolved the Postal Service's appeal.[53] The Commission denied the motion, finding that the Postal Service did not provide any justification to suspend proceedings.[54] This rulemaking is currently pending before the Commission.

ETHICS

The Commission established Docket No. RM2017-4 to consider changes to the Commission's ethics rules to reflect the Commission's regulatory role under the PAEA. The proposed changes were intended to protect the integrity of the Commission's programs and processes, maintain public confidence that Commission employees are fulfilling their duties impartially and objectively, and reflect lessons learned through the Commission's experiences with the existing ethics policies and procedures.[55]

On May 19, 2017, the Commission issued an NPR to amend the Commission's ethics rules in 39 C.F.R. part 3000, subpart A.[56] The proposed rules treated employees' and former employees' interactions with the Postal Service substantially the same as if those interactions were with entities that are not part of the Federal Government.[57]

That same day, the Commission, jointly with the Office of Government Ethics, issued another NPR to amend the supplemental standards of ethical conduct in 5 C.F.R. part 5601 that apply to Commission employees.[58] The proposed changes clarified requirements concerning prohibited financial holdings, disqualification when seeking non-federal employment, and outside employment.[59] After considering comments received, the Commission adopted both sets of proposed rules without substantial changes.[60] The revised ethics rules and supplemental standards of ethical conduct went into effect on November 30, 2017 and December 1, 2017, respectively.[61]

FREEDOM OF INFORMATION ACT

On December 19, 2016, the Commission issued an NPR to propose revisions to its regulations governing requests for agency records made under the FOIA.[62] These changes were necessary to comply with the FOIA Improvement Act of 2016. After considering comments received, the Commission adopted final rules incorporating commenters' suggested revisions, as well as several other changes to reflect guidance published by the Department of Justice.[63]

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53 Docket No. RM2016-6, Motion of the United States Postal Service to Suspend Proceedings, April 11, 2017.
54 Docket No. RM2016-6, Order No. 3879, Order Denying Motion, April 28, 2017.
55 Docket No. RM2017-4, Notice of Proposed Rulemaking on Amendments to Supplemental Standards of Ethical Conduct for Employees of the Postal Regulatory Commission, May 19, 2017, at 3 (Order No. 3906); Docket No. RM2017-4, Notice of Proposed Rulemaking on Amendments to Ethics Rules, May 19, 2017, at 5 (Order No. 3907).
56 *See Order No. 3907.*
57 *Id. at 1-2.*
58 *See* Order No. 3906.
59 *Id*. at 1.
60 Docket No. RM2017-4, Order No. 4177, Order Amending Supplemental Standards of Ethical Conduct for Employees of the Postal Regulatory Commission, October 25, 2017; Docket No. RM2017-4, Order No. 4178, Order Amending Ethics Rules, October 25, 2017.
61 82 Fed. Reg. 50319 (October 31, 2017); 82 Fed. Reg. 50493 (November 1, 2017).
62 Docket No. RM2017-2, Order No. 3671, Notice of Proposed Rulemaking to Revise Procedures for the Freedom of Information Act, December 19, 2016.
63 Docket No. RM2017-2, Order No. 3812, Order Adopting Final Rules Revising Procedures for the Freedom of Information Act, March 1, 2017.

Proposals To Change Analytical Principles

The Commission's rules allow any interested person, including the Postal Service and Public Representative, to petition the Commission to initiate proceedings to consider proposals to change accepted analytical principles.[64] These proceedings, which are filed in rulemaking dockets, are intended to improve the quality, accuracy, or completeness of data or data analysis in the Postal Service's annual periodic reports to the Commission.[65]

During FY 2017, the Commission considered 12 Postal Service proposals to change various accepted analytical principles. The Commission issued final orders for 10 of the proposals. The remaining two proposals are currently pending before the Commission. Several of these proposals are discussed below.

On August 22, 2016, the Postal Service filed a proposal to change the methodology for calculating attributable purchased highway transportation costs.[66] It proposed to implement this change by incorporating a new method of calculating the variability of purchased highway transportation capacity with respect to volume, as calculated by a newly developed econometric model, when calculating attributable costs for purchased highway transportation.[67]

The Commission approved this proposal with respect to the calculation of variabilities applicable to transportation accounts associated with regular routes only.[68] The Commission did not approve the proposal with respect to emergency and Christmas transportation routes because the Postal Service did not provide sufficient empirical support for updating variabilities for accounts associated with these routes.[69]

On June 30, 2017, the Postal Service filed a proposal seeking to establish a procedure to be used annually to update the estimated proportion of city carrier letter route time spent delivering parcels.[70] After considering comments received, the Commission approved the proposal because it found that the proposed modifications would improve the accuracy of the Postal Service's costing methodology for the estimated proportion of city carrier letter route time spent delivering parcels.[71] The Commission directed the Postal Service to provide supporting materials in its Annual Compliance Report (ACR) to help ensure that the Postal Service reports accurate data concerning city carrier letter route street time evaluations.[72]

On July 31, 2017, the Postal Service filed a proposal relating to rates for Nonprofit USPS Marketing Mail.[73] USPS Marketing Mail has different rates for Nonprofit and Commercial mail. The PAEA requires that the estimated average revenue per piece the Postal Service

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64 *39* C.F.R. § 3050.11(a). The Commission, acting on its own behalf, may also initiate a proceeding to change an accepted analytical principle. *Id*.
65 *Id*.
66 Docket No. RM2016-12, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), August 22, 2016 (Docket No. RM2016-12 Petition).
67 Docket No. RM2016-12 Petition at 1.
68 Docket No. RM2016-12, Order on Analytical Principles Used in Periodic Reporting (Proposal Four), June 22, 2017, at 2, 40-41 (Order No. 3973).
69 Order No. 3973 at 40-41.
70 Docket No. RM2017-8, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), June 30, 2017.
71 Docket No. RM2017-8, Order on Analytical Principles Used in Periodic Reporting (Proposal Four), December 1, 2017, at 22 (Order No. 4259).
72 Order No. 4259 at 21-22.
73 Docket No. RM2017-12, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Eight), July 31, 2017 (Docket No. RM2017-12 Petition).

receives from Nonprofit mail must equal, as nearly as practicable, 60 percent of the estimated average revenue per piece the Postal Service receives from Commercial mail.[74] This requirement is called the 60 Percent Rule, which the Postal Service has applied to USPS Marketing Mail at the class-level since filing its first Market Dominant rate case in FY 2008.

The Postal Service proposes to apply the 60 Percent Rule below the class-level separately to the Nonprofit price categories for USPS Marketing Mail Regular and USPS Marketing Mail Enhanced Carrier Route price categories.[75] The Postal Service asserts that this approach is consistent with the language of the PAEA and will help address the ongoing issue of Nonprofit mail revenues consistently failing to reach 60 percent of the average per piece revenues for Commercial mail.[76] The Commission received over 100 sets of comments. This proceeding is currently pending before the Commission.

The Commission approved several other proposals it found would improve the quality, accuracy, or completeness of financial data or data analysis. The proposals included initiatives to update and improve data sources for existing cost and revenue systems that either streamline data production or improve data quality. For example, the Commission approved Postal Service proposals to revise the reporting methodology for measuring the national totals of revenue, pieces, and weight

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in the Revenue, Pieces, and Weight Report for certain mailpieces[77] and to revise the reporting methodology for insured, Collect on Delivery, and Registered Mail extra services associated with domestic mailpieces bearing PC Postage indicia.[78]

[74] 39 U.S.C. § 3626(a)(6)(A).
[75] Docket No. RM2017-12 Petition at 1.
[76] *Id*. at 1, 3.
[77] Docket No. RM2017-7, Order No. 4066, Order on Analytical Principles Used in Periodic Reporting (Proposal Three), August 24, 2017
[78] Order No. 3827 at 2, 13-14.

Annual Reports

Each year, the Commission receives the Annual Compliance Report (ACR) from the Postal Service and issues three related reports: (1) the ACD, (2) the Analysis of Postal Service Performance Goals and Performance Plan, and (3) the Financial Analysis Report. In FY 2017, these three reports were issued in Docket No. ACR2016 and respectively: (1) assessed the Postal Service's compliance with statutory pricing and service requirements, (2) evaluated whether the Postal Service met its performance goals, and (3) analyzed the Postal Service's overall financial position.

Annual Compliance Determination

The ACD is an important tool for enhancing transparency and determining whether the Postal Service complies with statutory pricing and service requirements. Under the PAEA and Commission regulations, the Postal Service has 90 days after the fiscal year ends to prepare and submit its ACR to the Commission. The ACR analyzes costs, revenues, rates, and quality of service for Market Dominant and Competitive products.[79] The ACR must also include information about mail volumes, service performance, and customer satisfaction for Market Dominant products, as well as information on workshare discounts and market tests.[80]

After receiving the ACR, the Commission has 90 days to solicit public comment and determine whether: (1) any rates or fees in effect during the fiscal year did not comply with applicable laws, and (2) the Postal Service met its service standards in effect during the fiscal year.[81] The Commission publishes its analysis of the ACR in the ACD.

On March 28, 2017, the Commission issued the FY 2016 ACD and made several principal findings and directives.[82] First, when reviewing Market Dominant products for compliance with statutory pricing policies, the Commission found that 21 workshare discounts did not comply with 39 U.S.C. § 3622(e). For 16 workshare discounts, the Commission directed the Postal Service to either align workshare discounts with avoided costs during the next Market Dominant price adjustment or specify an applicable statutory exception.[83]

Second, for the Periodicals class, the Commission found that the Postal Service meaningfully addressed the FY 2015 ACD directives to report on the cost and contribution impact of worksharing incentives offered for 5-Digit and Carrier Route presortation and progress in improving pricing efficiency. The Commission directed the Postal Service to continue reporting on Periodicals pricing issues in its FY 2017 ACR.[84]

Third, the Commission identified 11 non-compensatory Market Dominant products that did not generate sufficient revenue to cover their attributable costs: (1) Periodicals In-County, (2) Periodicals Outside County, (3) USPS Marketing Mail Flats, (4) USPS Marketing

[79] 39 U.S.C. § 3652(a)(1).
[80] *Id*. § 3652(a)(2), (b), (c).
[81] *Id*. § 3653(a), (b).
[82] Docket No. ACR2016, *Annual Compliance Determination* Report Fiscal Year 2016, March 28, 2017 (FY 2016 ACD).
[83] *Id*. at 1.
[84] *Id*. at 2.

Mail Parcels, (5) Media Mail/Library Mail, (6) Inbound Letter Post, (7) Stamp Fulfillment Services, (8) Money Orders, (9) Collect on Delivery, (10) Stamped Envelopes, and (11) Market Dominant negotiated service agreement with PHI Acquisitions, Inc.[85] For Periodicals In-County, Periodicals Outside County, and USPS Marketing Mail Flats, the Commission found that additional transparency was necessary to hold the Postal Service accountable. The Commission stated it would initiate a strategic rulemaking to develop proposed reporting requirements related to flats operational cost and service issues.[86] For other non-compensatory products, the Commission issued specific directives to the Postal Service such as implementing above-average price increases in future Market Dominant price adjustments to improve cost coverage and reporting on the volume and mail mix forecasts for the remainder of the PHI Acquisitions, Inc. NSA.[87]

Fourth, the Commission found that 16 Competitive products did not cover their attributable costs as required by 39 U.S.C. § 3633(a)(2). The Commission directed the Postal Service to take corrective action, such as reporting on an investigation of cost estimates, reporting on the status of contract negotiations, and taking remedial action on NSAs with revenues not covering attributable costs.[88]

Fifth, the Commission found that the majority of products failed to meet their service performance targets for FY 2016. In particular, service performance results for all First-Class Mail products, both Periodicals products, most products in USPS Marketing Mail, Bound Printed Matter Flats, and Post Office Box Service did not meet their targets despite Postal Service initiatives to improve performance. The Commission requested that the Postal Service provide additional transparency by reporting specific information on First-Class Mail Single-Piece Letters/Postcards metrics within 90 days after the FY 2016 ACD was issued and as part of the FY 2017 ACR.[89]

Sixth, the Commission noted its ongoing concern with the increasing number of postal retail facilities under suspension. The Commission required the Postal Service to significantly reduce the number of suspended facilities in FY 2017 and provide updated information after the close of each fiscal quarter.[90]

Seventh, the Commission found that the Postal Service appears to lack a comprehensive plan to measure, track, and report flats cost and service issues. The Commission stated it would initiate a strategic rulemaking to develop proposed reporting requirements related to flats operational cost and service issues.[91]

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85 *Id*. at 3. On November 15, 2016, the Commission approved the Postal Service's request to change the name of "Standard Mail" to "USPS Marketing Mail." Docket No. R2017-1, Order on Rate Adjustments for First-Class Mail, Standard Mail, Periodicals, and Package Services Products and Related Mail Classification Changes, November 15, 2016, at 39 (Order No. 3610). Although both "Standard Mail" and "USPS Marketing Mail" were used during FY 2017, this Annual Report uses "USPS Marketing Mail" throughout.

86 *See* Docket No. RM2018-1, Advance Notice of Proposed Rulemaking to Develop Data Enhancements and Reporting Requirements for Flats Issues, October 4, 2017 (Order No. 4142).

87 FY 2016 ACD at 2, 59, 61, 63, 74.

88 Id. at 3, 78.

89 *Id.* at 3

90 *Id.* at 3, 151.

91 *Id.* at 4; see Order No. 4142.

Analysis of Performance Goals

Each year, the Commission must evaluate whether the Postal Service met the performance goals established in its Annual Performance Report and Performance Plan.[92] The Commission may also provide the Postal Service recommendations related to protecting or promoting public policy objectives in title 39.[93]

On April 27, 2017, the Commission issued a detailed analysis of the Postal Service's progress during FY 2016 toward its four performance goals: (1) Deliver High-Quality Service, (2) Provide Excellent Customer Experiences, (3) Ensure a Safe Workplace and Engaged Workforce, and (4) Sustain Controllable Income.[94]

The Commission found that the FY 2016 Annual Performance Report and FY 2017 Performance Plan complied with all but one of the requirements in 39 U.S.C. §§ 2803 and 2804. However, the Commission noted that these documents as submitted lacked sufficient information for the Commission to determine compliance with applicable statutory requirements, and that the issuance of Chairman's Information Requests (CHIRs) was necessary to obtain the required information. The Commission directed the Postal Service to include all information necessary to show compliance with 39 U.S.C. §§ 2803 and 2804 in future annual performance plans and performance reports. The Commission also provided further guidance on how the Postal Service can fully comply with 39 U.S.C. § 2803(a).[95]

The Commission's analysis further found that the Postal Service partially met each performance goal in FY 2016.[96] The Commission provided an appendix of its complete findings and recommendations for each performance goal to help the Postal Service meet its goals and better assess its performance in future years.

Financial Analysis Report

On March 31, 2017, the Commission issued its *Financial Analysis of United States Postal Service Financial Results and 10-K Statement*.[97] The Commission analyzed the Postal Service's overall financial position and evaluated relationships between the essential components of the Postal Service's financial statements to assess the Postal Service's viability, and stability. The Commission also described volume, revenue, and cost trends for Market Dominant and Competitive products and analyzed the Postal Service's financial status using financial ratios.

In summary, the Commission's analysis showed that in FY 2016, the Postal Service generated its third consecutive fiscal year of operating income despite an increase in operating expenses and the expiration of the exigent surcharge in April 2016. In FY 2016, net operating income was $0.6 billion, which was due in part to revenue from

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92 39 U.S.C. § 3653(d).
93 *Id.*
94 Docket No. ACR2016, Analysis of the Postal Service's *FY 2016 Annual Performance Report and FY 2017 Performance Plan*, April 27, 2017.
95 *Id*. at 9-22.
96 *Id*. at 23.
97 Docket No. ACR2016, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement Fiscal Year 2016*, March 31, 2017.

Market Dominant and Competitive products rate increases, the exigent rate surcharge during the first half of FY 2017, and the continuing growth in Competitive products volume. However, net operating income excludes the Postal Service's payment to the Retiree Health Benefits Fund (RHBF), the supplemental contribution to the Federal Employees Retirement System (FERS) annuity, the non-cash adjustments to the workers' compensation liability, and any one-time expense or revenue adjustments. After adjusting for these expenses, the Postal Service incurred a total net loss of $5.6 billion largely due to a $1.5 billion increase in overall compensation and benefits costs and an increase in non-cash workers' compensation expense of $0.9 billion caused by a decrease in the discount rate.[98]

The Commission found that at the end of FY 2016, net liabilities primarily consisted of RHBF missed payments, workers' compensation liability, and the total net debt owed to the Federal Financing Bank. Current liabilities, consisting largely of RHBF obligations and short-term borrowing, contributed to a large portion (67.3 percent) of the $81.2 billion in total liabilities. The Postal Service had not paid the RHBF statutory requirement for FY 2011 through FY 2016, which accounted for $33.9 billion of current liabilities.[99]

Furthermore, the Commission's report noted that at the end of FY 2016, the Postal Service recorded a $55.9 billion net deficiency resulting from several years of net losses starting in FY 2007. Although the Postal Service generated operating income during the past three fiscal years, the slow replacement of fully depreciated capital assets and high personnel related liabilities led to the continued erosion of financial sustainability.[100]

Rate Changes

There are two types of postal rates: (1) rates of general applicability, and (2) rates not of general applicability. Rates of general applicability are available to all mailers equally on the same terms and conditions.[101] These rates are available to the general public; examples include Forever Stamps and Priority Mail Flat Rate boxes. Rates not of general applicability are offered by the Postal Service to specific mailers through NSAs.[102] NSAs are written contracts, effective for a defined period of time, between the Postal Service and a mailer, that provide for customer-specific rates, fees, or terms of service according to the terms and conditions of the contract.[103]

In FY 2017, the Commission reviewed the Postal Service's proposed changes to rates of general applicability and rates not of general applicability for both Market Dominant and Competitive products. Each is discussed below.

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98 *Id.* at 1, 6.
99 *Id.* at 23.
100 Docket No. RM2016-12, Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Four), August 22, 2016 (Docket No. RM2016-12 Petition).
101 39 C.F.R. § 3001.5(u).
102 39 C.F.R. § 3010.1(g).
103 39 C.F.R. § 3001.5(r).

Market Dominant Products

RATES OF GENERAL APPLICABILITY

The PAEA allows the Postal Service to change rates of general applicability for Market Dominant products as long as the rate adjustments meet certain statutory and regulatory requirements:

- Rate adjustments for each Market Dominant mail class must not exceed the annual rate of inflation, as determined by the Consumer Price Index for All Urban Consumers.[104]
- Workshare discounts must not exceed the Postal Service's avoided costs unless a statutory exception applies.[105]
- Preferred rates must be set consistent with statutory preferences.[106]

The rate adjustments must also comply with the Commission's rules in 39 C.F.R. part 3010.

In early FY 2017, the Postal Service proposed changing rates of general applicability by filing a notice of inflation-based rate adjustments affecting most Market Dominant domestic and international products and services, along with numerous proposed MCS changes.[107] The Commission evaluated the Docket No. R2017-1 Notice for compliance with applicable laws. The Docket No. R2017-1 Notice and initial supporting documentation contained several errors and inconsistencies.[108] Consequently, nine CHIRs and one Commission Information Request (CIR) were issued to clarify the proposed rate adjustments and MCS changes and ensure the record contained accurate and complete data.[109] The Commission held a technical conference to discuss issues presented in the CHIRs and to clarify certain rate adjustment calculations.[110]

After analyzing the filings and considering comments received, the Commission approved the Postal Service's proposed rate adjustments and MCS changes for First-Class Mail, USPS Marketing Mail, Periodicals, and Package Services, finding that they complied with applicable legal requirements.[111] The Commission also approved the Postal Service's request to change the name of "Standard Mail" to "USPS Marketing Mail."[112]

Because of delays in receiving necessary information, the Commission analyzed proposed Special Services rate adjustments and MCS changes in a separate order. The Commission approved these proposed rate adjustments in Order No. 3670, finding that they complied with applicable laws.[113] However, the Commission denied the Postal Service's proposed Collect on Delivery MCS change because it was a significant change that exceeded the scope of the rate adjustment proceeding.[114]

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[104] 39 U.S.C. §§ 3622(d)(1)(A), (d)(2)(A)
[105] 39 U.S.C. § 3622(e)(2); see Docket No. RM2009-3, Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, September 14, 2010, at 18.
[106] 39 U.S.C. § 3626.
[107] *See* Docket No. R2017-1, United States Postal Service Notice of Market Dominant Rate Adjustment, October 12, 2016 (Docket No. R2017-1 Notice).
[108] Order No. 3610 at 4.
[109] *Id*. at 4-5.
[110] *Id*. at 5; *see* Docket No. R2017-1, Order No. 3566, Order Scheduling Technical Conference, October 14, 2016.
[111] Order No. 3610 at 55-56.
[112] *Id*. at 39.
[113] Docket No. R2017-1, Order on Rate Adjustments for Special Services Products and Related Mail Classification Changes, December 15, 2016, at 8, 16 (Order No. 3670).
[114] Order No. 3670 at 10-11, 16.

On June 30, 2017, the Postal Service proposed another change in rates of general applicability by filing a notice of Market Dominant rate adjustment and proposed MCS changes related to the Move Update assessment charge.[115] The Postal Service proposed to increase the Move Update assessment charge from 7 cents to 8 cents, amend the Move Update MCS language in the MCS, and extend the Full-Service Address Correction Service fee to non-Full-Service Mailpieces for mailers that meet specific criteria.[116] After considering comments received, the Commission approved the Postal Service proposed rate adjustments and MCS changes, finding them reasonable and consistent with applicable laws.[117]

RATES NOT OF GENERAL APPLICABILITY (NSAs)

For Market Dominant products, the Postal Service sets rates not of general applicability by entering into NSAs with mailers or foreign postal operators.[118] The Commission reviews these NSAs to ensure they either improve the Postal Service's net financial position or enhance the performance of various operational functions.[119] The NSAs must also not cause unreasonable harm to the marketplace and be available on public and reasonable terms to similarly situated mailers.[120] This review also ensures that the NSAs comply with the Commission's rules in 39 C.F.R. part 3010, subpart D.

In FY 2017, the Postal Service filed four NSAs with foreign postal operators: (1) Korea Post, (2) China Post, (3) Australia Post, and (4) Hong Kong Post.[121] The Commission found that these NSAs complied with applicable laws and approved them for inclusion within the product Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1.[122]

The Postal Service also filed a change in rates not of general applicability with its request to add Inbound Market Dominant PRIME Tracked Service Agreement to the Market Dominant product list.[123] This product is a multilateral agreement between

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[115] Docket No. R2017-7, United States Postal Service Notice of Market Dominant Rate Adjustment and Classification Changes, June 30, 2017 (Docket No. R2017-7 Notice).

[116] Docket No. RM2016-12 Petition at 1.

[117] Docket No. R2017-7, Order No. 4059, Order Approving Rate Adjustment and Classification Changes Related to Move Update Assessment, August 23, 2017, at 19-20.

[118] 39 C.F.R. § 3010.7.

[119] *See* 39 U.S.C. § 3622(c)(10).

[120] *See* 39 U.S.C. § 3622(c)(10).

[121] The Commission previously approved requests to extend the predecessor contracts for Hong Kong Post, China Post, and Korea Post until March 31, 2017. *See* Docket No. R2015-5 and CP2015-136, Order No. 3620, Order Approving Modification One to Agreement and Denying as Moot Motion for Temporary Relief, November 17, 2016 (Hong Kong Post); Docket No. R2015-6, Order No. 3618, Order Approving Modification to Existing Agreement, November 16, 2016 (China Post); Docket No. R2016-1, Order No. 3617, Order Approving Modification to Existing Agreement, November 16, 2016 (Korea Post).

[122] Docket No. R2017-2, Order No. 3742, Order Approving Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement with Australia Post, January 10, 2017; Docket No. R2017-4, Order No. 3809, Order Approving Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement (with China Post Group), March 1, 2017; Docket No. R2017-5, Order No. 3811, Order Approving Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement (with Hong Kong Post), March 1, 2017; Docket No. R2017-6, Order No. 3810, Order Approving Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement (with Korea Post), March 1, 2017.

[123] Docket Nos. MC2017-71 and R2017-3, Request of United States Postal Service to Add Inbound Market Dominant PRIME Tracked Service Agreement to the Market Dominant Product List, Notice of Type 2 Rate Adjustment, and Application for Non-Public Treatment, December 23, 2016 (Docket Nos. MC2017-71 and R2017-3 Request).

postal operators concerning the exchange of Letter Post items weighing up to 2 kilograms, tendered as PRIME Tracked items and branded with a common logo.[124] The Commission approved the request and rate adjustment on January 17, 2017.[125]

Also, the Commission approved modifications to several international Market Dominant NSAs.[126]

Competitive Products

The Commission reviews the Postal Service's proposed rates for Competitive products to ensure they comply with three statutory requirements in 39 U.S.C. § 3633(a):

1. Competitive products must not be cross-subsidized by Market Dominant products.[127] The Commission uses incremental costs to test whether Competitive products are being cross-subsidized by Market Dominant products.[128] There is no cross-subsidy if the Commission finds that Competitive product revenues as a whole are equal to or exceed total incremental costs.
2. Each Competitive product must cover its attributable costs, which are "the direct and indirect postal costs attributable to such product through reliably identified causal relationships."[129]
3. All Competitive products must collectively cover what the Commission determines to be an appropriate share of the Postal Service's institutional costs.[130] The Commission previously determined that the contribution from Competitive products as a whole must be at least 5.5 percent of the Postal Service's total institutional costs.[131]

The Commission also reviews proposed rates for Competitive products to ensure compliance with the Commission's rules in 39 C.F.R. part 3015. In FY 2017, the Commission reviewed the Postal Service's proposed changes to both rates of general applicability and rates not of general applicability for Competitive products. There were also several other proceedings related to Competitive products. Each is discussed below.

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[124] Docket No. MC2017-71 and R2017-3 Request at 1.

[125] Docket Nos. MC2017-71 and R2017-3, Order No. 3755, Order Adding Inbound PRIME Tracked Service Agreement to Market Dominant Product List, January 17, 2017.

[126] Docket Nos. MC2016-168 and R2016-6, Order No. 3799, Order Acknowledging Revised Version of Inbound Market Dominant Registered Service Agreement, February 22, 2017; Docket No. R2017-5 and CP2017-130, Order No. 3868, Order Approving Modification to an Inbound Market Dominant Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement and an Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement, April 24, 2017; Docket Nos. R2017-4 and CP2017-131, Order No. 3884, Order Approving Modification to an Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators 1 Negotiated Service Agreement and an Inbound Competitive Multi-Service Agreement with Foreign Postal Operators 1 Negotiated Service Agreement, May 3, 2017; Docket No. R2016-6, Order No. 4016, Order Approving Modifications of PRIME Registered Agreement, July 26, 2017; Docket No. R2011-6, Order No. 4015, Order Approving Modifications of Exprès Service Agreement, July 26, 2017.

[127] 39 U.S.C. § 3633(a)(1).

[128] 39 C.F.R. § 3015.7(a).

[129] 39 U.S.C. §§ 3633(a)(2), 3631(b). The Commission calculates a Competitive product's attributable costs as the sum of its volume-variable costs, product-specific costs, and those inframarginal costs calculated as part of the product's incremental costs. 39 C.F.R. § 3015.7(b).

[130] 39 U.S.C. § 3633(a)(3).

[131] 39 C.F.R. § 3015.7(c); Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Institutional Costs, August 23, 2012 (Order No. 1449). The Commission is currrently reviewing the institutional cost contribution requirement for Competitive products in Docket No. RM2017-1. See Docket No. RM2017-1, Advance Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, November 22, 2016 (Order No. 3624). Docket No. RM2017-1 is discussed under the Other Proceedings section, *infra*.

RATES OF GENERAL APPLICABILITY

In FY 2017, the Postal Service filed two notices proposing to change rates of general applicability. First, on October 19, 2016, the Postal Service filed a notice of changes in rates of general applicability for several domestic and international Competitive products, along with related MCS changes.[132] The Commission approved these proposed rate adjustments in Order No. 3622, finding that they complied with applicable laws.[133] The Commission also approved the proposed MCS changes except for those related to Market Dominant Collect On Delivery and permit fees.[134]

On July 28, 2017, the Postal Service proposed rates of general applicability for additional services to be added to the First-Class Package Service product, along with MCS changes.[135] These rates relate to the Commission's order conditionally approving the transfer of the First-Class Mail Parcels Retail (Single-Piece) price category from the Market Dominant to the Competitive product list.[136] The Commission approved the proposed rates and MCS changes, finding that they complied with applicable laws.[137]

RATES NOT OF GENERAL APPLICABILITY

Negotiated Service Agreements. For Competitive products, the Postal Service sets rates not of general applicability by entering into NSAs with specific mailers. These NSAs require prior Commission review for compliance with 39 U.S.C. § 3633(a) and 39 C.F.R. part 3015. In FY 2017, the Commission reviewed and approved 316 Competitive NSAs: 208 were domestic and 108 were international. Table III-1 shows the number of NSAs the Commission approved between FY 2012 and FY 2017.

Table III-1: Competitive NSAs Approved by the Commission FY 2012 through FY 2017

Competitive NSAs[a]	FY 2017	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
Domestic	208	186	81	40	52	32
International	108	95	58	36	29	22
Total	316	281	139	76	81	54

[a]This table shows approved NSAs the Postal Service filed as new products or as functionally equivalent to the baseline agreement of existing products. This table does not include NSA modifications or amendments.

[132] Docket No. CP2017-20, Notice of the United States Postal Service of Changes in Rates of General Applicability for Competitive Products Established in Governors' Decision No. 16-7, October 19, 2016

[133] Docket No. CP2017-20, Order Approving Price Adjustments for Competitive Products, November 18, 2016, at 8, 13 (Order No. 3622).

[134] Order No. 3622 at 13.

[135] Docket No. CP2017-230, Notice of the United States Postal Service of Changes in Rates of General Applicability for a Competitive Product, Established in Governors' Decision No. 16-9, July 28, 2017.

[136] *See* Court of Appeals Cases section, *infra*.

[137] Docket No. CP2017-230, Order Approving Price Adjustment for First-Class Package Service Product, August 9, 2017, at 1, 4-5 (Order No. 4032).

Products with non-published rates enable the Postal Service to enter into contracts featuring negotiated rates without prior Commission approval. These non-published rate contracts must comply with applicable filing and regulatory requirements, including pre-approved pricing formulas, minimum cost coverage, and documentation. The absence of prior review streamlines the approval process, providing the Postal Service with additional flexibility.

Table III-2 shows the number of non-published rate contracts implemented by the Postal Service between FY 2012 and FY 2017.

Table III-2: Non-Published Rate Contracts Implemented by the Postal Service FY 2012 through FY 2017

Non-Published Rate Product[a]	Number Non-Published Rate Contracts						
	FY 2017	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012	Total
Global Expedited Package Services– Non-Published Rate 1–12	393	244	91	124	129	141	1,122
Priority Mail– Non-Published Rate	121	207[b]	0	1	2	3	334
Total	514	451	91	125	131	144	1,456

[a] Table III-2 lists all 12 Global Expedited Package Services—Non-Published Rate products as a single line item.
[b] On December 28, 2016, the Postal Service notified the Commission that it had entered into several hundred Priority Mail-Non-Published Rate contracts during CY 2016. Docket No. CP2011-51, Customer Contract Filing Notice for Priority Mail—Non-Published Rates Serial Number Ending: 0010 through 0247, December 28, 2016. The Postal Service acknowledged that most of these contracts were not filed in a timely manner. For this reason, these Priority Mail-Non-Published Rate contracts were not included in the FY 2016 Annual Report. Docket No. CP2011-51, Motion for Late Acceptance of Customer Contract Filing Notice for Priority Mail—Non-Published Rates Serial Number Ending: 0010-0247, December 28, 2016.

Inbound Parcel Post (at Universal Postal Union (UPU) *rates)*. Inbound Parcel Post (at UPU rates) is a Competitive product that relates to the acceptance and delivery of inbound packages from foreign postal operators at air rates, surface rates, and e-commerce parcel (ECOMPRO) rates. Rates for Inbound Parcel Post (at UPU rates) are rates not of general applicability because they are only available to designated foreign postal operators.

Under UPU regulations, the Postal Service and other designated postal operators may qualify for semi-annual increases to their "base" rates for inbound air parcels if they provide certain value-added services. These rate increases are applied to the base rates effective January 1 and July 1 of each year. During FY 2017, the Postal Service proposed two changes in rates for Inbound Parcel Post (at UPU rates).[138] The Commission issued two orders acknowledging revised rates for this product.[139]

[138] Docket Nos. MC2017-58 and CP2017-86, Notice of the United States Postal Service of Filing Changes in Rates Not of General Applicability for Inbound Parcel Post (at UPU Rates), Change in Mail Classification Schedule, and Application for Non-Public Treatment, December 19, 2016 (Docket Nos. MC2017-58 and CP2017-86 Notice); Docket No. CP2017-214, Notice of the United States Postal Service of Filing Changes in Rates Not of General Applicability for Inbound Parcel Post (at UPU Rates), and Application for Non-Public Treatment, June 16, 2017.

[139] Docket Nos. MC2017-58 and CP2017-86, Order No. 3716, Order Acknowledging Changes in Prices for Inbound Parcel Post (at UPU Rates), December 30, 2016; Docket No. CP2017-214, Order No. 3985, Order Acknowledging Changes in Prices for Inbound Parcel Post (at UPU Rates), June 29, 2017.

The Postal Service also requested Commission approval to add ECOMPRO as part of the Inbound Parcel Post (at UPU rates) product.[140] After reviewing supplemental financial workpapers, the Commission approved the addition of ECOMPRO at Inbound Air Parcel Post prices.[141] Later, the Postal Service proposed, and the Commission approved, ECOMPRO prices.[142]

Other Proceedings

In FY 2017, there were several other proceedings concerning Competitive products. These addressed the institutional cost contribution requirement, market tests, and assumed federal income tax on Competitive products income.

Institutional cost contribution requirement. On November 22, 2016, the Commission initiated a rulemaking to evaluate the institutional cost contribution requirement for Competitive products.[143] The PAEA requires that the Commission's regulations "ensure that all [C]ompetitive products collectively cover what the Commission determines to be an appropriate share of the institutional costs of the Postal Service."[144] In its initial rulemaking establishing regulations under the PAEA, the Commission set the minimum contribution level for Competitive products at 5.5 percent of total institutional costs.[145]

The PAEA directs the Commission to revisit the institutional cost contribution requirement for Competitive products every 5 years to determine whether to retain it in its current form, or to modify or eliminate it.[146] The Commission conducted its first 5-year review in FY 2012, where the Commission decided to retain the minimum contribution level of 5.5 percent.[147] The Commission initiated its second 5-year review in Docket No. RM2017-1 on November 22, 2016, and invited interested persons to submit initial and reply comments.[148] This rulemaking is currently pending before the Commission.

Market tests. In FY 2017, the Postal Service conducted two Competitive market tests of experimental products under 39 U.S.C. § 3641.[149] The Commission evaluated two Postal Service requests related to these market tests.

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[140] Docket Nos. MC2017-58 and CP2017-86 Notice at 5.

[141] Docket Nos. MC2017-58 and CP2017-86, Order No. 3748, Order Approving in Part Classification Changes for Inbound Parcel Post (at UPU Rates), January 11, 2017.

[142] Docket No. CP2017-267, Notice of the United States Postal Service of Filing Changes in Rates Not of General Applicability for Certain Inbound Parcel Post (at UPU Rates), and Application for Non-Public Treatment, August 15, 2017; Docket No. CP2017-267, Order No. 4070, Order Approving Changes in Prices Not of General Applicability for Certain Inbound Parcel Post (at UPU Rates), August 28, 2017.

[143] *See* Order No. 3624.

[144] 39 U.S.C. § 3633(a)(3).

[145] 39 C.F.R. 3015.7(c); Docket No. RM2007-1, Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products, October 29, 2007, 3040-47 (Order No. 43); see Docket No. RM2007-1, Errata Notice Concerning Order No. 43, October 31, 2007.

[146] 39 U.S.C. § 3633(b). When making its determination, the Commission must consider "all relevant circumstances, including the prevailing competitive conditions in the market, and the degree to which any costs are uniquely or disproportionately associated with any competitive products." Id.

[147] Order No. 1449 at 2, 27.

[148] *See* Order No. 3624.

[149] The Postal Service must correctly categorize an experimental product as either Market Dominant or Competitive for purposes of a market test. 39 U.S.C. § 3641(b)(3).

First, the Global eCommerce Marketplace (GeM) Merchant market test allows participating domestic online merchants to offer their international customers the ability to estimate and prepay customs duties and taxes to foreign countries when purchasing items.[150] The Postal Service offers GeM Merchant to a limited number of online merchants through NSAs.[151] The Commission authorized the market test to proceed for 2 years.[152]

On August 22, 2017, the Postal Service filed a motion asking the Commission to acknowledge that customer agreements executed during the second year of the GeM Merchant market test may expire after the market test ends to enable full performance of these agreements.[153] Alternatively, the Postal Service asked the Commission to extend the market test for another year.[154] After reviewing the record and considering comments received, the Commission authorized a limited extension of the GeM Merchant market test to satisfy one-year customer agreements executed during the second year of the market test.[155] The market test is scheduled to expire on June 26, 2019.[156]

Second, the Customized Delivery market test allows the Postal Service to deliver groceries and other prepackaged goods to customers.[157] Total revenues anticipated or received by the Postal Service from the Customized Delivery market test must not exceed $10 million in any fiscal year, as adjusted for inflation, unless the Commission grants an exemption.[158] On April 4, 2017, the Postal Service filed a request for an exemption from the $10 million annual revenue limitation.[159] After evaluating the filing and considering comments received, the Commission approved the request for exemption, finding it consistent with applicable legal requirements.[160]

Assumed federal income tax on Competitive products. Each year, the Postal Service is required to calculate its assumed federal income tax on Competitive products income and to transfer this amount from the Competitive Products Fund to the Postal Service Fund.[161] The Postal Service filed this calculation for FY 2016 on January 12, 2017.[162] After reviewing the filing and comments received, the Commission approved the Postal Service's calculation of the FY 2016 assumed Federal income tax on Competitive products income.[163]

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150 Docket No. MT2016-1, Order Authorizing Market Test of Global eCommerce Marketplace (GEM) Merchant, May 25, 2016, at 2 (Order No. 3319).
151 Order No. 3319 at 2.
152 *Id.* at 26.
153 Docket No. MT2016-1, United States Postal Service Motion for Clarification of Order No. 3319, or, in the Alternative, for Extension of Market Test Time Period, August 22, 2017, at 1 (Docket No. MT2016-1 Motion).
154 Docket No. MT2016-1 Motion at 3.155 Docket No. T2017-1, Notice of The United States Postal Service of Submission of the Calculation of the FY 2016 Assumed Federal Income Tax on Competitive Products, January 12, 2017.
155 Docket No. MT2016-1, Order Authorizing Limited Extension of Global eCommerce Marketplace (GeM) Merchant Market Test, October 12, 2017, at 1, 7 (Order No. 4158).
156 Order No. 4158 at 7.
157 Docket No. MT2014-1, Order No. 3543, Order Approving Extension of Customized Delivery Market Test and Updating Data Collection Plan, September 28, 2016, at 2.
158 39 U.S.C. §§ 3641(e)(1) and (g); 39 C.F.R. § 3035.15(b).
159 Docket No. MT2014-1, Request of the United States Postal Service for Exemption from Revenue Limitation on Market Test of Experimental Product – Customized Delivery, with Portions Filed Under Seal, April 4, 2017.
160 Docket No. MT2014-1, Order No. 3905, Order Approving Request for Exemption, May 18, 2017, at 4, 11.
161 39 U.S.C. § 3634; *see* 39 C.F.R. § 3060.40 et seq. The Competitive Products Fund was created by the PAEA to serve as a repository for competitive products' revenues, returns on investments, and other amounts directly related to Competitive products. *See* 39 U.S.C. § 2011; Docket No. ACR2012, *Annual Compliance Determination Report Fiscal Year 2012*, May 7, 2013, at 174. The Postal Service Fund is available to the Postal Service "to carry out the purposes, functions, and powers authorized [by title 39] (other than any of the purposes, functions, or powers for which the Competitive Products Fund is available)." 39 U.S.C. § 2003(a).
162 Docket No. T2017-1, Notice of The United States Postal Service of Submission of the Calculation of the FY 2016 Assumed Federal Income Tax on Competitive Products, January 12, 2017.
163 Docket No. T2017-1, Order No. 3773, Order Approving the Calculation of the FY 2016 Assumed Federal Income Tax on Competitive Products, February 6, 2017.

Public Inquiries

City Carrier Costs

In FY 2016, the Commission issued an order approving the Postal Service's proposal to update the model for developing estimates of city carrier street time costs.[164] In that order, the Commission directed the Postal Service to investigate several issues, including the steps required to collect daily volume measurements that necessitated certain special studies and the feasibility of updating the cost model used to assign the costs of Sunday delivery hours and parcel routes.[165]

On May 31, 2017, the Commission initiated a public inquiry to ascertain the Postal Service's progress to update its city carrier cost models and data collection capabilities as required by the Commission.[166] The Commission received five sets of comments. This proceeding is currently pending before the Commission.

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Service Performance

The PAEA requires the Postal Service to measure service performance for Market Dominant products using an objective external performance measurement system unless it obtains Commission approval for use of an internal measurement system.[167] On January 29, 2015, the Commission established Docket No. PI2015-1 to consider a Postal Service request for the Commission to approve an internal service performance measurement system to replace the External First-Class (EXFC) Measurement system predominately used to measure the service performance of Single-Piece First-Class Mail.[168] The Postal Service's request also proposes to replace components of EXFC used in the measurement of service performance for presorted First-Class Mail, Periodicals, USPS Marketing Mail, and Package Services mailpieces.

The Commission issued an interim order, Order No. 2544, which noted that the measurement system was still under development and outlined the Commission's expectations of what would be required to complete a review of the Postal

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[164] *See* Docket No. RM2015-7, Order Approving Analytical Principles Used in Periodic Reporting (Proposal Thirteen), October 29, 2015 (Order No. 2792).
[165] Order No. 2792 at 65-66.
[166] Docket No. PI2017-1, Order No. 3926, Notice and Order Establishing Docket Concerning City Carrier Special Purpose and Letter Route Costs and to Seek Public Comment, May 31, 2017
[167] 39 U.S.C. § 3691(b)(1)(D), (b)(2). "Internal" service performance measurement systems are under the direct control of the Postal Service, while "external" service performance measurement systems are under the direct control of an independent third party. Docket No. PI2015-1, Notice of Request for Comments and Scheduling of Technical Conference Concerning Service Performance Measurement Systems for Market Dominant Products, January 29, 2015, at 1 n.1 (Order No. 2336).[168] Docket No. RM2016-12, Order on Analytical Principles Used in Periodic Reporting (Proposal Four), June 22, 2017, at 2, 40-41 (Order No. 3973).
[168] Order No. 2336 at 1-2. EXFC is an external sampling measurement system for First-Class Mail managed by an independent contractor. FY 2016 ACD at 92.

Service's proposal.[169] It directed the Postal Service to provide certain information and run the proposed measurement system in parallel with the current EXFC measurement system "for sufficient time to ensure the internal system is operational and verifiable."[170]

At the request of the Postal Service, the Commission hosted three off-the-record technical conferences. The Postal Service also began filing preliminary service performance data from the proposed internal measurement system during this timeframe.[171] On July 14, 2017, the Commission issued Order No. 4002 describing the progress the Postal Service made thus far.[172] It raised concerns about the data generated by the proposed measurement system, including the lack of audited data and significant differences between results obtained using the current EXFC measurement system.[173] The Commission reiterated its goal of obtaining four consecutive quarters of data free of all major issues and directed the Postal Service to continue running the proposed internal measurement system in parallel with the EXFC measurement system.[174] This proceeding is currently pending before the Commission.

Post Office Closing Appeals

The Commission adjudicated two post office closing appeals in FY 2017. Both were dismissed for lack of jurisdiction. First, the Commission considered an appeal of the Postal Service's decision to relocate retail postal services from the Grand Island, Nebraska main post office to a nearby mail processing facility. The Commission granted the Postal Service's motion to dismiss because the Commission lacks appellate jurisdiction over post office relocations.[175]

Second, the Commission considered an appeal of the Postal Service's decision to close the Rio Nido, California contract post office. The Commission has jurisdiction over appeals to close or consolidate contract post offices only if the contract post office is the sole source of postal services to the affected community.[176] Because the Commission was unable to conclude that the Rio Nido contract post office was the sole source of postal services to the community, the Commission dismissed the appeal for lack of jurisdiction.[177]

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[169] Order No. 2544 at 4.
[170] *Id.*
[171] *See* Postal Regulatory Commission, *Annual Report to the President and Congress Fiscal Year 2016*, January 12, 2017, at 31 (FY 2016 Annual Report); Docket No. PI2015-1, Order No. 3813, Order Scheduling Technical Conference to Review the Audit Plan, March 2, 2017.[172] Docket No. RM2016-12 Petition at 1.
[172] Docket No. PI2015-1, Second Interim Order Concerning Service Performance Measurement Systems for Market Dominant Products, July 14, 2017 (Order No. 4002).
[173] Order No. 4002 at 4.
[174] *Id.* at 4-5.
[175] Docket No. A2017-1, Order No. 3963, Order Granting Motion to Dismiss, June 15, 2017, at 5
[176] Docket No. A2017-2, Order Affirming Determination, September 1, 2017, at 8-9 (Order No. 4088).
[177] Order No. 4088 at 1, 11-12.

Court of Appeals Cases

The following cases were before the D.C. Circuit during FY 2017.

First-Class Mail Parcels Transfer

In FY 2015, the Commission issued an order denying the Postal Service's proposal to transfer First-Class Mail Parcels from the Market Dominant to the Competitive product list.[178] The Postal Service appealed the Commission's decision to the D.C. Circuit.[179] On December 6, 2016, the Court remanded the case to the Commission for further consideration.[180]

On July 20, 2017, the Commission issued an order addressing the issues raised by the court.[181] The Commission reviewed and distinguished three prior parcels transfer cases identified by the court.[182] It reiterated its conclusion that additional information was necessary to support transferring First-Class Mail Parcels to the Competitive product list.[183] Additionally, the Commission explained how it will evaluate market power as applicable to 39 U.S.C. § 3642(b)(1) in the future for product list assignment cases.[184]

In response to a CHIR issued by the Commission, the Postal Service provided additional information in support of its original transfer proposal. Using this information, the Commission was able to reanalyze the Postal Service's transfer proposal in light of the new information and find that the proposed transfer met applicable legal requirements.[185] The Postal Service's request to transfer the First-Class Mail Parcels Retail (Single-Piece) price category was conditionally approved pending the proposal, review, and approval of rates.[186] On July 28, 2017, the Postal Service filed a notice with the Commission proposing rates, along with related MCS changes.[187] The Commission approved the proposed rates and MCS changes, finding that they complied with applicable laws.[188]

Changes Concerning Attributable Costing

On December 1, 2016, the Commission issued an order adopting final rules on attributable costs.[189] United Parcel Service, Inc. (UPS) appealed this order to the D.C. Circuit on December 12, 2016.[190] The D.C. Circuit consolidated this case with UPS's appeal of Order No. 3506, which reviewed UPS's three proposals asking the Commission to consider changes to postal costing methodologies.[191] The consolidated appeal is currently pending before the court.

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[178] Docket No. MC2015-7, Order No. 2686, Order Denying Transfer of First-Class Mail Parcels to the Competitive Product Category, August 26, 2015; see FY 2016 Annual Report at 58.

[179] First-Class Mail Parcels included two subcategories: (1) Single-Piece Parcels, and (2) Keys and Identification Devices. The Postal Service only challenged the Commission's decision concerning the Single-Piece Parcels subcategory.

[180] *United States Postal Service v. Postal Regulatory Commission*, 842 F.3d 1271 (D.C. Cir. 2016).

[181] Docket No. MC2015-7, Order Conditionally Approving Transfer, July 20, 2017 (Order No. 4009).

[182] Order No. 4009 at 14-27.

[183] *Id*. at 2, 27.

[184] *Id*. at 27, 29.

[185] *Id*. at 29-40.

[186] *Id*. at 40.

[187] *See* n. 135, *supra*.

[188] Order No. 4032 at 1, 4-5.

[189] Docket No. RM2016-13, Order No. 3641, Order Adopting Final Rules on Changes Concerning Attributable Costing, December 1, 2016.

[190] *United Parcel Service, Inc. v. Postal Regulatory Commission*, No. 16-1419 (D.C. Cir. filed December 12, 2016).

[191] *United Parcel Service, Inc. v. Postal Regulatory Commission*, Nos. 16-1354 and 16-1419 (D.C. Cir. Order, January 23, 2017); see FY 2016 Annual Report at 34.

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Complaint of Ramon Lopez

In FY 2011, Ramon Lopez filed a complaint with the Commission under 39 U.S.C. § 3662 alleging that the Postal Service had wrongly suspended mail delivery to his home in Florida.[192] He asked that the Commission direct the Postal Service to restore mail service to his home address and claimed at least $2,500 in damages.[193] Because the Postal Service represented that it resumed delivery to Lopez's house, the Commission dismissed the complaint as moot and denied Lopez's claim for damages.[194]

In FY 2012, Ramon Lopez appealed the Commission's order dismissing his complaint to the D.C. Circuit.[195] The D.C. Circuit ultimately dismissed Lopez's appeal as moot, but transferred the claim for damages to the District Court for the Southern District of Florida.[196]

Other Pending Court Appeals

The following appeals are also pending before the D.C. Circuit

- Statutory Review of Market Dominant Rate System[197]
- Mail Preparation Changes and the Price Cap[198]
- Return Receipt for Merchandise Service[199]
- Complaint of Frederick Foster[200]

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192 Docket No. C2011-5, Complaint of Ramon Lopez, July 12, 2011.
193 *Id.* at 2.
194 Docket No. C2011-5, Order No. 1392, Order Dismissing Complaint, July 3, 2012.
195 *Ramon Lopez v. Postal Regulatory Commission*, No. 12-1341 (D.C. Cir. filed August 3, 2012).
196 *Ramon Lopez v. Postal Regulatory Commission*, No. 12-1341 (D.C. Cir. December 11, 2017) (unpublished per curiam).
197 *National Postal Policy Council v. Postal Regulatory Commission*, No. 17-1276 (D.C. Cir. filed December 29, 2017).
198 *United States Postal Service v. Postal Regulatory Commission*, No. 16-1284 (D.C. Cir. filed August 11, 2016); see FY 2016 Annual Report at 29.
199 *United States Postal Service v. Postal Regulatory Commission*, No. 16-1412 (D.C. Cir. filed November 30, 2016); see FY 2016 Annual Report at 59.
200 *Frederick Foster v. Postal Regulatory Commission*, No. 15-1339 (D.C. Cir. filed September 23, 2015).

International Postal Policy

The Secretary of State is responsible for formulating, coordinating, and overseeing international postal policy, including concluding postal treaties such as those involving the UPU.[201] Headquartered in Bern, Switzerland, the UPU is an international treaty organization responsible for facilitating high-quality universal mail service at affordable rates. Although the State Department has primary authority over international postal policy, it must request the Commission's views on whether any treaty, convention, or amendment that establishes a rate or classification for a Market Dominant product is consistent with the PAEA's modern system of ratemaking for Market Dominant products.[202] The State Department must ensure that each treaty, convention, or amendment concluded is consistent with the Commission's views unless there is a foreign policy or national security concern.[203]

On November 29, 2016, the Commission provided the Secretary of State with its views on specific proposals to amend the Regulations of the UPU Convention that were to be discussed at the December 2016 session of the UPU Postal Operations Council.[204] These proposals established rates or classifications for Market Dominant products, and were the consequence of proposals amending the UPU Convention that the UPU Congress approved in September 2016.

On September 22, 2017, the Commission published a study commissioned to Copenhagen Economics discussing the impact of terminal dues on financial transfers among designated UPU postal operators.[205] Terminal dues rates are the prices paid between designated UPU postal operators for the acceptance, processing, and delivery of letter post items weighing up to 4.4 pounds. This report updated two earlier reports by Copenhagen Economics that the Commission published in September 2014 and December 2015.[206] In its 2017 Report, Copenhagen Economics updated its estimates of the net financial transfers that result from the UPU terminal dues system to reflect the new terminal dues rates that will go into effect in 2018. Copenhagen Economics found that the new rates would only have a minor impact on the total value of financial transfers created by the UPU terminal dues system.

In FY 2017, the Commission continued its participation in UPU and interagency discussions on rates and classifications for Market Dominant products and international postal policy issues. The Commission also continued its role as an active member of the State Department's Federal Advisory Committee on International and Postal Delivery Services.

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201 39 U.S.C. § 407.

202 39 U.S.C. § 407(c)(1).

203 39 U.S.C. § 407(c)(2).

204 Letter from Robert G. Taub, Acting Chairman, Postal Regulatory Commission, to the Honorable Bathsheba N. Crocker, Assistant Secretary for International Organization Affairs, United States Department of State, November 29, 2016; see Docket No. IM2016-1, Notice of Posting Views, December 16, 2016.

205 Copenhagen Economics, *Terminal Dues: Impact on Financial Transfers Among Designated Postal Operators of the Universal Postal Union 2018-2021 Cycle Agreements*, September 22, 2017 (2017 Report).

206 Copenhagen Economics, *Economics of Terminal Dues,* September 30, 2014 (2014 Report), published January 14, 2015; Copenhagen Economics, *Quantification of Financial Transfers Caused by Universal Postal Union Terminal Dues*, November 3, 2015 (2015 Report), published November 18, 2015. The 2014 Report found that the UPU system of terminal dues potentially created specific market distortions. The 2015 Report quantified net financial transfers among postal operators as a result of the UPU terminal dues system. Financial transfers between designated postal operators occur in cases where the sending postal operator overpays or underpays for last-mile delivery in the destination country by paying terminal dues instead of domestic postal rates. An underpayment for delivery implies a financial transfer from the receiving postal operators to the sending one. An overpayment for delivery implies a financial transfer from the sending postal operator to the receiving one.

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CHAPTER IV | Universal Service Obligation and Postal Monopoly

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Background

In this chapter, the Commission provides its annual estimates of the cost of the Universal Service Obligation (USO) and the value of the postal monopoly. In its *Report on Universal Postal Service and the Postal Monopoly*, the Commission stated that the overarching USO of the Postal Service is set forth in 39 U.S.C. § 101(a), which states that the Postal Service must "provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities." The USO has seven principal attributes: (1) geographic scope, (2) product range, (3) access, (4) delivery, (5) pricing, (6) service quality, and (7) an enforcement mechanism.[207]

The postal monopoly is the Postal Service's exclusive right to carry and deliver certain types of mail and deposit mail into mailboxes.[208] Unlike the cost of the USO (USO Cost), the Commission is not required to estimate the value of the postal monopoly. The Commission provides estimates for both the USO Cost and the value of the postal monopoly to present a balanced perspective.

In 2008, the Commission estimated the USO Cost and the value of the postal monopoly in the USO Report. The Commission updates these estimates each year in the Annual Report.

[207] Postal Regulatory Commission, *Report on Universal Postal Service and the Postal Monopoly*, December 19, 2008, at 18 (USO Report)
[208] USO Report at 10 n.1.

Estimated USO Cost

The PAEA requires the Commission to estimate the costs incurred by the Postal Service in providing three types of public services or activities:[209]

- Postal services to areas of the nation the Postal Service would not otherwise serve
- Free or reduced rates for postal services as required by title 39
- Other public services or activities the Postal Service would not otherwise provide but for the requirements of law.

The USO Cost is the total amount of costs incurred by the Postal Service in providing these public services or activities. Table IV-1 illustrates the estimated USO Cost for the last 5 fiscal years, FY 2012 to FY 2016.

Table IV-1: Estimated USO Cost ($ Billions)

	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
Postal Services to Areas of the Nation the Postal Service Would Not Otherwise Serve*	0.39	0.35	0.51	0.61	0.77
Estimated Revenue Not Received	1.64	1.63	1.62	1.65	1.64
Other Public Services or Activities	2.37	2.26	2.21	2.39	2.43
TOTAL*	4.40	4.24	4.34	4.65	4.84

*FY 2012 through FY 2014 figures differ from past Annual Reports because the Commission recalculated the costs of maintaining small post offices. See Maintaining Small Post Offices section, infra. The sum of row components may not equal total due to rounding.

In this chapter, the Commission provides estimates of the costs incurred by the Postal Service in providing the public services or activities under 39 U.S. C. § 3651(b)(1), describes related statutory requirements, and explains the methodologies used to estimate these costs.[210]

[209] 39 U.S.C. § 3651(b)(1)
[210] *See* 39 U.S.C. § 3651(b)(2).

Postal Services to Areas of the Nation the Postal Service Would Not Otherwise Serve

The Commission must estimate the costs incurred by the Postal Service in providing

> postal services to areas of the Nation where, in the judgment of the Postal Regulatory Commission, the Postal Service either would not provide services at all or would not provide such services in accordance with the requirements of this title if the Postal Service were not required to provide prompt, reliable, and efficient services to patrons in all areas and all communities, including as required under the first sentence of [39 U.S.C.] section 101(b)[.][211]

The Commission determines these costs by combining the estimated costs of maintaining small post offices, the Alaska Air Subsidy, and Group E Post Office Boxes. Table IV-2 compares the costs of each one from FY 2012 to FY 2016.

Table IV-2: Estimated Costs of Providing Postal Services to Areas of the Nation the Postal Service Would Not Otherwise Serve ($ Millions)

	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
Maintaining Small Post Offices*	245	209	366	468	610
Alaska Air Subsidy	113	107	112	114	122
Group E Post Office Boxes	34	33	33	31	34
TOTAL*	392	349	511	613	766

*FY 2012 through FY 2014 figures differ from past Annual Reports because the Commission recalculated the costs of maintaining small post offices. See Maintaining Small Post Offices section, infra.

As shown in Table IV-2, the estimated cost of providing postal services to areas of the nation the Postal Service would not otherwise service declined between FY 2012 and FY 2015. This decline was due primarily to the large reductions in the cost of maintaining small post offices, as described below. However, between FY 2015 and FY 2016, the cost of maintaining small post offices increased due to the increase in clerk costs.

[211] U.S.C.§ 3651(b)(1)(A). 39 U.S.C. § 101(b) requires the Postal Service to "provide a maximum degree of effective and regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining." *Id*. § 101(b).

MAINTAINING SMALL POST OFFICES

The Postal Service maintains small post offices, which are generally located in rural or remote areas, as part of its duty "to establish and maintain postal facilities of such character and in such locations, that postal patrons throughout the Nation will, consistent with reasonable economies of postal operations, have ready access to essential postal services."[212] The Postal Service uses Cost Ascertainment Group (CAG) classifications A to L to categorize post offices based on volume of revenue generated.[213] Small post offices are those that fall within CAG K and L classifications.[214]

PHOTO BY RADOSLAW LECYK

The Commission determines the cost of maintaining small post offices by estimating the amount the Postal Service would save if rural carriers on the street provided the same services as those provided at small post offices, as well as the amount of revenue lost from existing CAG K and L Post Office Boxes. The Commission uses the Rural Mail Count to estimate the cost of rural carriers providing retail services and for new delivery service to those who would no longer have a CAG K and L Post Office Box.[215]

Table IV-2 lists the estimated costs of maintaining small post offices from FY 2012 to FY 2016. Some of these costs differ from those in past Annual Reports because the costs of maintaining small post offices were recalculated to account for recent changes in the staffing of small post offices. The recalculated costs incorporate all of the categories of employees who may perform functions that were previously performed primarily by postmasters to more completely identify those costs associated with this element of the USO Cost.[216]

Table IV-3 disaggregates the cost of maintaining small post offices by component and illustrates the recent large shifts between these components. It also illustrates changes in employee categories staffing CAG K and L post offices. Total Postmaster salary cost (along with overhead and other personnel and non-personnel related costs) have dropped sharply since FY 2013, while the total cost of other employees assuming postmaster duties have had corresponding increases.

Total Postmaster direct and indirect costs decreased from $587 million in FY 2012 to $25 million in FY 2016. Conversely, in FY 2013 and FY 2014, total CAG L leave replacement costs were more than double what they were in FY 2012. However, starting in FY 2015, total CAG L leave replacement costs have dropped sharply. Beginning in FY 2015, CAG K clerk costs have increased substantially, over $100 million, in FY 2016.

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[212] 39 U.S.C. § 403(b)(3).
[213] Docket No. RM2015-19, Order Approving Analytical Principles Used in Periodic Reporting (Proposal Ten), November 24, 2015, at 1 n.2 (Order No. 2837)..
[214] *See* USO Report, Appendix F, Section 3 (Robert H. Cohen and Charles McBride, "Estimates of the Current Costs of the USO in the U.S." at 26).
[215] The Rural Mail Count classifies all remunerable activities of rural carriers as either post office or street activities. However, some post office activities can occur on the street. For example, even though it occurs on the street, parcel acceptance is considered a post office activity because it can substitute for a customer sending a parcel at a post office window.
[216] *See* FY 2016 Annual Report at 42.

Table IV-3: Estimated Cost Savings from Closing CAG K and L Post Offices
Derivation of Updated Costs of Maintaining Small Post Offices ($ Millions)

Selected CAG K and L Post Offices Annual Operating Costs	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
CAG K and L Postmasters[a]	25	26	228	332	587
CAG L Leave Replacements	29	102	216	219	105
CAG K Clerks	289	176	13	6	5
Total Potential Operating Costs Saved (If CAG K and L Post Offices Closed)	343	304	457	558	698

Annual Estimated Cost Saving Adjustments (If CAG K and L Post Offices Closed)	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
Rural Carrier Now Provides Retail Services Costs[b]	18	17	16	16	16
Rural Carrier Now Provides Delivery Service (CAG K and L Post Office Boxes No Longer Available)[c]	42	42	41	41	40
CAG K and L Post Office Boxes Revenue Foregone[d]	37	36	33	33	32
Total Annual Cost Savings Adjustment	97	96	91	89	88

Updated Costs of Maintaining Small Post Offices	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
(Potential Operating Costs Saved Less Cost Savings Adjustments)	245	209	366	468	610

Note: The sum of individual row components may not equal totals due to rounding

[a] Consistent with the USO Report, previous Annual Reports used the approximated total CAG K and L postmaster salary costs (along with overhead and other personnel and non-personnel related costs) to represent the total potential operating costs saved if CAG K and L post offices closed. Postmaster costs at CAG K and L post offices were derived by using the postmaster salary costs from the Postmaster Position Schedule CAG group proportions to distribute total postmaster (less CAG L leave replacements) costs to the CAG K and L group. However, due to recent staffing changes at small post offices, the costs of maintaining small post offices shown in Table IV-2 were recalculated to also include the CAG L leave replacement (postmaster relief employees) and CAG K clerk costs in addition to the postmasters costs in the potential operating costs saved total. The costs of maintaining small post offices in the FY 2012 and FY 2013 Annual Reports inadvertently listed the unadjusted total potential CAG K and L postmaster operating costs saved.

[b] The annual number of CAG K and L retail transactions was approximated using the most currently available data: the FY 2010 retail transactions per revenue dollar and the FY 2013 POStPlan revenues in Docket No. N2012-1. The annual number of CAG K and L retail transactions was approximated to be about 142 million and was used in this calculation for the fiscal years shown in the table.

[c] FY 2010 CAG K and L Post Office Box volumes were used to estimate the number of new delivery points (for those CAG K and L Post Office Boxes no longer available).

[d] The FY 2010 CAG K and L Post Office Box volumes were used with the respective current fiscal year Post Office Box unit revenue (billing determinants) to estimate fiscal year CAG K and L Post Office Boxes revenue foregone.

SOURCES:
Postmaster Position Schedule CAG Group Proportions: Library Reference 32 in Docket Nos. ACR2012, ACR2013, ACR2014, ACR2015, and ACR2016 (CRA "B" Workpapers, "I-Forms" workbook, "I-CS01.0.2" tab).
Postmasters, CAG L Leave Replacement and Clerks CAG K costs: Library Reference 5 in Docket Nos. ACR2012, ACR2013, ACR2014, ACR2015, and ACR2016 (Cost Segments and Components Reconciliation to Financial Statement and Account Reallocation, "seg 1" and "seg 4" tabs in workbook).
Rural Mail Count: Library Reference 40 in Docket Nos. ACR2012, ACR2013, ACR2014, ACR2015, and ACR2016.

ALASKA AIR SUBSIDY

Alaska Bypass Service allows mailers to ship goods such as food and other cargo on pallets directly to rural customers in Alaska. Commercial airline carriers deliver goods on pallets to hub airports in either Anchorage or Fairbanks. Smaller airline companies or independent pilots then break down these pallets and deliver the goods to remote communities accessible only by air, which are commonly called bush sites. The shipped goods "bypass" the Postal Service's network.

With Alaska Bypass Service, the Postal Service pays for the cost of air transportation from hub airports to bush sites. The difference between this cost of air transportation from hub airports to bush sites and the average cost of ground transportation if it were available is called the Alaska Air Subsidy. The Commission previously concluded that the Alaska Air Subsidy is part of the USO.[217] The Alaska Air Subsidy increased slightly from $107 million in FY 2015 to $113 million in FY 2016.

PHOTO BY ASPEN ROCK

GROUP E POST OFFICE BOXES

Group E Post Office Boxes are provided free of charge to postal customers who do not receive mail delivery. The Postal Service provides this service to address potential discrimination issues arising from instances where customers do not receive carrier delivery.[218] In FY 2011, the Commission approved treating the cost of providing Group E Post Office Boxes as an institutional cost to more equitably distribute the USO Cost. The Commission also concluded that this treatment was analogous to, and consistent with, the treatment of the Alaska Air Subsidy.[219] Consequently, the Commission approved including the cost of Group E Post Office Boxes, which are primarily facility-related, in estimating the USO Cost. In FY 2016, Group E Post Office Boxes cost approximately $34 million.

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[217] USO Report at 139.
[218] Docket No. RM2011-9, Order Concerning Analytical Principles Used in Periodic Reporting (Proposal One), June 9, 2011, at 2 (Order No. 744).
[219] Order No. 744 at 4.

Free or Reduced Rates

The Commission must estimate the costs incurred by the Postal Service in providing "free or reduced rates for postal services as required by [Title 39.]"[220] The Commission estimates these costs by combining preferred rate discounts net of costs and the negative contribution of Periodicals (Periodicals Losses). Table IV-4 shows the estimated revenue not received as a result of preferred rate discounts and Periodicals Losses between FY 2012 to FY 2016.

Table IV-4: Estimated Revenue Not Received Due to Free or Reduced Rates ($ Millions)

	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
Preferred Rate Discounts Net of Costs	1,105	1,116	1,114	1,130	974
Periodicals Losses	537	512	509	521	670
TOTAL	1,642	1,628	1,623	1,651	1,644

PREFERRED RATE DISCOUNTS NET OF COSTS

39 U.S.C. § 3626 requires the Postal Service to provide reduced rates for preferred rate categories in Standard Mail, Periodicals, and Library Mail.[221] The Commission determines estimated revenue not received by quantifying the difference in revenue between mail that is statutorily required to receive a discount and the revenue the Postal Service would have received if those mail pieces were not discounted. This increase in revenue is adjusted for potential decreases in costs. If not discounted, rates for these mail pieces would be higher, resulting in a loss of volume and, consequently, lower costs.

PHOTO BY USPS

[220] 39 U.S.C. § 3651(b)(1)(B). The Postal Service provides free postage for blind and disabled persons and for overseas voting. Id. §§ 3403, 3406. The Postal Service receives appropriated funds reimbursing it for providing free postage. Id. § 2401(c). For this reason, the cost of providing free postage is not included in the USO Cost.

[221] FY 2016 ACD at 41.

PERIODICALS LOSSES

Periodicals Losses are the annual amount by which Periodicals attributable cost exceeds revenue.[222] The PAEA's price cap does not allow the Postal Service to fully recover Periodicals Losses through rate increases.[223] It is assumed that, if not for the price cap, the Postal Service would raise Periodicals rates to the level necessary to cover attributable cost. Accordingly, the Commission considers these losses to be part of the USO Cost.

Table IV-4 illustrates that although there was some variation year-to-year, Periodicals losses declined significantly between FY 2012 and FY 2014 but increased in FY 2015 and FY 2016. During the 5-year period shown, FY 2012 had the largest overall loss at $670 million.

The Periodicals class has not covered its attributable cost since the PAEA was enacted.[224] In Order No. 4258, the Commission has proposed changes to the Current System that would address this issue by providing the Postal Service an additional 2 percentage points of rate authority per calendar year.[225]

Other Public Services or Activities

The Commission must estimate the costs incurred by the Postal Service in providing "other public services or activities which, in the judgment of the Postal Regulatory Commission, would not otherwise have been provided by the Postal Service but for the requirements of law."[226] Currently, these costs include the costs of providing Six-Day Delivery and uniform rates for First-Class Mail and Media Mail/Library Mail.[227] Table IV-5 shows the costs of providing these public services or activities from FY 2012 to FY 2016.

SIX-DAY DELIVERY

Since 1984, appropriations bills have included a provision requiring the Postal Service to continue providing Six-Day Delivery.[228] The cost of providing Six-Day Delivery is measured as

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[222] In this Annual Report, attributable cost means incremental cost. See Docket No. RM2016-2, Order Concerning United Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three), September 9, 2016, at 125 (Order No. 3506). The attributable cost for years before FY 2016 reflect the accepted methodology for those years and has not been recalculated. 39 U.S.C. § 3622(c)(2) defines attributable cost as the "direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type[.]" In Order No. 3506, the Commission revised the methodology for determining attributable cost to include inframarginal costs, developed as part of the estimation of incremental costs. Before that order, attributable cost only included the sum of volume-variable costs, which rise as volume increases and fall as volume decreases, and product-specific fixed costs, which are costs caused by a specific product, but do not vary with volume. *See* FY 2016 *Financial Analysis* Report at 37.

[223] Periodicals is a preferred class of mail and receives several statutory discounts such as a 5 percent discount for nonprofit and classroom publications. These losses were initially called "Losses on Market Dominant Products" in past Annual Reports. The Commission later clarified that the USO Cost only includes Periodicals Losses. Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2012, January 3, 2013, at 37 n.3. Losses on other unprofitable Market Dominant products are not included because those products are in classes that were profitable overall. USO Report at 134.

[224] FY 2016 ACD at 42.

[225] Order No. 4258, Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market Dominant Products, December 1, 2017 at 26, 84.

[226] 39 U.S.C. § 3651(b)(1)(C).

[227] The Commission previously issued an order interpreting "other public services or activities" under 39 U.S.C. § 3651(b)(1)(C). Docket No. PI2014-1, Order No. 2820, Order Interpreting 39 U.S.C. § 3651(b)(1)(C), November 17, 2015. The Commission continues to conclude that no new public services or activities should be added at this time. See FY 2016 Annual Report at 47.

[228] *See*, e.g., Consolidated Appropriations Act, 2017, Pub L. No. 115-31, 131 Stat. 135, 369 (2017) ("6-day delivery and rural delivery of mail shall continue at not less than the 1983 level").

Table IV-5: Other Public Services or Activities the Postal Service Would Not Provide But for Legal Requirements ($ Millions)

Public Service or Activity	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
Six-Day Delivery	2,191	2,074	2,080	2,212	2,240
Uniform First-Class Mail Rates	78	86	93	109	117
Uniform Media Mail/Library Mail Rates	102	101	37	70	71
TOTAL	2,371	2,261	2,210	2,391	2,428

the estimated savings the Postal Service would achieve by providing residential delivery service 5 days a week instead of 6 days a week. Table IV-5 shows the cost of Six-Day Delivery from FY 2012 to FY 2016.[229]

UNIFORM RATES

Rates for First-Class Mail must be uniform throughout the United States.[230] To determine the cost of uniform First-Class Mail rates, the Commission estimates the increased contribution that the Postal Service would earn if dropship discounts were allowed for workshared First-Class Mail. Table IV-5 shows the cost of uniform First-Class Mail rates. In FY 2016, the cost of uniform First-Class Mail rates declined from $86 million in FY 2015 to $78 million in FY 2016.

Media Mail/Library Mail rates must be uniform for mail of the same weight and must not vary with the distance transported.[231] The Commission estimates the cost of the distance component by assuming that without this requirement, Media Mail/Library Mail would provide the unit contribution of Bound Printed Matter, a proxy that does not have this restriction. The Commission estimates the additional unit contribution by determining the difference between the unit contributions of Bound Printed Matter and Media Mail/Library Mail. Media Mail/Library Mail total volumes are then multiplied by the estimated additional unit contribution to produce an estimate of the total additional contribution if Media Mail/Library Mail rates were not uniform.

In FY 2016, the estimated cost of providing uniform Media Mail/Library Mail rates was approximately $102 million, similar to the FY 2015 cost of $101 million. The substantial increase in cost between FY 2014 and FY 2015 was due primarily to the large decrease in the unit contribution of Media Mail/Library Mail.[232]

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[229] The current cost of Six-Day Delivery methodology differs from the USO 2008 methodology as it reflects refined and more comprehensive costs based on the Commission's findings in its Advisory Opinion on Elimination of Saturday Delivery. See Docket No. N2010-1, Advisory Opinion on Elimination of Saturday Delivery, March 24, 2011; Postal Regulatory Commission, Annual Report to the President and Congress Fiscal Year 2011, December 21, 2011, at 41.

[230] 39 U.S.C. § 404(c).

[231] 39 U.S.C. § 3683.

[232] The large decrease in the unit contribution of Media Mail/Library Mail was due to the 26 percent increase in the unit attributable cost for Media Mail/Library Mail in FY 2015. See Financial Analysis of the United States Postal Service Financial Results and 10-K Statement, March 29, 2016, at 67-68.

Value of the Postal Monopoly

The postal monopoly is the Postal Service's exclusive right to carry and deliver certain types of mail and deposit mail into mailboxes. The mailbox monopoly is the Postal Service's exclusive right to deliver to and collect from mailboxes.[233] The letter monopoly is the Postal Service's exclusive right to carry and deliver most addressed, paper-based correspondence.[234]

The value of the postal monopoly is an estimate of the profit that the Postal Service would lose if both the mailbox and letter monopolies were lifted, and the Postal Service were subject to competition for mail currently covered by the postal monopoly.

Table IV-6 shows the values of the postal and mailbox monopolies from FY 2012 to FY 2016. Subtracting the value of the mailbox monopoly from the value of the postal monopoly does not yield the value of the letter monopoly because there is an overlap in the contestable mail and a different frequency of delivery by the competitor. A separate estimate of the value of the letter monopoly alone (retaining the mailbox monopoly) is not provided. Without access to mailboxes, it is unlikely that the competitor could successfully capture mail directed to a specific person or address because those mail pieces are delivered to and collected from mailboxes.

The increase in the estimated value of the postal monopoly from FY 2013 to FY 2016 is largely due to increases in the percentage of mail that is considered contestable.[235] The value of the mailbox monopoly is estimated based on contestable mail volumes in Periodicals, Standard Mail ECR, and Parcel Select. Changes in the volume of contestable mail affect the number of profitable routes the competitor could deliver to and the amount of contribution the Postal Service would lose if the competitor captured the contestable mail on those routes.

Table IV-6: Values of the Postal and Mailbox Monopolies ($ Billions)

	FY 2016	FY 2015	FY 2014	FY 2013	FY 2012
Postal Monopoly	5.68	5.45	4.61	3.93	3.28
Mailbox Monopoly	1.24	1.03	0.77	0.81	0.70

[233] 18 U.S.C. § 1725.
[234] The letter monopoly is codified in the Private Express Statutes. See 18 U.S.C. §§ 1693–1699 and 39 U.S.C. §§ 601–606.
[235] Contestable mail is mail that is dropshipped to the processing facility or delivery unit closest to its destination. The competitor would need to perform little or no mail processing to prepare it for delivery.

The Commission uses the model described in the USO Report to update current estimates.[236] The model assumes that the competitor will "win" or "skim" all of the contestable mail on a route if the revenue it would earn from these mail volumes is greater than the fixed and attributable costs related to the volumes. The model also assumes the competitor would deliver only local and regional mail to focus on the most profitable delivery routes and avoid the need for significant capital to establish a processing and transportation network.

Even with the postal monopoly, competitors still deliver material (e.g., newspapers' weekly advertising supplements) that might otherwise be sent via the Postal Service. If the mailbox monopoly alone were lifted, competitors could deliver and deposit into mailboxes products that fall outside of the letter monopoly, such as Periodicals, unaddressed saturation mail, catalogs over 24 pages, and letters over 12.5 ounces. The letter monopoly prevents competitors from delivering certain mail that is directed to a specific person or address, such as First-Class Presorted Letters/Postcards and Standard Mail Letters. If the letter monopoly were also lifted, this restriction would not apply.

The key variables for estimating the values of the postal and mailbox monopolies are the competitor's delivery frequency, the cost of entry to the competitor, the rates charged by the competitor, and the volume of the contestable mail. The model assumes that the competitor is 10 percent more efficient than the Postal Service, but needs to offer a 10 percent discount to entice customers to switch from the Postal Service. Because this discount offsets the competitor's efficiency advantage, reducing delivery frequency is the only way for the competitor to lower delivery costs below that of the Postal Service.[237]

The model currently evaluates the competitor's entry for each route regardless of the extent of route clustering. Focusing on routes in the same cluster or area would reduce the competitor's fixed costs.[238] Also, because the model assumes that the competitor does not incur mail processing costs, values of the postal and mailbox monopolies do not reflect the cost of sorting to carrier routes, which is necessary to deliver mail presorted to the 5-digit ZIP Code. The model also does not account for mailers' switching costs or brand loyalty.[239] In addition, bulk parcels, which are Competitive products, are considered contestable mail.

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[236] *See* USO Report at 143-52.

[237] The current model assumes the competitor will deliver mail 3 days a week under the postal monopoly and 1 day a week under the mailbox monopoly.

[238] The Commission would need route-level geographic-specific data to account for clustering. Further improvements could be made by assuming the competitor would design routes to more efficiently deliver the contestable mail. However, this would require information about volume delivered to each stop that is not currently available.

[239] Although the model assumes a 10 percent discount would be necessary to entice customers to switch, brand loyalty, inertia, the need to prove quality, and other factors affect the pace at which customers would switch from the Postal Service to a competitor. The model assumes a competitor would capture 100 percent of the contestable mail on routes that are skimmed. See USO Report at 149. However, some customers may not switch to a competitor even if a discount were offered.

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