SECTION 701 REPORT

Analysis of the Postal Accountability and Enhancement Act of 2006

November 14, 2016

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EXECUTIVE SUMMARY

This marks the Postal Regulatory Commission's (Commission) second report under section 701 of the Postal Accountability and Enhancement Act (PAEA) of 2006. Every 5 years the Commission is required to issue a report and its first one was submitted to Congress and the President in 2011 (2011 Report). In general, the reports are to reflect the Commission's assessment of how well the PAEA is operating and is an opportunity to recommend legislation or other measures necessary to improve the effectiveness and efficiency of our Nation's postal laws.

The Commission's 2016 report, like its 2011 Report, emphasizes the starkly different environment faced by the Postal Service since the PAEA's enactment in 2006 – a time when volume was growing and the Postal Service was earning revenues that exceeded costs. Today, the Postal Service faces the reverse: mail volume that has declined more than 25 percent since 2006 coupled with a total net loss of $5.1 billion in FY 2015 - despite an exigent surcharge that generated an additional $2.1 billion in revenue.

Twice this year, the Commission was invited to provide testimony at congressional hearings focused on the steadily deteriorating financial condition of the U.S. Postal Service. Specifically, the Commission was asked to share with the Senate and House oversight committees key findings of its annual *Financial Analysis of U.S. Postal Service Financial Results.* Testimony delivered by Acting Chairman Taub described the fundamental problems facing the Postal Service: a growing liability for retiree health benefits; an inability to borrow for needed capital investments, such as new delivery vehicles and package sortation equipment; and the continued loss of high margin First-Class Mail revenues.

This fiscal year total net loss as of June 30, 2016, was $3.3 billion compared to a net loss of $2.8 billion for the same period last year, a deterioration of $0.5 billion. For this same time period, the Postal Service's total liabilities exceeded the total value of its assets by $53.7 billion. The Postal Service has recorded monthly net operating losses since the expiration of the exigent surcharge in April this year; and working capital for the 9 months which ended June 30, 2016, was negative $43.3 billion. The net deterioration of $2.3 billion in working capital from the beginning of the fiscal year was largely due to the growth in employee-related liabilities, including the statutory accruals for payments into the Retirement Health Benefits Fund (RHBF).

It is clear, the most important legislative recommendations the Commission can make relate directly to improving the financial condition of the U.S. Postal Service. While this year's 701 report will again discuss and make recommendations related to certain rate and

service matters, along with improvements to Commission processes, the Commission places a particular emphasis upon the following recommendations:

- The Commission renews its recommendation from its 2011 Report that Congress modify the retiree health benefits fund prefunding level and payment schedule as a measure to improve Postal Service sustainability. Decreasing the funding target to one more in line with industry norms would provide much needed improvement in the Postal Service's assets to liabilities ratio.
- The Commission recommends lengthening the amortization period of the current unfunded liability. The current amortization period is 40 years. Extending the amortization period would free significant capital by reducing Postal Service annual payments.
- Further improvement in liquidity could be provided by allowing the Postal Service to use any available Federal Employees Retirement System (FERS) surplus, rather than requiring the surplus to be transferred to the RHBF. The Commission, therefore, recommends that Congress grant the Postal Service the authority to use available FERS surpluses to pay off current or future liabilities, including debt to the U.S. Treasury, pension liabilities, and retiree health benefit liabilities.

Finally, it must be noted that the timing of this report coincides closely with a significant Commission undertaking. By law, after December 20, 2016, the Commission shall commence a review of the price cap system for regulating Market Dominant products. The purpose is to determine whether the system is achieving its statutory objectives and if it is not, to "make such modification or adopt such alternative system" to achieve the objectives. Considering the breadth of this review, certain postal rate matters that would normally be addressed in this report will be deferred for consideration in December's review.

In this report, the Commission also details a variety of other recommendations for possible changes to discreet rate, service, and regulatory matters or processes. All of the Commission's recommendations are listed in Appendix A.

On October 20, 2016, the Commission sent its report to the Postal Service for review and an opportunity to comment, consistent with Section 701 of PAEA. On November 9, 2016, the Postal Service sent back its comments, which are attached at Appendix B.

I. EVALUATION OF THE PAEA AMENDMENTS AND RECOMMENDATIONS FOR LEGISLATIVE CHANGE

A. Introduction

Every 5 years, the Postal Regulatory Commission (Commission) is required to:

> (a) [S]ubmit a report to the President and Congress concerning—(1) the operation of the amendments made by [PAEA]; and (2) recommendations for any legislation or other measures necessary to improve the effectiveness or efficiency of the postal laws of the United States.

Pub. L. 109-435, 120 Stat. 3198 (2006).[1] Additionally, PAEA section 701(b) requires the Commission to afford the Postal Service a reasonable opportunity to review the report and submit written comments.

This report marks the second section 701 report to the President and Congress. The first section 701 report was submitted in 2011 (2011 Report).[2] The recommendations of the 2011 Report are summarized in section II, below. In addition, on April 14, 2016, the Commission issued a notice seeking public comment on issues the Commission should consider in the current 701 report, and those comments are reviewed in section II as well.[3] Because we are in the tenth year since the passage of the PAEA, the timing of this report occurs adjacent to another significant Commission undertaking, the review of the system for regulating rates and classes for Market Dominant products required by 39 U.S.C. § 3622(d)(3) (Section 3622 Review). As a result, some of the areas previously addressed by

[1] Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006), section 701.

[2] *Postal Regulatory Commission, Section 701 Report*, Analysis of the Postal Accountability and Enhancement Act of 2006, September 22, 2011 (2011 Report).

[3] Docket No. PI2016-3, Notice and Order Seeking Comments on Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, April 14, 2016 (Order No. 3238).

the Commission in the 2011 Report will instead be covered during the Section 3622 Review.

B. Postal Service Financial Situation

1. Introduction and Background

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

The Commission requires the Postal Service to file monthly, quarterly, and annual reports regarding its financial results. *See* 39 C.F.R. part 3050. Until FY 2014, the Commission addressed the overall financial health of the Postal Service in the Annual Compliance Determination (ACD). However, given the time frame for conducting the ACD, the Commission determined that a detailed analysis of Postal Service financial data would be better served by a separate analysis. In FY 2013, the Commission developed a separate annual financial analysis report to provide a more detailed analysis of the Postal Service's financial position. The annual financial report reviews the overall financial position of the Postal Service, as well as volumes, revenues, and costs of both Market Dominant products and Competitive products.[4] The report also analyzes the Postal Service's profitability, solvency, activity, and financial stability using accounting ratios.[5]

As reported in the Commission's FY 2015 Financial Report, the Postal Service had a net loss of $5.1 billion in FY 2015. FY 2015 Financial Report at 7. This marks the ninth consecutive net loss posted since FY 2007, increasing the cumulative net deficit since FY 2007 to $56.8 billion.[6] These losses have reduced the Postal Service's liquidity. *See* FY 2015 Financial Report at 25. At the end of FY 2015, the Postal Service's current net assets totaled $7.9 billion, while its current liabilities totaled $48.9 billion.[7] This gap is the result of a multitude of factors including the continuing decline in the volume of Market Dominant products, and high personnel-related expenses.

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[4] *See* Postal Regulatory Commission, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement*, Fiscal Year 2015, March 29, 2016 (FY 2015 Financial Report).

[5] The *Financial Analysis Report* examines the Postal Service's Altman-Z score, which is a compilation of financial ratios developed by New York University Professor Edward Altman, as a tool to gauge an entity's long-term viability. *See* FY 2015 Financial Report at 84.

[6] *See* United States Postal Service, *Annual Report on Form 10-K for the Fiscal Year Ended September 30, 2015*, at 32 (Annual Report on Form 10-K).

[7] *Id.* at 24. Table 11-7. $6.9 billion of the current net assets was cash or cash equivalents. *Id.*

From FY 2007, the total volume for Market Dominant products has declined by 60.4 billion pieces. *Id.* at 37, Figure III-1. The volume decline was precipitated by a long-term trend of mail migrating to electronic media and exacerbated by the economic recession that began in December of 2007. The Postal Service states that the volume lost to electronic media is not expected to return, as the migration represents a fundamental and permanent change in mail use by households and businesses.[8] The decline in First-Class Mail volume, a 4.3 percent average annual rate of decline since FY 2007, is particularly troubling because First-Class Mail contributes the most revenue to the Postal Service's total overhead costs. *See* FY 2015 Financial Report at 37; Appendix A.

The Postal Services also faces the challenge that its personnel-related obligations include off-balance sheet items not recognized in the Postal Service's financial statements. FY 2015 Financial Report at 30. These items include costs for unfunded liabilities in both the Civil Service Retirement and Disability Fund (CSRDF) and the Postal Service's Retirement Health Benefits Fund (RHBF). *Id.*

The CSRDF provides pension benefits to retired and disabled Federal employees, including Postal Service employees covered by the Civil Service Retirement System (CSRS) and Federal Employee Retirement System (FERS). Both the CSRS and FERS pension plans had unfunded Postal Service liabilities in FY 2014. *Id.* at 31.[9] In FY 2015, OPM directed the Postal Service to pay an additional $241 million per year for 30 years to eliminate the unfunded portion of the FERS liability. Annual Report on Form 10-K at 22. Beginning in FY 2018, the Postal Service must begin making actuarial payments on the unfunded CSRDF liability. 5 U.S.C. § 8348(h)(2)(B).

The PAEA established the RHBF to fund the long-term retiree health benefits for postal employees, retirees, and their survivors. Like CSRS and FERS, the RHBF is administered by OPM. *See* 2011 Report at 19-20. The initial funding of $17.1 billion was transferred from the CSRS surplus at the end of FY 2006. FY 2015 Financial Report at 32. The PAEA requires the Postal Service to contribute annual payments to the fund averaging $5.2 billion per year, added to the annual government share of retiree health benefit premiums. *Id.* at 31. The Postal Service has not made its annual contribution to the fund since FY 2010. *Id.* at 32. Each year since FY 2007, OPM has determined the increase in the retiree health benefit liability and the funding status of the RHBF. The defaulted payments are accrued and reported as a current liability on the Postal Service's balance sheets. Through FY 2015, the

[8] United States Postal Service, Ensuring a Viable Postal Service for America: An Action Plan for the Future, March 2, 2010, at 4.

[9] In 2017, the Office of Personnel Management (OPM) must determine the funding status of CSRS, and any surplus must be transferred to the RHBF. However, if there is an unfunded liability, which appears to be increasingly likely, OPM must develop a 30 year amortization of the unfunded liability, which the Postal Service will have to begin paying in FY 2017.

Postal Service missed a total of $28.1 billion in payments, and owes $5.8 billion for FY 2016. *Id.* This current liability contributes significantly to the Postal Service's negative working capital. As of FY 2015, the defaulted RHBF payments made up 57 percent of the Postal Service's current liabilities, substantially impacting the Postal Service's liquidity and overall sustainability. *Id.* at 77.

In FY 2017, the funding of the RHBF will change by law. The Postal Service will be required to fund the RHBF with amortized payments consisting of the normal cost, plus the unfunded portion of the RHBF liability. 5 U.S.C. § 8909a(d)(3)(b). With this change, the RHBF, rather than the Postal Service, will pay the annual government share of the postal retiree health benefit premiums. FY 2015 Financial Report at 32.

2. Commission Recommendations

In the 2011 Report, the Commission recommended that Congress adjust the current RHBF payment schedule. 2011 Report at 21. The Commission noted that the financial condition of the Postal Service had dramatically changed since the passage of the PAEA. *Id.* Five years later, the Postal Service remains unable to achieve the financial stability contemplated by the PAEA. The Commission urges Congress to consider the Postal Service's current financial situation, as fully discussed in the Commission's annual financial analysis reports.

The Commission renews its recommendation from the 2011 Report that Congress modify the retiree health benefits prefunding level and payment schedule as a measure to improve Postal Service sustainability. As noted by several commenters, the Postal Service is faced with a unique requirement to fund 100 percent of its retiree health benefits liability. The Commission supports decreasing the funding target to one more in line with industry norms as a means of improving Postal Service liquidity and solvency. The Commission recommends that Congress amend the current required prefunding level to comport to standard industry practice in both private and public sectors.

In its 2011 Report, the Commission provided estimated statutory payments for FY 2011 through FY 2016 for funding levels of 50, 60, and 70 percent. 2011 Report at 24. The forecasted scenarios resulted in higher funding levels than private sector and other public entities, while also provided a significant reduction in estimated liabilities. *Id.* at 23-24. If Congress adjusts the prefunding level in the near term, the Postal Service would likely receive a comparable cash benefit. While the Commission does not endorse a particular funding level in line with industry norms, it anticipates that any reduction in the RHBF prefunding target would provide needed improvement in the Postal Service's assets to liabilities ratio.

Relief from the 100 percent prefunding target would provide the Postal Service some flexibility to make needed capital investments.[10] In addition to reducing the prefunding target, the Commission further recommends lengthening the amortization period of the current unfunded liability. The new payment schedule for the current unfunded liability begins in FY 2017. The current amortization period is 40 years. FY 2015 Financial Report at 31-32. Extending the amortization period would free significant capital by reducing Postal Service annual payments.

Further improvement in liquidity could be provided by allowing the Postal Service to use any available FERS surplus, rather than requiring the surplus to be transferred to the RHBF. The Commission recommends that Congress provide this flexibility, as it may help restore the Postal Service's borrowing capability. A FERS surplus could first be paid toward the Postal Service's debt to the U.S. Treasury, and after that debt was paid off, any remaining or future surplus could be applied to pension liabilities, retiree health benefit liabilities, or other general debt. The Commission recommends that Congress grant the Postal Service the authority to use available FERS surpluses to pay off current or future liabilities. 2011 Report at 19-21.

C. Market Dominant Rate System

1. Introduction and Background

The Commission analyzes three general categories of the Market Dominant rate system: the price cap, the recent exigent surcharge removal, and workshare discounts.

a. Price Cap

The PAEA created a new system for regulating rates and classes for Market Dominant products, a departure from the previous cost-of-service ratemaking system under the Postal Reorganization Act of 1970 (PRA). The current system provides for an annual limitation in the percentage change in rates for each class of Market Dominant mail. 39 U.S.C. § 3622(d)(1). In general, the average rate increase for mail within a class cannot exceed the increase in the Consumer Price Index for All Urban Consumers (CPI-U) unadjusted for seasonal variation in a given year (Annual Limitation). 39 U.S.C. § 3622(d)(1),(2). When the Postal Service elects to use less than its full authority in a given price adjustment, it may "bank" unused rate adjustment authority. It may subsequently use banked authority to adjust prices by more than the Annual Limitation. Any unused banked

[10] "The FY 2015 Integrated Financial Plan (IFP) included a capital investment budget of $1.5 billion for mail processing equipment, vehicles, and information technology." Total actual capital investments were $0.4 billion less than planned. *See* FY 2015 Financial Report at 2-3, n.9.

authority expires after 5 years. Banked authority must be used on a first-in-first-out basis, and for any class or service the rate adjustment authority used must not exceed the Annual Limitation by more than 2 percent. 39 U.S.C. § 3622(d)(2)(C).

The Postal Service must provide a schedule for rate changes at regular intervals and by predictable amounts. 39 U.S.C. § 3622(d)(1)(B). However, if no sufficient banked authority exists, the Postal Service may request a rate increase greater than the Annual Limitation on an expedited basis due to either extraordinary or exceptional circumstances. The Commission must determine whether the exigent price adjustment request is reasonable, equitable, and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. 39 U.S.C. § 3622(d)(1)(E).

b. History of Exigent Requests

The Postal Service first filed a request for exigent price adjustment in FY 2010 seeking to increase rates for Market Dominant products by 5.6 percent, on average.[11] After a public hearing and an analysis of the record, the Commission denied the exigent request.[12] The Commission found that although the Great Recession and its impact were an "extraordinary or exceptional circumstance", the Postal Service failed to demonstrate that the proposed rate adjustments were "due to" the Great Recession and also failed to quantify the impact of the recession on postal finances and relate that impact to the requested price adjustment. Order No. 547 at 50, 64. The Postal Service appealed the Commission's order to the U.S. Court of Appeals for the District of Columbia Circuit. Although the court concluded that the Commission correctly construed "due to" to require a causal relationship between the exigent circumstances' effects on the Postal Service and the amount of the above-cap rate increases, it remanded the exigent price adjustment decision, in part, for the Commission to address how closely an exigent price adjustment must financially offset the triggering extraordinary or exigent circumstance.[13] On remand,[14] the Commission concluded "that exigent rate adjustments are permitted only if, and to the extent that, they compensate for the net adverse financial impact of the exigent circumstances." Order No. 864 at 45. It also clarified the level of proof sufficient to demonstrate the causal nexus of the "due to" clause of section 3622(d)(1)(E) at 46-55.

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[11] Docket No. R2010-4, Exigent Request of the United States Postal Service, July 6, 2010.

[12] Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010 (Order No. 547).

[13] *United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263 at 1264, 1268 (D.C. Cir. 2011).

[14] Docket No. R2010-4R, Order Resolving Issues on Remand, September 20, 2011 (Order No. 864).

The Postal Service subsequently renewed its request for an exigent rate adjustment on September 26, 2013.[15] This time, the Postal Service requested a 4.3 percent across-the-board increase to restore contribution lost as a result of the Great Recession. On December 24, 2013, the Commission found that the Postal Service was entitled to collect $2.766 billion in 2014 after-rates contribution as a result of losses incurred due to the Great Recession.[16] The Postal Service again petitioned the U.S. Court of Appeals for the District of Columbia Circuit for review of the Commission's order. The court's order largely affirmed the Commission's finding in Order No. 1926 but vacated the Commission's method for accounting for mail volume lost due to the exigent circumstance and it remanded the case to the Commission.[17] On remand,[18] the Commission found that the Postal Service was entitled to recover $1.191 billion in additional contribution in addition to the amount originally authorized. On August 28, 2015, the Postal Service filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit for review of Order No. 2623. That petition is currently pending before the court.[19] On February 25, 2016, the Postal Service filed notice of its intention to remove the exigent surcharge from existing Market Dominant rates effective April 10, 2016.[20] The Commission approved the Postal Service's planned removal of the exigent surcharge on March 29, 2016.[21] The exigent surcharge was removed April 10, 2016.

c. Worksharing

Workshare discounts refer to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail. 39 U.S.C. § 3622(e)(1). These discounts provide reduced rates for mail prepared or entered to avoid certain activities that the Postal Service would otherwise have to perform. The amount of each discount is based on the estimated avoided costs that result from the mailer performing that activity. The Commission is responsible for ensuring that workshare discounts do not exceed the costs that the Postal Service avoids as a result of the worksharing activity. 39 U.S.C. § 3622(e)(2).

The passthrough, or the amount of discount relative to the cost avoided, may exceed 100 percent in four instances: if the discount is associated with a new postal service, change to

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[15] *See* Docket No. R2013-11, Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059, September 26, 2013.

[16] *See* Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013 (Order No. 1926).

[17] *Alliance of Nonprofit Mailers v. Postal Regulatory Commission*, 790 F.3d 186 (D.C. Cir. 2015).

[18] *See* Docket No. R2013-11R, Order Resolving Issues on Remand, July 29, 2015 (Order No. 2623).

[19] *United States Postal Service v. Postal Regulatory Commission*, No. 15-1297 (D.C. Cir. filed Aug. 28, 2015).

[20] *See* Docket No. R2013-11, Notice of the United States Postal Service of Removal of the Exigent Surcharge, February 25, 2016.

[21] *See* Docket No. R2013-11, Order No. 3186, Order on Removal of the Exigent Surcharge and Related Changes to the Mail Classification Schedule, March 29, 2016.

existing postal service, or with a new workshare initiative related to an existing postal service and is necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discounts in excess of the cost avoided will be phased out over time; if the amount of the discount above avoided costs is necessary to mitigate rate shock and will be phased out over time; if the discount is provided in connection with mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value; or if reducing or eliminating the discount would impede the efficient operation of the Postal Service. 39 U.S.C. § 3622(e)(2)(A)-(D).

2. Commission Recommendation

The Commission is required by statute to conduct a review, 10 years after enactment of the PAEA, of the modern system of regulating rates and classes for Market Dominant products pursuant to 39 U.S.C. § 3622(d)(3). The Commission intends to consider matters related to the Market Dominant system of rate making during its Section 3622 Review, including discussions regarding the price cap and other related matters.[22]

As for worksharing, the Commission recognizes that establishing a "soft floor" (a lower limit subject to certain exceptions) on worksharing discounts may eliminate inefficiencies caused by the Postal Service performing work that mailers may perform at a lower cost. If Congress chooses to establish such a requirement, the Commission notes that the Postal Service's concerns about pricing flexibility may be balanced with the goal of increased efficiency by allowing limited statutory exceptions to the soft floor requirement. These statutory exceptions would be modeled on the exceptions that currently exist for the worksharing discount "soft ceiling" (an upper limit subject to certain exceptions). Currently, the Postal Service may claim an exception for workshare discounts exceeding the costs avoided if:

> (A) the discount is (i) associated with a new postal service, a change to an existing postal service, or with a new work share initiative related to an existing postal service; and (ii) necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discount in excess of the cost that the Postal Service avoids as a result of the workshare activity will be phased out over a limited period of time;

[22] Press Release, Postal Regulatory Commission, PRC Announces Plan for 10-year Review of System of Regulating Rates and Classes for Market Dominant Products (September 1, 2016).

> (B) the amount of the discount above costs avoided (i) is necessary to mitigate rate shock; and (ii) will be phased out over time;
>
> (C) the discount is provided in connection with the subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value; or
>
> (D) reduction or elimination of the discount would impede the efficient operation of the Postal Service.

39 U.S.C. § 3622(e)(2).

With clearly defined and limited exceptions similar to those already in place for the workshare discount ceiling, the Commission notes that establishing a soft floor would be an enhancement to the PAEA that would benefit the postal community by providing appropriate pricing signals to incentivize efficient mail preparation.

D. Competitive Product Rate System

1. Introduction and Background

The PAEA tasks the Commission with determining whether a product offered by the Postal Service is Competitive or Market Dominant. Pursuant to 39 U.S.C. § 3642(b)(1), the Commission must consider whether "the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products." Products over which the Postal Service exercises such power are categorized as Market Dominant while all others are categorized as Competitive.[23] Competitive product prices are subject to Commission review for compliance with 39 U.S.C. § 3633.

The remainder of this section discusses three issues relevant to these statutory requirements including the "appropriate share" that Competitive products must contribute towards the Postal Service's institutional cost and the cost attribution methodologies used to determine compliance with 39 U.S.C. § 3633.

[23] Any product covered by the letter monopoly is categorized as Market Dominant regardless of market analysis, pursuant to 39 U.S.C. § 601 *et seq*.

a. Competitive Contribution to Institutional Cost

Pursuant to 39 U.S.C. § 3633(a), the Postal Service's Competitive prices must not result in those products' subsidization by Market Dominant products; ensure that each Competitive product covers its attributable costs; and ensure that all Competitive products collectively contribute an appropriate share of the institutional costs of the Postal Service. With regard to the third criterion, the Commission promulgated regulations to ensure that Competitive products, collectively, bear an "appropriate share" of the Postal Service's institutional costs. *See* 39 C.F.R. § 3015.7(c). At a minimum, every 5 years, the Commission is required to review its "appropriate share" regulation. 39 U.S.C. § 3633(b). The Commission may also eliminate the contribution requirement. *Id.* In Order No. 1449, the Commission conducted its first review of that regulation and determined the "appropriate share" should remain 5.5 percent of total institutional costs as initially set in FY 2007.[24]

b. Competitive Product Costing

Underlying the Commission's review pursuant to 39 U.S.C. § 3633(a) are the costs used by the Commission in its evaluation of cost coverages. Additionally, it relies upon the Postal Service's reported costs to ensure that the prices set by the Postal Service for its competitive products satisfy the prohibition against subsidization of Competitive products by Market Dominant products. The Commission has reviewed and implemented numerous methodological changes since FY 2007. Recently, in Docket No. RM2016-2, the Commission considered a cost attribution methodology proposed by United Parcel Service (UPS). UPS's proposed methodology in that docket sought to increase the costs attributed to products and, consequently, raise the price floor for Competitive products. The Commission's final decision on UPS's proposal is discussed in the recommendation section below.

2. Commission Recommendations

There have been several significant changes to Competitive products since the Commission's last review of the appropriate institutional cost share. The Commission has approved numerous additions to the competitive product list and transfers from the market dominant product list to the competitive product list (*e.g.,* Inbound Surface Parcel Post (at Universal Postal Union (UPU) rates),[25] Parcel Post,[26] Commercial Standard Mail

[24] *See* Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Attributable Costs, August 23, 2012 (Order No. 1449).

[25] Docket No. MC2014-28, Order No. 2160, Order Approving Product List Transfer, August 19, 2014.

[26] Docket No. MC2012-13, Order No. 1411, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 20, 2012.

Parcels,[27] and Commercial First-Class Mail Parcels[28]). Additionally, since FY 2007, Competitive product volume and revenue have grown significantly.[29] Moreover, Competitive products represent a greater share of total volume than in FY 2007, when the appropriate share was set. As the Commission stated in Order No. 3506,[30] the Commission intends to consider changes to the appropriate share in the next 5-year review. No legislative change is necessary at this time on the issue of the appropriate institutional cost share as the Commission intends to review the appropriate share during FY 2016.

As for cost attribution methodology, the Commission considered the efficacy of the methodologies used to attribute costs to products in Docket No. RM2016-2. In Order No. 3506, the Commission concluded its consideration of the cost attribution proposals put forth by UPS. The Commission did not adopt UPS's proposal to incorporate all the variable costs in the costs attributable to individual products. Order No. 3506 at 3. However, the Commission recognized additional costs that are reliably identified and causally related but have not been previously attributed. In that Order, the Commission found that product-level and class-level incremental costs are attributable costs. *Id.* As a result, the Commission makes no recommendations requiring potential statutory changes to the cost attribution methodology.[31]

E. Negotiated Service Agreements

1. Introduction and Background

The Postal Service is empowered by the PAEA to enter into special agreements with mailers, including negotiated service agreements (NSA). From FY 2008 through July 2016, the Commission has reviewed 29 Market Dominant NSAs (4 domestic and 26 international) and 630 Competitive NSAs (265 domestic and 365 international). The Commission reiterates its statement from the 2011 Report that both Competitive and Market Dominant NSAs offer many potential benefits to the Postal Service and the mailing community. Below, the Commission discusses its experience with different types of NSAs, its current methods for providing access to non-public NSA information, and recommends a potential change to the Market Dominant NSA standard.

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[27] Docket No. MC2010-36, Order No. 689, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011.

[28] *See* Docket No. MC2011-22, Order No. 710, Order Adding Lightweight Commercial Parcels to the Competitive Product List, April 6, 2011.

[29] *See* Docket No. ACR2007, Annual Compliance Determination, March 27, 2008, at 24 (FY 2007 ACD); FY 2015 Financial Report at 71.

[30] 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 123 (Order No. 3506).

[31] *United Parcel Service, Inc., v. Postal Regulatory Commission*, No. 16-1354 (D.C. Cir. filed Oct. 12, 2016).

a. Competitive NSAs

As with any proposed Competitive product, before adding an NSA to the competitive product list, the Commission must determine that the Postal Service does not exercise sufficient market power that it can effectively set the price of the product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products. *See* 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.34. It must also consider the availability and nature of private sector enterprises engaged in delivering the product, the views of those who use the product, and the likely impact on small business concerns. *See* 39 U.S.C. § 3642(b)(3); 39 C.F.R. §§ 3020.32(f), (g), and (h).

Finally, once the Commission determines that an NSA meets all the above requirements, prior to approving the NSA, it must determine that the agreement covers its attributable costs, does not cause Market Dominant products to subsidize Competitive products, and contributes to the Postal Service's institutional costs. 39 U.S.C. § 3622(a); 39 C.F.R. §§ 3015.5 and 3015.7.

b. Commission Procedures Regarding Non-Public NSA Information

Many of the terms of NSAs are customized based on specific details of the customer's use of the mail and are considered non-public. The Commission's rules for obtaining access to non-public materials are currently set forth in 39 C.F.R. §§ 3007.1 through 3007.62. Any party who wishes to obtain access to non-public materials in a Commission docket (including all NSA filings) must file a motion setting forth a detailed justification for access and a list of relevant affiliations of the party requesting access. 39 C.F.R. § 3007.40.

To determine whether to grant a party access to non-public material, the Commission applies the balancing test based on Federal Rule of Civil Procedure 26, which balances the need of the requesting party to have access to participate effectively in a Commission proceeding against the Postal Service or a third party with a proprietary interest in the materials.[32]

[32] *See* Docket No. RM2008-1, Order No. 225, Final Rules Establishing Appropriate Confidentiality Procedures, June 19, 2009, at 16-17; 39 C.F.R. § 3007.42.

c. Market Dominant NSAs

(1) International Market Dominant NSAs

As an alternative to UPU terminal dues, the Postal Service enters into bilateral NSAs with foreign postal operators that include negotiated rates for some or all of their inbound letter post items.

International Market Dominant NSAs are composed largely of agreements with foreign postal operators. By the Postal Service's own estimate, these have lost approximately $25 million in net revenue in FY 2012.[33] 2013 GAO Report at 12. However, the mail sent under these NSAs would have generated even greater losses if the volumes were sent under UPU rates. *Id.*

(2) Domestic Market Dominant NSAs

When the Postal Service submits a proposed domestic Market Dominant NSA for approval by the Commission, the Commission must first independently determine whether the product is properly categorized as Market Dominant. The Commission does so by evaluating whether "the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products." 39 U.S.C. § 3642(b)(1). If a product meets these specifications or is covered by the postal monopoly, then it is categorized as Market Dominant. 39 U.S.C. § 3642(b)(2). All other products are categorized as Competitive.[34]

When evaluating the new product, the Commission is required to give "due regard" to:

> (A) the availability and nature of enterprises in the public sector engaged in the delivery of the product involved;
>
> (B) the views of those who use the product involved on the appropriateness of the proposed action; and
>
> (C) the likely impact of the proposed action on small business concerns (within the meaning of section 3641(h)).

39 U.S.C. § 3642(b)(3).

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[33] United States Government Accountability Office, *U.S. Postal Service: Opportunities to Increase Revenue Exist with Competitive Products; Reviewing Long-Term Results Could Better Inform Promotions Decisions*, GAO-13-578, June 2013 (2013 GAO Report).

[34] Any product covered by the letter monopoly is categorized as Market Dominant regardless of market analysis, pursuant to 39 U.S.C. § 601 *et seq*.

If the Commission determines that the proposed NSA is properly classified as Market Dominant, it must then determine that the NSA will either: (i) improve the net financial position of the Postal Service through reducing costs or increasing overall contribution to institutional costs or (ii) enhance the performance of mail preparation, processing, transportation, or other functions. It must also find that the NSA will not cause unreasonable harm to the marketplace. 39 U.S.C. § 3622(c)(10). The NSA must also be made available "on public and reasonable terms to similarly situated mailers." 39 C.F.R. § 3010.40(c).

Since the PAEA has been in effect, the Commission has evaluated four domestic Market Dominant NSAs, approving three and denying one.[35] Domestic Market Dominant NSAs have collectively had a negative impact on net revenue. Table I-1, below, sets forth the net effect on Postal Service contribution for each domestic Market Dominant NSA approved after the passage of the PAEA. The Commission has encouraged the Postal Service to identify a more reliable method for evaluating the financial impact of Market Dominant NSAs.

[35] *See* Docket Nos. MC2011-19 and R2011-3, Order No. 694, Order Adding Discover Financial Services 1 Negotiated Service Agreement to the Market Dominant Product List, March 15, 2011; Docket Nos. MC2012-14 and R2012-8, Order No. 1448, Order Approving Addition of Valassis Direct Mail, Inc. Negotiated Service Agreement to the Market Dominant List, August 23, 2012; Docket Nos. MC2014-21 and R2014-6, Order No. 20197, Order Adding PHI Acquisitions Inc. Negotiated Service Agreement to the Market Dominant Product List, June 19, 2014; Docket Nos. MC2015-3 and R2015-2, Order No. 2410, Order Rejecting the Postal Service's Request to Add Discover Negotiated Services Agreement to the Market Dominant Product List, March 24, 2015.

Table I-1

Net Effect on Postal Service Contribution

Contract Partner	($ Thousands)	Source
Discover	-25,378	FY 2014 ACD, at 59
Valassis	100	FY 2015 ACD, at 75
PHI Acquisitions	112	FY 2015 ACD, at 74

The Commission's current accepted methodology for estimating volume changes due to the Postal Service's pricing incentive programs uses price elasticity. Order No. 738 at 1. In Docket RM2010-9, the Commission sought public comment on potential "new methods to estimate volume changes resulting from pricing incentive programs of the Postal Service" but after receiving comments, determined that it was unpersuaded "that the alternatives offer a demonstrable improvement over the current method" and opted to retain the elasticity-based methodology.[36]

The Postal Service continues to take the position that it "should have the flexibility to determine and employ relevant and appropriate methodologies compatible with its business model."[37] It contends that no statutory requirement mandates the use of any one methodology. *Id.* In the FY 2014 ACD, the Commission directed the Postal Service to use the elasticity-based accepted analytical principle when estimating volume changes resulting from its pricing incentive programs unless the Commission accepts an alternative analytical principle.[38]

2. Commission Recommendations

The Commission continues to have a positive view of the Competitive NSA process, which has proven beneficial to both the Postal Service and the mailing community.

[36] *See* Docket No. RM2010-9, Order No. 469, Notice of Proposed Rulemaking Concerning Methods to Estimate Volume Changes Caused by Pricing Incentive Programs, June 8, 2010; Docket No. RM2010-9, Order No. 738, Order Terminating Proceeding, May 27, 2011, at 1.

[37] Docket No. ACR2014, Reply Comments of the United States Postal Service, February 18, 2015, at 11 (Docket No. ACR2014, USPS Reply Comments).

[38] Docket No. ACR2014, Annual Compliance Determination, March 27, 2015, at 60 (FY 2014 ACD).

While commenters offer divergent views on the current treatment of non-public material, the Commission maintains that the current approach to granting access to non-public material strikes the appropriate balance between the public interest in transparency and the Postal Service's and contract partner's need to keep certain information confidential. Any party may petition the Commission at any time to consider modification or improvement of the rules and the balance they strike. The Commission does not at this time recommend any legislative changes related to Competitive NSAs or procedures for seeking access to non-public material.

For domestic Market Dominant NSAs, these have not consistently performed up to expectations. Several commenters remarked that the current statutory standard has a chilling effect on domestic Market Dominant NSAs. Congress should clarify whether the more stringent standard set forth in 39 U.S.C. § 3622 (c)(10) that the agreement "improve the net financial position" of the Postal Service is still intended, rather than the standard for Competitive NSAs which are only required to cover their attributable costs.

This approach would have the advantage of providing the Postal Service with increased opportunities to experiment with its pricing, with a goal towards designing domestic Market Dominant NSAs that ultimately result in an improved financial position. However, the disadvantages of this approach include the likelihood that the Postal Service will continue to lose money on these agreements while it searches for the correct pricing formula. Given the inelastic demand for Market Dominant products, price reductions on these products have rarely proven to be profitable in the past. In addition, the Commission notes that if Congress chooses to implement this new standard, the Commission's review would be limited to the consideration of whether the proposed domestic Market Dominant NSA would improve the Postal Service's position from a cost coverage perspective, rather than its current holistic analysis of whether the Postal Service would be financially better off overall with the NSA than it would be otherwise.

F. Post Office Closings and Consolidations

1. Introduction and Background

The PAEA sets forth the requirements for Postal Service determinations to close or consolidate post offices. *See* 39 U.S.C. § 404(d). Section 404(d) also delineates the Commission's jurisdiction to review such determinations upon appeal by any person served by the post office subject to the determination. 39 U.S.C. § 404(d)(5).

In deciding whether or not to close or consolidate a post office, the Postal Service must consider: (i) the effect on the community served by the post office; (ii) the effect on the employees of the post office; (iii) consistency with a policy of providing a maximum degree

of effective and regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining; (iv) economic savings to the Postal Service from the closing or consolidation; and (v) other factors as the Postal Service determines are necessary. 39 U.S.C. § 404(d)(2)(A).

Section 404(d)(5) authorizes any person served by the post office subject to the determination of closure or consolidation to file an appeal with the Commission within 30 days of the determination. When considering an appeal, the Commission must set aside a determination found to be arbitrary or capricious, without observance of procedure required by law, or unsupported by substantial evidence on the record. The Commission must complete its administrative review no later than 120 days after receiving the appeal.

In the 2011 Report, the Commission did not recommend changes to the statutory procedural requirements under 39 U.S.C. § 404(d). However, the Commission did recommend that Congress consider requiring the Postal Service to provide regular reports to the Commission on plans and activities regarding the Postal Service's retail network. *See* 2011 Report at 77. The Commission noted that such reporting would enhance the PAEA's goals of transparency and accountability. *Id.* The Commission's 2011 Report also included a recommendation that the scope of the Commission's administrative review be clarified to adopt the plain meaning of the term "post office". *Id.*

The Commission recently concluded Docket No. PI2016-2 concerning post office consolidations and closings.[39] The Commission opened PI2016-2 to seek input as to what, in commenters' views, constitutes a relocation or rearrangement of postal services and is thus exempt from Commission review pursuant to section 404(d); and when or if the Commission should have jurisdiction to review the closing or consolidation of a contract postal unit (CPU).[40] The comments are summarized in section II with the public comments received as input to this report.

2. Commission Recommendations

There is disagreement on the Commission's authority to review post office closings on appeal over what is, and what is not, a "post office" under 39 U.S.C. § 404(d).

The Postal Service maintains that it should be extended substantial deference in defining the terms in 39 U.S.C. § 404(d) because it claims that it should retain substantial discretion

[39] Docket No. PI2016-2, Order No. 3456, Order Concluding Proceeding, August 8, 2016.

[40] Docket No. PI2016-2, Notice and Order Seeking Comments on Commission Jurisdiction Over Postal Service Determinations to Close or Consolidate Post Offices, December 10, 2015, at 4 (Order No. 2862).

concerning closures and consolidations of post offices.[41] The Postal Service suggests that the plain language of section 404(d), read in accordance with Congress's interpretation and legislative intent, suggests that the term "post office" does not include stations or branches. *Id.* at 9. The Postal Service's regulations provide that "[p]ost [o]ffices are established and maintained at locations deemed necessary to ensure that regular and effective postal services are available to all customers within specified geographic boundaries." 39 C.F.R. § 241.1. The Postal Service considers this definition to include only "Postal Service-operated retail facilities operated or staffed by a postmaster, or by an employee at the direction of a postmaster. . . ." Docket No. PI2016-2, USPS Comments at 6.

The Postal Service notes that nearly all stations and branches are found within urban areas where a central facility or main post office is located in the same community, and customers have multiple options for retail service. Thus, according to the Postal Service, the stations and branches within the geographic boundary of the post office are not post offices themselves. Similarly, the Postal Service also takes the position that CPUs are not post offices under section 404(d), asserting that designating a termination of a CPU contract as a closing would restrict the Postal Service's ability to function as a business. *Id.* at 12.

Other members of the postal community urge a broader definition of a post office. They suggest that the Commission's jurisdiction regarding appeals should include closings of *all* types of post office, including independent post offices, stations, branches, and contract post offices. They argue that appeals procedures should be similar for all types of retail facilities.

The Commission, for its part, has long held that the term "post office" includes not only postal facilities covered by the Postal Service's organizational unit definition, but stations and branches as well.[42] The opposing interpretations of the term "post office" continue to create uncertainty and confusion among the public. Legislative clarification of the definition of a post office would remove ambiguity as to which closings or consolidations are subject to administrative review by the Commission. The Commission again recommends that the definition of a post office be clarified to adopt the plain meaning of

[41] *See* Docket No. PI2016-2, United States Postal Service Comments on the Interpretation of Terms Related to 39 U.S.C§ 404(d), February 5, 2016, at 2-3 (Docket No. PI2016-2, USPS Comments).

[42] Docket No. A2013-5, Order No. 1866, Order Affirming Determination, October 31, 2013, at 11. "The Commission has repeatedly held that 39 U.S.C§ 404(d) provides appeal rights to persons served by post offices that are labeled for administrative purposes as stations or branches." *See*, *e.g.*, Order No. 436, Docket No. A82-10, *In re Oceana Station, Virginia Beach, Virginia*, June 25, 1982, at 4 (*Oceana Station);* Order No. 1480, Docket No. A2006-1, *In re Observatory Finance Station Pittsburg, PA* 15214-0651, September 29, 2006, at 6-12; Order No. 748, Docket No. A2011-16, Akron-East Station, Akron, Ohio, June 17, 2011, at 2; Order No 865, Docket No. A2011-18, Order Affirming Determination (Valley Falls Station), September 20, 2011; Order No. 1037, Docket No. A2011-49, Order Affirming Determination (Village Station), December 12, 2011; Order No. 1317, Docket No. A2012-108, Order Remanding Determination (South Valley Station), April 18, 2012. *Id.* at n.13.

the term post office, inclusive of branches and stations. The Commission further recommends clarification on whether CPUs and nonpostal operation units also fall under the Commission's administrative review authority under section 404(d).

As discussed in the Commission's 2011 Report, the Postal Service utilizes emergency suspensions of post offices in certain situations. The Postal Service defines an emergency as "an occurrence that constitutes a threat to the safety and health of Postal Service employees or customers or to the security of mail or revenue."[43] These occurrences include natural disasters, termination of a lease or rental agreement, lack of personnel to operate the facility, severe health or safety hazard, severe damage to the office, or lack of measures to safeguard the office or revenues. Postal Service Discontinuance Handbook, section 611.

Many emergency suspensions represent genuine emergencies requiring the suspension of operations. The Postal Service's reliance on anticipated terminations of leases, however, are more problematic. In Docket No. PI2010-1, the Commission sought to investigate the number and duration of emergency suspensions.[44] The Commission recognized that the Postal Service could suspend operations of a post office as a means of avoiding the discontinuance process indefinitely, and imposing a *de facto* closing of the office.

Following the 2011 report, the Postal Service changed its regulations regarding closing and consolidations, located at 39 C.F.R. part 241. The regulations provided that where an anticipated lease expiration was the reason for the emergency suspension, "responsible personnel should initiate [an] initial feasibility study sufficiently in advance of the circumstance prompting the emergency suspension to allow a meaningful opportunity for public input to be taken into account." 39 C.F.R. 241.3(a)(5)(iv). The initial feasibility study is intended to "assist the district manager in determining whether to proceed in with a written proposal to discontinue the facility." 39 C.F.R. 241.3(a)(5).

Congress may wish to consider a maximum time a post office may remain in suspension status. The Commission has previously recommended that the Postal Service "proceed expeditiously in either discontinuing offices under suspension or reopening them." *See* FY 2013 ACD at 121; FY 2014 ACD at 121; FY 2015 ACD at 150. In the FY 2015 ACD, the Commission directed the Postal Service "to reduce the number of facilities under suspension in FY 2016" and, "if it was unable to do so . . . include a detailed explanation of why it was unable to do so in the FY 2016 Annual Compliance Report." FY 2015 ACD at 150.

[43] Post Office Discontinuous Guide, Handbook PO 101, Chapter 6 – Special Considerations, Subchaper 61 – Emergency Suspensions (Postal Service Discontinuous Handbook).

[44] Docket No. PI2010-1, Order No. 335, Notice and Order Providing an Opportunity to Comment, November 9, 2009.

G. Service Standards

1. Introduction and Background

The PAEA requires that the Postal Service, in consultation with the Commission, to establish service standards for Market Dominant products. 39 U.S.C. § 3691(a). Each year, the Postal Service is required to report to the Commission on each Market Dominant product's "level of service (described in terms of speed of delivery and reliability)" and the degree of customer satisfaction. 39 U.S.C. § 3652(a)(2)(B). The Commission reviews the Postal Service's service performance in accordance with the regulations set forth at 39 C.F.R. part 3055. The PAEA intended this review to ensure that quality of service does not deteriorate as a result of cost-cutting measures implemented to comply with the consumer price index (CPI) price cap.

The Postal Service uses a variety of measuring systems to measure service performance for its various products, including: External First-Class Measurement System (EXFC); Intelligent Mail Accuracy and Performance System (iMAPS); Product Tracking System (PTS); Seamless Acceptance and Service Performance (SASP); International Mail Measurement System (IMMS); and Intelligent Mail Barcode (IMb).[45] The Postal Service utilizes these systems and compares the collected transit times against service performance targets for its respective products. For reporting service performance to the Commission, service performance must be measured by an objective external performance measurement system unless the Commission approves the use of an internal measurement system. *See* 39 U.S.C. § 3691(b)(1)(D) and (b)(2). Currently before the Commission is a public inquiry docket regarding proposals to develop new internal service performance measurement systems. The Commission's evaluation of the new systems has included reviews of the systems' performance data, as well as technical conferences wherein the Postal Service has detailed the operation of the internal systems. The Commission has requested further information from the Postal Service, which is necessary to review the proposed internal systems.[46]

The Postal Service generally makes its performance goals available to the public via its website[47] and also includes its performance data in quarterly reports and in its Annual

[45] For a detailed description of the abovementioned measurement systems, *see* Docket No. ACR2015, Annual Compliance Determination, March 28, 2016, at 95-98 (FY 2015 ACD).

[46] *See* Docket No. PI2015-1, Order No. 2336, Notice of Request for Comments and Scheduling of Technical Conference Concerning Service Performance Measurement Systems for Market Dominant Products, January 29, 2015.

[47] *See* United States Postal Service, Service Performance Targets FY 2016 Market Dominant Products, *http://about.usps.com/what-we-are-doing/service-performance/fy2016-targets-page.html.*

Compliance Report. Speed of delivery is evaluated based on a mailpiece reaching its destination within a given service window. FY 2015 ACD at 94. Reliability refers to consistency of delivery. *Id.*

In September 2015, the Government Accountability Office (GAO) published a report recommending that the Commission hold a public hearing to address how the Postal Service may improve the completeness of its service data.[48] In response to the 2015 GAO Report, the Commission opened a public inquiry docket pertaining to potential improvements in service performance measurement data.[49] The Commission found that additional reporting by the Postal Service is necessary to enhance the quality and completeness of service performance data.[50] The Commission directed the Postal Service to provide descriptions of the methodologies used to verify accuracy, reliability and representativeness of all current measurement systems and to regularly report on mail excluded from measurement and mail volumes measured and unmeasured by Full Service IMb. Order No. 3490 at 24-25.

The Commission's Annual Compliance Determination analyzes the yearly service performance data. In FY 2015, for the first time since the Postal Service began reporting service performance for all Market Dominant mail products, no First-Class Mail product met or exceeded its service performance targets. *See* FY 2015 ACD at 131-138. This decline in service performance coincided with a shift to longer processing periods. *Id.* at 135.

The Commission found that the Postal Service met service performance targets for Standard Mail High Density and Saturation Letters, but noted concern with slippage in the performance of Standard Mail Letters and the failure to meet targets for Every Door Direct Mail – Retail and Standard Mail High Density and Saturation Flats/Parcels. *Id.* at 141. The Commission also found that Standard Mail Carrier Route and Standard Mail Flats fell substantially below performance targets. *Id.* at 142. The Commission directed the Postal Service to provide a report on long-term difficulties in processing and delivering flats in a timely and cost-effective manner. *Id.* at 180-181. On July 27, 2016, the Postal Service submitted its report.[51] On September 27, 2016, the Commission requested additional information from the Postal Service.[52] The Commission held an off-the-record technical

[48] United States Government Accountability Office, *U.S. Postal Service: Actions Needed to Make Delivery Performance Information More Complete, Useful, and Transparent*, GAO-15-756, September 30, 2015 (2015 GAO Report).

[49] Docket No. PI2016-1, Order No. 2791, Notice Establishing Docket Concerning Service Performance Measurement Data, October 29, 2015.

[50] Docket No. PI2016-1, Order Enhancing Service Performance Reporting Requirements and Closing Docket, August 26, 2016 (Order No. 3490).

[51] Docket No ACR2015, Third Response of the United States Postal Service to Commission Requests for Additional Information in the FY 2015 Annual Compliance Determination, July 26, 2016.

[52] Docket No. ACR2015, Commission Information Request No. 1, September 27, 2016.

conference on October 21, 2016, during which the Postal Service provided a presentation on the status of its proposed method to measure, track, and report cost and service performance issues with Flats delivery.[53]

Service performance results for Periodicals in FY 2015 decreased for the second consecutive year, and fell below performance targets for the fourth straight year. *Id.* at 142. Package Services were inconsistent, as Media Mail/Library Mail and Bound Printed Mail Parcels exceeded performance targets, while Bound Printed Matter Flats fell substantially below other Package Services products for the fourth straight year. *Id.* at 144. All Special services met or exceeded performance targets with the exception of Post Office Box Service. *Id.*

2. Commission Recommendations

The Commission recognizes its statutory role in setting and enforcing service standards has created challenges for the postal community. Accordingly, the Commission reiterates and expands upon its recommendations from the 2011 Report.

The first of these recommendations is that Congress consider clarifying under which circumstances the Postal Service is required to consult with the Commission. *See* 2011 Report at 64-65. There is no dispute that the Postal Service must consult with the Commission when establishing service standards. *See* 39 U.S.C. § 3691(a). However, the law is silent as to whether the Postal Service must consult with the Commission when it changes service standards. Currently, the Postal Service does not formally consult with the Commission when it changes service standards, although the Commission has interpreted section 3691 as a requirement that the Postal Service do so. 2011 Report at 64. To eliminate potential confusion and the conflicting interpretations, Congress should clarify the provision as to whether or not consultations with the Commission are required for proposals to change service standards.

Perhaps equally ambiguous is the section 3691 requirement to establish standards "in consultation with" the Commission. There is substantial room for interpretation as to what the term "in consultation with" actually requires of the Postal Service. For example, a narrowly construed interpretation of the term "in consultation with" may simply obligate the Postal Service to notify the Commission of proposed service standards. A broader interpretation would suggest that the Postal Service might be required to receive and respond to Commission recommendations and input. The Commission recommends that Congress clarify the responsibilities of the Postal Service inherent in its requirement to

[53] Docket No. ACR2015, Order No. 3539, Order Scheduling Technical Conference, September 27, 2016.

consult with the Commission. These clarifications would provide more meaningful consultation in setting service standards, while promoting the transparency and accountability of the Postal Service.

The Commission's 2011 Report recommendations included a proposal for service price adjustments as an incentive for the Postal Service to improve its service performance. *See* 2011 Report at 65. The Commission appreciates that commenters maintain interest for or against such a proposal. However, the relationship between service performance and price cap authority has not been fully explored. The Commission may review the relationship between service performance and pricing authority in its Section 3622 Review.

H. Nonpostal Services

1. Introduction and Background

The passage of the PAEA revoked the Postal Service's authority to offer new nonpostal services. *See* 39 U.S.C. § 404(e)(2). It required the Commission to review each existing nonpostal service offered and determine whether those services should continue. 39 U.S.C. § 404(e)(3). The Commission was required to consider the public's need for each service and the ability of the private sector to meet the public need.

The Commission established Docket No. MC2008-1 to review and evaluate existing nonpostal services.[54] The Commission sought and received evidence and arguments of interested participants in evaluating whether the existing nonpostal services should continue. In Order No. 154, the Commission identified the nonpostal services that should be continued.[55]

[54] Docket No. MC2008-1, Order No. 50, Notice and Order Concerning Review of Nonpostal Services, December 20, 2007.

[55] S*ee* Docket No. MC2008-1, Review of Nonpostal Services under the Postal Accountability and Enhancement Act, December 19, 2008 (Order No. 154).Order No. 154 left open the issue of whether to allow the following nonpostal activities to continue: the licensing of mailing and shipping supplies; the warranty repair program; and the sale of CDs and DVDs. *See* Order No. 154 at 4, 35. The Commission initiated Phase II of Docket No. MC2008-1 to resolve those three services. *See* Docket No. MC2008-1 (Phase II), Notice and Order Initiating Phase II Proceedings (Order No. 168), January 9, 2009. The Commission concluded that: licensing of mailing and shipping supplies should not be part of the competitive nonpostal service of licensing; warranty repair should be discontinued; and sales of CDs and DVDs should be discontinued. On appeal, the United States Court of Appeals for the District of Columbia Circuit remanded to the Commission for further consideration the issue of licensing the Postal Service's logo for use on mailing and shipping supplies. *LePage's 2000, Inc. and LePage's Products., Inc. v. Postal Regulatory Commission*, 642 F.3d 225 (D.C. Cir. Jun. 7, 2011), slip op. at 1. On remand, the Commission concluded that mailing and shipping licensing could continue because it serves a public need that the private sector cannot meet. Docket No. MC2008-1 (Phase IIR), Order Resolving Issues on Remand, April 30, 2012, at 2 (Order No. 1326).

The current list of Postal Service nonpostal service offerings and their descriptions was approved in Order No. 1575.[56] Currently, the Postal Service's nonpostal offerings include two Market Dominant services:[57]

- Alliances with the Private Sector to Defray Cost of Key Public Functions
- Philatelic Sales

In FY 2015, these two services generated net revenue of $62 million, representing a 13 percent increase from FY 2014. FY 2015 ACD at 75.

The mail classification schedule also includes nine Competitive nonpostal services:[58]

- Advertising
- Licensing of Intellectual Property other than Officially Licensed Retail Products(OLRP)
- Mail Services Promotion
- Officially Licensed Retail Products (OLRP)
- Passport Photo Service
- Photocopying Service
- Rental, Leasing, Licensing or Other Non-Sale Disposition of Tangible Property
- Training Facilities and Related Services
- USPS Electronic Postmark Service (EPM) Program

In FY 2015, Competitive nonpostal services generated net revenue of $89 million, representing a 4 percent increase from FY 2014. FY 2015 ACD at 92.

2. Commission Recommendations

The Commission reiterates the recommendations in the 2011 Report regarding new offerings of nonpostal services. If Congress decides to allow the Postal Service to offer nonpostal services, it should include adequate safeguards to reduce the risks of:

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[56] *See* Docket No. MC2010-24, Order Approving Mail Classification Schedule Descriptions and Prices for Nonpostal Service Products, December 11, 2012 (Order No. 1575).

[57] Mail Classification Schedule, section 1700.2.

[58] Mail Classification Schedule, section 2700.2.

unprofitable business ventures; distortion of private markets for nonpostal services; and diversion of Postal Service resources from core responsibilities. *See* 2011 Report at 50.

The Commission recommends that if the Postal Service is permitted to offer new nonpostal services, proposed offerings should be subject to the same regulatory review the Commission applied when reviewing existing nonpostal services pursuant to section 404(e)(3). Applying such review would require the Commission to consider the public need and the ability of the private sector to meet the need for proposed new nonpostal services. Proposed nonpostal services should also primarily utilize existing Postal Service assets to minimize risk. The Commission would not approve new nonpostal service offerings that did not meet these statutory tests.

Similarly, the Commission recommends that where a proposed offering meets the statutory test for new nonpostal services, the Commission should have the authority to designate the service as a Market Dominant, Competitive, or experimental product. *See* 39 U.S.C. § 404(e)(5). Regulatory oversight of approved new nonpostal services would operate in the same way it does currently for existing services.

Implementation of these changes would safeguard against market distortion and the diversion of Postal Service resources.

I. Advisory Opinion Process

1. Introduction and Background

Any change made by the Postal Service that will generally affect service on a nationwide or substantially nationwide basis requires the Postal Service to seek an advisory opinion from the Commission pursuant to 39 U.S.C. § 3661.

Since the PAEA was enacted, the Postal Service has filed seven requests for advisory opinions with the Commission. These cases are commonly referred to as "N-cases."[59] As the Postal Service's financial situation has deteriorated, the number of N-cases has increased. Of the requests filed since FY 2006, four have required 200 days or more to complete.[60] Table I-2, below, illustrates the number of days taken to complete N-cases since the passage of the PAEA.

[59] Where "N" stands for "Nature of Service."

[60] Docket No. RM2012-4, Order Adopting Amended Rules of Procedure for Nature of Service Proceedings Under 39 U.S.C. 3661, May 20, 2014, at 4-5 (Order No. 2080).

Table I-2

Time to Complete Nature of Service Dockets

Docket No.	Subject	Days
N2006-1	Evolutionary Network Development Service Changes, 2006	308
N2009-1	Station and Branch Optimization and Consolidation Initiative, 2009	251
N2010-1	Six-Day to Five-Day Street Delivery and Related Service Changes, 2010	359
N2011-1	Retail Access Optimization Initiative, 2011	149
N2012-1	Mail Processing Network Rationalization Service Changes, 2012	259
N2012-2	Post Office Structure Plan	87
N2014-1	DSCF Standard Mail Load Leveling	89

In the 2011 Report, the Commission recommended that Congress consider adding statutory language allowing the Postal Service to request expedited consideration for time-sensitive N-Cases and requiring the Postal Service to submit a written response to the advisory opinion prior to implementing its changes in service. 2011 Report at 84. The Postal Service's written response would include an explanation of how the Commission's recommendations would be implemented or, in the alternative, why it disagrees with the Commission's recommendations. The Commission suggested that the proposed changes not be implemented until the Postal Service's written response was provided to Congress. *Id.*

In its response to the 2011 Report, the Postal Service expressed support for a legislative proposal pending at the time which would require the Commission to issue an advisory opinion within 90 days and remove the formal hearing requirement from the advisory opinion process.[61] The Postal Service did not comment on the requirement of a formal written response.

After the 2011 Report was issued, the Commission opened Docket No. RM2012-4, proposing and ultimately adopting amended rules of procedure for N-cases to address the need for more timely completion of the advisory opinion process. The Commission cited several considerations for prescribing a 90-day time frame for its advisory opinion process, including the need for more prompt resolution of N-cases given the Postal Service's current financial situation. Order No. 2080 at 13.

[61] United States Postal Service Response to Commission's Draft Section 701 Report, September 16, 2011, at 22 (USPS Response to 2011 Report).

The most significant change adopted in Docket No. RM2012-4 was the establishment of a pro forma procedural schedule for N-cases that contemplates issuance of an advisory opinion by the Commission within 90 days of the Postal Service's proposal. Order No. 2080 at 7. Other modifications to the regulations affecting N-cases were established to streamline procedures while still providing the requisite level of due process to participants. These ancillary changes included:

- The establishment of a pre-filing phase intended to inform interested persons of the Postal Service's proposal and to provide the Postal Service with feedback useful in preparing a final proposal less likely to require substantial revisions after commencement of formal Commission proceedings;
- A limitation on the scope of the proceeding to the Postal Service's proposal with an opportunity for participants to explore related subjects by means of special Commission studies or public inquiry proceedings;
- The adoption of expedited deadlines for filing and responding to motions;
- The adoption of new discovery procedures that provide for a mandatory technical conference and a limitation on the number of written interrogatories;
- Expedited filing of rebuttal and surrebuttal testimony, if any;
- Revised hearing procedures that provide for back-to-back hearings on the Postal Service's direct case; rebuttal testimony, if any; and surrebuttal testimony, if any;
- An expedited briefing schedule and limitations on the length of initial and reply briefs; and
- The adoption of a policy of issuing advisory opinions targeted to the Postal Service's proposal and, when appropriate, the institution of special studies or a public inquiry proceeding to explore related subjects.

Order No. 2080 at 7.

2. Commission Recommendations

39 U.S.C. § 3661 prohibits the Commission from issuing an advisory opinion "until an opportunity for a hearing on the record under sections 556 and 557 of title 5 has been accorded to the Postal Service, users of the mail, and an officer of the Commission who shall be required to represent the interests of the general public." 39 U.S.C. § 3661(c). In Docket No. RM2012-4, the Commission adopted new procedural rules that, to date, have not been tested because the Postal Service has not filed a new request for an advisory opinion with the Commission after its adoption of the new rule. The Commission's approach in its regulations attempted to balance the desirability and utility of an expeditious advisory opinion with the statutory mandate for a hearing on the record under the Administrative

Procedure Act. As long as the requirement for the hearing on the record exists, so will the potential for scheduling difficulties and delays in the advisory opinion process.

However, notwithstanding the new back-to-back hearing schedule in the new procedures, the Commission noted the potential logistical challenges inherent in maintaining the opportunity for back-to-back hearings on the record in Order No. 2080. It noted that other procedural changes designed to increase transparency regarding the Postal Service's proposal may minimize potential logistical challenges.

Some commenters oppose elimination of the hearing on the record requirement because they maintain that a hearing would provide a valuable avenue for stakeholders to explore the potential implications of the Postal Service's proposal. Pursuant to the pro forma procedural schedule for N-cases, however, the hearing on the record would occur between the 42nd-56th day of the pro forma procedural schedule, depending on whether any rebuttal or surrebuttal cases were filed. Order No. 2080 at 83. Other stages of the procedure, such as the pre-filing conference, technical conference, and discovery stage, all provide opportunities for stakeholders to question the Postal Service and alert the Commission about potential implications to the proposal at an earlier stage of the advisory opinion process. The updated procedures include various safeguards to ensure that ample opportunities are provided to stakeholders well in advance of the hearing stage to discover problems with the Postal Service's proposal.

Congress should consider that the hearing on the record requirement affords the highest form of due process available in an administrative proceeding. The hearing on the record requirement is a key signifier of legislative intent to provide participants with all the protections of a formal adjudicatory proceeding. *See City of W. Chicago, Ill. v. U.S. Nuclear Regulatory Comm'n*, 701 F.2d 632, 644 (7th Cir. 1983); *Izaak Walton League of Am. v. Marsh*, 655 F.2d 346, 341 (D.C. Cir. 1981). The Commission emphasizes that a delicate balance exists between its obligations to provide stakeholders with sufficient opportunities to identify and discuss the potential impacts of Postal Service proposals to substantially change service within a formal adjudicatory structure and the need for expedition in the advisory opinion process.

The Commission notes its recommendation from the 2011 Report that Congress consider adding language to 39 U.S.C. § 3661 that requires, upon receipt of the Commission's advisory opinion, the Postal Service provide a written response to Congress, prior to implementation, addressing the Commission's recommendations.

J. Market Tests of Experimental Products

1. Introduction and Background

Under the PAEA, the Postal Service has the authority to conduct market tests of experimental products. *See* 39 U.S.C. § 3641. The provision allowing for such market tests was driven by Congress' recognition of the Postal Service's need to "innovate and develop new products and services" to "meet the evolving needs of its customers." S. Rep. 108-318, at 16 (2004).

Section 3641(b) sets forth the requirements for market tests of experimental products. First, the subject product must be, from the viewpoint of mail users, significantly different from all products offered by the Postal Service within the 2 year period preceding the start of the market test. 39 U.S.C. § 3641(b)(1). Second, the product must not create an unfair or otherwise inappropriate competitive advantage for the Postal Service or any mailer. 39 U.S.C. § 3641(b)(2). Finally, the product must be correctly classified as either a Market Dominant or Competitive product. 39 U.S.C. § 3641(b)(3).

Market tests are subject to a 24 month limit in duration, though the Commission may grant an extension up to an additional 12 months. 39 U.S.C. § 3641(d). Revenues for products introduced in a market test, either anticipated or actually received by the Postal Service, may not exceed $10 million in any year, subject to inflation. 39 U.S.C. § 3641(e).

The Postal Service must file a notice of a market test with the Commission and publish the notice in the *Federal Register* at least 30 days prior to the market test's initiation. 39 U.S.C. § 3641(c)(1). The notice must describe the nature and scope of the market test and set forth the basis for the Postal Service's determination that the market test meets the statutory requirements. In reviewing market tests for compliance, the Commission considers public comments from interested persons, mailers, and other stakeholders in the postal community. The Commission also reviews Postal Service responses to specific requests for information issued by the Commission.

Since the submission of the 2011 Report, the Postal Service has filed five notices of market tests of experimental products: Docket No. MT2012-1, First-Class Tracer; Docket No. MT2013-1, Metro Post; Docket No. MT2013-2, International Merchandise Return Service Non-Published Rates; Docket No. MT2014-1, Customized Delivery; and Docket No. MT2016-1, Global eCommerce Marketplace (GeM) Non-Published Rates. The Commission ultimately approved the First-Class Tracer, Metro Post, International Merchandise Return

Service Non-Published Rates, Customized Delivery, and GeM market tests. The Postal Service requested, and the Commission granted, a one year extension of the Metro Post market test.[62] The Commission granted a request for a one year extension of the International Merchandise Return Service market test to accommodate one year negotiated service agreements executed in the second year of the market test.[63]

2. Commission Recommendations

The Commission maintains its position that the statutory authority and rules under the PAEA governing market tests of experimental products are working as intended and providing the Postal Service increased flexibility in the development of new postal products. *See* 2011 Report at 70.

a. Increases on Maximum Revenue and Duration

In its 2011 Report, the Commission recommended Congress consider raising the maximum revenue limitation on market test products. 2011 Report at 70. The Commission continues to support this change, which would provide the Postal Service more opportunities for advancement of new postal products to bolster revenue streams. Accordingly, the Commission reiterates its 2011 Report recommendation that Congress consider raising the maximum revenue limitation for market tests. The Commission also recommends that Congress increase the maximum duration limitation on market tests for experimental products. As with an increase in the revenue limitation, an increased maximum duration should encourage more innovation by giving the Postal Service flexibility to advance more ideas to bolster revenue streams.

b. Modification of "Market Disruption" Requirement

The Commission has identified one potentially problematic area in the PAEA's conditions for market tests. The PAEA requires experimental products to be "significantly different from all products offered by the Postal Service" within the 2 years preceding the start of a market test 39 U.S.C. § 3641(b)(1). The Postal Service is required to show that the introduction of the product will not cause market disruption. 39 U.S.C. § 3641(b)(2). In practice, the juxtaposition between these two requirements creates a challenge for the Postal Service in implementing market tests.

On one hand, the introduction of the product must not create an unfair advantage for the Postal Service or any mailer. The Commission's rules require that, in a notice of a market test, the Postal Service establish that the product will not create a market disruption. 39

[62] Docket No. MT2013-1, Order No. 2243, Order Approving Request for Extension and Expansion of Metro Post Market Test, November 7, 2014.

[63] Docket No. MT2013-2, Order No. 1806, Order Authorizing Market Test to Proceed and Granting Extension, August 12, 2013.

C.F.R. § 3035.3(a)(1)(ii). On the other hand, the product must be one that is significantly different from any product the Postal Service has offered within the last 2 years. Because experimental products necessarily must not have been offered recently by the Postal Service, the Postal Service generally lacks the relevant data necessary to determine the experimental product's potential impact on the market. Without having offered a similar product itself, the Postal Service's determination that the product would not create an unfair advantage is highly speculative. The Postal Service generally does not, prior to implementation of a market test, have access to revenues and volumes of similar products offered by individual competitors, or revenue and volume for the market for similar products as a whole. As a result, the determination that an experimental product would not cause market disruption is often hypothetical.

For example, in establishing that the GeM experimental product would not cause market disruption, the Postal Service was unable to rely on its own data, as it had not offered a similar product.[64] As a result, the Postal Service was forced to speculate that while at least four companies offered similar services, the offering would not create an unfair advantage. *Id.* Without specific information as to the competitors and market disruption, the Commission sought additional information from the Postal Service.[65] The information requests provided the Commission more information about the nature of the experimental product, and about competitors offering similar services.

UPS filed comments regarding the notice of market test.[66] UPS argued that introduction of the GeM product would indeed cause market disruption, because the Postal Service enjoys monopoly privileges as a state-owned enterprise and UPU designated operator. Docket No. MT2016-1, UPS Comments at 3-4. Lacking sufficient market information, the Commission was compelled to issue a Notice of Inquiry, requesting from interested parties volume and revenue information for the previous 3 years, and for the related market as a whole.[67] This information-gathering process requires the expenditure of significant resources, while still providing only limited market information. The GeM market test request illustrates the difficulty in balancing the requirements of insuring against market disruption while offering a substantially new product.

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[64] Docket No. MT2016-1, Notice of the United States Postal Service of Market Test of Experimental Product – Global eCommerce Marketplace (GeM) Merchant Solution and Notice of Filing GeM Merchant Model Contract and Application for Non-Public Treatment of Materials Filed Under Seal, March 16, 2016, at 5 (Docket No. MT2016-1, Notice).

[65] *See* Docket No. MT2016-1, Chairman's Information Request No. 1, March 30, 2016 (Docket No. MT2016-1, CHIR No. 1); Docket No. MT2016-1, Chairman's Information Request No. 2, April 5, 2016 (Docket No. MT2016-1, CHIR No. 2);Docket No. MT2016-1, Commission Information Request No. 1, April 29, 2016 (Docket No. MT2016-1, CIR No. 1).

[66] Docket No. MT2016-1, Comments of United Parcel Service on Postal Service Notice of Global eCommerce Marketplace Proposed Market Test, April 19, 2016 (Docket No. MT2016-1, UPS Comments).

[67] Docket No. MT2016-1, Notice of Inquiry No. 1, April 29, 2016 (Docket No. MT2016-1, NOI No. 1).

Congress may consider modifying the standard of proof for section 3641(b)(2) to instead require the Postal Service to set forth to the Commission its reasonable basis for belief that the introduction of the proposed experimental product will not cause market disruption. This proposed standard would be less onerous than the current requirement that the Postal Service attempt to demonstrate that no market disruption will occur (for an experimental product that is substantially different than anything the Postal Service has offered within 2 years) before the test. Congress could safeguard the potential for market disruption of an experimental product by allowing an avenue to challenge the experimental product, if during the market test a user of the mail believed such a product created an unfair or otherwise inappropriate competitive advantage for the Postal Service or other mailer (especially small business concerns). This approach would be similar to the avenue made available by 39 U.S.C. § 404a(a)(1) for rules or regulations of the Postal Service that may have an anticompetitive effect. This would provide the Postal Service with the appropriate flexibility in its market test offerings while still safeguarding the interests of the market as a whole.

K. Universal Service and the Postal Monopoly

1. Introduction and Background

The Commission is required to report to the President and Congress estimates of costs incurred by the Postal Service in providing universal service on an annual basis. 39 U.S.C. § 3651(b)(1)(A). Additionally, in December 2008, the Commission provided a report to the President and Congress detailing the current status of the Postal Service's Universal Service Obligation (USO) and the postal monopoly, including any deficiencies in universal service; and options for considering how to change both in the future.[68] The USO Report was mandated in section 702(a)(2) of the PAEA.[69] The Commission's subsequent annual reports contain yearly estimates of the costs of the USO and postal monopoly. The recommendations in the USO Report and the estimates in the FY 2015 Annual Report are discussed in more detail below.

a. USO Report

In drafting its USO Report, the Commission sought public input by holding three field hearings, sponsoring an open workshop, and soliciting formal and informal written comments. The Commission found, as a threshold matter, that both senders and recipients were generally satisfied with the level of universal service, no geographic areas were

[68] Postal Regulatory Commission, *Report on Universal Postal Service and the Postal Monopoly*, December 19, 2008 (USO Report).

[69] Pub. L. 109-435, 120 Stat. 3198 (2006), section 701(a)(2).

unserved by the Postal Service, and no service was deficient in scope or quality. USO Report at 1. However, the report noted that the still unfolding Great Recession was having a substantial impact on postal revenues and recognized that the Postal Service would have to assess and evaluate its options in the near future in response to its financial challenges. *Id.* at 2.

In the USO Report, the Commission found that the Postal Service's obligation to provide service to all persons in all parts of the nation, as well as its territories and possessions, remains paramount and should not be altered. It also found that the USO was applicable to both Market Dominant and Competitive products, and included seven relevant attributes: Geographic scope; Range of Products; Access to Postal Facilities; Delivery Frequency; Prices and Affordability; Quality of Service; and Users' Rights of Enforcement. *Id.* at 19-21; 25. Its initial estimate of the annual cost of the USO, based on FY 2007 data, was $4.4 billion. *Id.* at 5. Its initial estimate of the values of the combined letter mail and mailbox monopolies, based on the same data, was $3.5 billion. *Id.* These estimates have been updated and refined in subsequent annual reports.

Finally, the USO Report included the following recommendations:

- That Congress consider and balance all the features of universal service as part of any review of changes necessary to preserve a financially viable Postal Service.
- That the Postal Service be directed to develop information on the probable impact on mail usage by large volume mailers in reaction to potential alternative changes in the seven features of universal service.
- That, before any decisions to adjust or eliminate universal service or the monopoly are made, the resulting impact on the societal benefits of a Federal postal service should be carefully addressed.

Id. at 6.

b. Annual Reports

The estimated cost of the USO and value of the postal monopoly, provided in the Commission's annual reports, are summarized in Table I-3 below:

Table I-3[70]

Annual Estimates of the Cost of the Universal Service Obligation (USO) and the Value of the Postal Monopoly

Fiscal Year	Estimated Cost of the USO ($ Billions)	Value of the Monopoly ($ Billions)
2014	4.13	5.38
2013	4.52	4.74
2012	4.81	3.98
2011	5.17	4.25
2010	5.03	4.02

Source: FY 2015 Annual Report

c. Federal Trade Commission Report

Pursuant to section 703(a)[71] in the PAEA, the Federal Trade Commission (FTC) was tasked with submitting a separate report, which was to identify federal and state laws that applied differently to the Postal Service in comparison to private carriers and include, as appropriate, an accounting of the net economic effects provided by the legal differences, as well as recommendations for bringing such legal differences to an end.[72]

The FTC report included the following conclusions:

- The Postal Service's unique legal status likely provides it with a net competitive disadvantage as compared to private carriers — legal and political restraints on the Postal Service increase its costs from between $330 million - $782 million annually, which is slightly mitigated by an implicit subsidy of its Competitive products estimated as $39 million - $117 million a year.
- The costs and benefits of the Postal Service's distinct legal obligations should be viewed as two market distortions that compound each other and negatively affect the provision of Competitive products.

[70] Postal Regulatory Commission, *Annual Report to the President and Congress*, Fiscal Year 2015, January 2016, at 41, 48.

[71] Pub. L. 109-435, 120 Stat. 3198 (2006), section 703(a).

[72] Federal Trade Commission, *Accounting for Laws that Apply Differently to the USPS and its Private Competitors*, December 2007 (FTC Report).

- Congress should consider acting to reduce the legal constraints on the Postal Service's Competitive product operations.
- The Commission should consider requiring the Postal Service to account for its implicit subsidies when making pricing and production decisions.
- Worksharing and the requirement that the Competitive products cover 5.5 percent of institutional costs may reduce any advantage that the postal monopoly provides in the delivery of competitive products.
- Long term options for addressing the distinct legal treatment between the Postal Service's competitive business and its private carrier competitors include relaxing the current mailbox monopoly; narrowing the scope of the postal monopoly; or establishing the Postal Service's Competitive products division as a separate corporate entity.

FTC Report at 8-11.

2. Commission Recommendations

The Commission notes that the challenges the Postal Service currently faces are similar to those discussed in the USO Report. *See* USO Report at 191-192. The attributes of the USO do not exist in a vacuum, and specific mandates for one or more attributes, such as the price cap on Market Dominant products or the annual appropriations requirement that delivery levels remain at 1983 levels, may impact how the Postal Service must consider and achieve other attributes. *See id*. at 193, 196-197. Given a flexible USO, how the Postal Service achieves each attribute does not remain fixed. The range of products offered may expand or contract to meet the needs of users of the mail. The quality of service provided for different products may be recalibrated to meet changing demand. Access to facilities and offerings may change as populations and technologies evolve. *See id.* at 194-198, 201. Comprehensive review and action on all attributes of the USO would allow for any changes to be considered in light of the potential effects on other attributes.

Given the continued financial and other challenges the Postal Service currently faces, and the discussion above, the Commission reiterates the principal findings of its USO Report, and emphasizes that all of its findings remain important for Congress to consider. In particular, it urges Congress to consider and balance all the features of universal service as part of any review of changes necessary to preserve a financially viable Postal Service. *Id.* at 6.

The Commission also concurs with commenters and notes that the postal industry and general public could benefit from an updated FTC Report with a more current accounting for the value of relevant legal differences between the Postal Service and its private competitors.

L. Public Representative

The Commission is statutorily required to designate an officer to represent the interests of the general public in all public proceedings. 39 U.S.C. § 505. The current process employed by the Commission involves appointing a member of its staff from the Office of General Counsel or Office of Accountability and Compliance as the public representative (Public Representative) in a given docket. Depending on the complexity of the docket, one or more other staff members may be assigned to assist the Public Representative in his or her analysis of the issues presented. The Public Representative then files comments on behalf of the general public in the docket to which he or she is assigned. The Public Representative is prohibited by both the Commission's *ex parte* rules and Commission policy from discussing substantive matters with Commission decision-making personnel for the dockets on which the individual is serving as Public Representative.

In FY 2016, the Commission evaluated 299 Competitive NSAs. Each of those routine cases requires a 7 day window for comments for all interested persons, which includes a Public Representative, to ensure expeditious Commission review. For each of these cases the Commission assigns an advisory team of an attorney and analyst as well as a second analyst to serve as a Public Representative. The Public Representative teams are staffed from the total Commission pool of 19 analysts, who also serve to staff each Commission docket requiring analytical expertise. To adequately staff each Competitive NSA in FY 2016, therefore, there were 598 analyst assignments from that pool. Public Representative responsibilities for larger cases are also assigned to Commission attorneys and analysts on the basis of expertise.

However, the Commission recognizes the value of the Public Representative program and appreciates the dedication of staff members assigned as Public Representatives. The Public Representative's insight has consistently proven valuable to the Commission in its decision-making process. Commenters have reiterated the importance of the Public Representative and the value provided to members of the postal community by the program.

II. 2011 REPORT RECOMMENDATIONS AND COMMENTS ON CURRENT 701 REPORT

A. 2011 Report Recommendations

The 2011 Report focused its recommendations and review on three main areas: the Postal Service's financial condition; postal rate and service matters; and improvements to Commission processes. 2011 Report at 1-2.

In its analysis of the Postal Service's financial condition in FY 2011, the Commission recommended that Congress adjust the schedule of payments to the Postal Service RHBF and suggested several alternative payment options intended to alleviate Postal Service liquidity issues. *Id.* at 21-25. The 2011 Report also included a discussion of the Postal Service's annual financial reporting requirements and Sarbanes-Oxley Act compliance, finding that the PAEA requirements resulted in improved transparency and greater cost savings. *Id.* at 25-27.

The 2011 Report also included several recommendations regarding rate and service matters. First, the Commission recommended that the PAEA be amended to allow the Postal Service to add new Market Dominant classes of mail. *Id.* at 44. Second, the Commission noted that if Congress approves the introduction of new nonpostal services, there be adequate safeguards to reduce the potential for introducing unprofitable products. *Id.* at 50. The Commission also suggested that any new nonpostal products be subject to review under 39 U.S.C. § 404(e)(3), the same regulatory review applied to determining whether to "grandfather" in a nonpostal service. *Id.*

Although the Commission found that the PAEA constraints on market tests were effective and not unduly burdensome, the 2011 Report included as its third recommendation that Congress consider raising the maximum revenue limitation on experimental market test products to further bolster Postal Service revenue streams. *Id.* at 70. Fourth, the Commission recommended that Congress clarify the PAEA to require the Postal Service to consult with the Commission not only in establishing service standards for market dominant products, but also when seeking to change existing service standards. *Id.* at 64-65. The Commission did not recommend any changes to existing procedures for price

adjustments but instead recommended that Congress consider allowing the Postal Service increased pricing flexibility based on improvements to quality of service. *Id.* at 40.

Finally, the Commission made three major recommendations aimed at developing enhancements to improve Commission processes. The first was a recommendation that Congress require the Postal Service to provide the Commission with regular reports on retail network plans and activities. *Id.* at 77. The second recommendation was to clarify the scope of the Commission's appellate review of post office closings, including a definition of "post office" that would encompass all Postal Service-operated retail facilities. *Id.* at 77-78. The third recommendation was that Congress consider allowing the Postal Service to obtain expedited consideration of requests for advisory opinions by the Commission. *Id.* at 83-84.

B. Comments Regarding Current 701 Report

On April 14, 2016, the Commission issued a Notice seeking public comment on the current 701 Report. Order No. 3238. The following parties submitted comments:

- The American Consumer Institute Center for Citizen Research (ACI)[73]
- A Grand Alliance to Save Our Public Postal Service (AGA)[74]
- Amazon Fulfillment Services, Inc. (Amazon)[75]
- American Postal Workers Union, AFL-CIO (APWU)[76]
- Citizens Against Government Waste (CAGW)[77]
- Don Cheney (Cheney)[78]
- Campaign for Postal Banking (CPB)[79]
- Former Utility Regulators (FUR)[80]
- Greeting Card Association (GCA)[81]
- Steven Hutkins (Hutkins)[82]

[73] Comments of the American Consumer Institute Center for Consumer Research, June 14, 2016 (ACI Comments).

[74] Comments of A Grand Alliance to Save Our Public Postal Service, June 14, 2016 (AGA Comments).

[75] Comments of Amazon Fulfillment Services, Inc., June 14, 2016 (Amazon Comments).

[76] Comments of American Postal Workers Union, AFL-CIO, June 14, 2016 (APWU Comments).

[77] Comments of the Citizens Against Government Waste, June 14, 2016 (CAGW Comments).

[78] Comments of Don Cheney, June 15, 2016 (Cheney Comments). Don Cheney concurrently filed a Motion from Don Cheney for Late Acceptance of Comments, June 15, 2016 (Cheney Motion). The Cheney Motion is granted.

[79] Comments of Campaign for Postal Banking, June 14, 2016 (CPB Comments).

[80] Comments of Former Utility Regulators, June 15, 2016 (FUR Comments). Former Utility Regulators concurrently filed a Motion for Late Acceptance of Comments of Former Utility Regulators, June 15, 2016 (FUR Motion). The FUR Motion is granted.

[81] Comments of the Greeting Card Association, June 14, 2016 (GCA Comments).

- Lexington Institute (Lexington Institute)[83]
- Elaine Mittleman (Mittleman)[84]
- MPA-Association of Magazine Media and Alliance of Nonprofit Mailers (MPA)[85]
- National Association of Letter Carriers, AFL-CIO (NALC)[86]
- National Association of Presort Mailers (NAPM)[87]
- National Taxpayers Union (NTU)[88]
- Linda O'Donnell (O'Donnell)[89]
- The Parcel Shippers Association (PSA)[90]
- Pitney Bowes Inc. (Pitney Bowes)[91]
- United States Postal Service (Postal Service)[92]
- The Association for Postal Commerce, Major Mailers Association, and Saturation Mailers Coalition (PostCom)[93]
- Public Representative[94]
- R Street Institute (R Street)[95]
- United Parcel Service, Inc. (UPS)[96]

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[82] Initial Comments by Steven Hutkins Regarding the Commission's Section 701 Report, June 14, 2016 (Hutkins Comments).

[83] Comments of the Lexington Institute, June 14, 2016 (Lexington Institute Comments).

[84] Comments of Elaine Mittleman on the Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, June 14, 2016 (Mittleman Comments). Elaine Mittleman filed Supplemental Comments on the Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act Comments about Historic Venice, California, Post Office Building and Biberman Mural, July 6, 2016 (Mittleman Supplemental Comments).

[85] Comments of MPA–Association of Magazine Mailers and Alliance of Nonprofit Mailers, June 14, 2016 (MPA Comments).

[86] Comment of the National Association of Letter Carriers, AFL-CIO, June 20, 2016 (NALC Comments). NALC also filed a Motion by the National Association of Letter Carriers, AFL-CIO for Extension of Time to File Comment, June 14, 2016 (NALC Motion). In Order No. 3372, the Commission denied NALC's request for a one week extension of time to file comments, but granted NALC an extension of 3 days to file its comments. Order No. 3372, Order Granting Extension of Time to File Comments, June 15, 2016, at 3. Concurrently with its comments, NALC filed a Motion by the National Association of Letter Carriers, AFL-CIO for Late Acceptance of Comment, June 20, 2016 (June 20, 2016, NALC Motion). The June 20, 2016, NALC Motion is granted.

[87] Comments of the National Association of Presort Mailers, June 14, 2016 (NAPM Comments).

[88] Comments of the National Taxpayer Union, June 14, 2016 (NTU Comments).

[89] Comments of Linda O'Donnell, June 14, 2016 (O'Donnell Comments).

[90] Comments of the Parcel Shippers Association, June 14, 2016 (PSA Comments).

[91] Comments of Pitney Bowes Inc., June 14, 2016 (Pitney Bowes Comments).

[92] United States Postal Service Comments in Response to Order 3238, June 14, 2016 (USPS Comments).

[93] Comments of the Association for Postal Commerce, Major Mailers Association, and Saturation Mailers Coalition, June 14, 2016 (PostCom Comments).

[94] Public Representative Comments, June 15, 2016 (PR Comments). The Public Representative concurrently filed a Motion of the Public Representative for Late Acceptance of Comments, June 15, 2016 (PR Motion). The PR Motion is granted.

[95] Comments of R Street Institute, June 14, 2016 (R Street Comments).

[96] Comments of the United Parcel Service, Inc. on the Section 701 Report, June 14, 2016 (UPS Comments).

- Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. (Valpak)[97]
- David Yao, (Yao)[98]

1. Comments on Postal Service Financial Situation

a. Financial Position and Liquidity

In Order No. 3238, the Commission requested comments on the PAEA's impact on the Postal Service's overall financial position, and suggestions for legislative recommendations. Order No. 3238 at 5. The Commission received comments from the Postal Service, APWU, AGA, PSA, GCA, NAPM, Yao, NALC, PostCom, Pitney Bowes, MPA, and the Public Representative. These commenters collectively discuss a number of areas related to the Postal Service's financial situation, including the RHBF, the expansion of Postal Service borrowing authority, and improvements to accounting methods.

The Postal Service states that it has sustained net losses each year since the PAEA was implemented. USPS Comments at 4. It notes that even when discounting RHBF liabilities, it sustained losses from FY 2009 through FY 2013, and would have continued to do so in FY 2014 and FY 2015 but for an exigent surcharge which has since expired. *Id.* In describing its own financial challenges, the Postal Service cites low liquidity, exhaustion of U.S. Treasury credit, and a lack of cash to meet current obligations and for much needed capital investments. *Id.* at 5-6. The Postal Service attributes its ability to maintain sufficient liquidity only to its default on legally mandated RHBF payments. *Id.* at 7.

The Postal Service lists four factors as the cause of its financial difficulties. First, it notes the decline in total mail volumes and a shift in mail mix from high- to low-margin products. *Id.* at 8-9. Second, it points to the price cap required by the PAEA. The Postal Service notes its inability to raise prices above the CPI-U based price cap, emphasizing that the remaining mail volumes do not generate enough to cover the Postal Service's costs. *Id.* at 9. Third, it points to its own fixed or growing infrastructure costs, which are inflexible. Declining volumes dictate that there is less and less revenue to pay for the infrastructure costs required to maintain a delivery network of 155 million delivery points. *Id.* at 9-10. Fourth, the Postal Service suggests that the PAEA limits its flexibility concerning cost structure, particularly with respect to personnel-related costs. *Id.* at 10-11.

[97] Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. Comments on Commission Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, June 14, 2016 (Valpak Comments).

[98] Comments of David Yao, June 15, 2016 (Yao Comments).

The Postal Service states that despite its constraints, it has been successful in reducing operating costs in response to declining volumes. *Id.* at 11. It notes that it has reduced its cost base by approximately $15 billion annually through rationalization of its retail, processing, transportation, and delivery networks, as well as labor cost reductions. *Id.* It cites increased total factor productivity (TFP)[99] in each of the past 6 years, despite declining volume. *Id.* at 11-12. However, the Postal Service suggests that it has taken advantage of most cost-cutting initiatives available to it in light of its universal service obligation. *Id.* at 12.

b. Postal Service Retiree Health Benefits Fund

Several commenters suggest changes regarding the funding of the RHBF, including removal of any funding requirement. For example, APWU suggests that while "the Postal Service is required to fully pre-fund future retiree health benefits 75 years in advance over a ten-year period," no other public or private entity does so. APWU Comments at 1-2. APWU suggests Congress eliminate the prefunding mandate and legislate a refund of payments to allow the Postal Service the necessary cash flow to "make the Postal Service viable again." *Id.* at 2.

AGA characterizes the PAEA's prefunding requirement as "an unfair crushing financial mandate" that no other government agency is forced to bear, and notes that without the mandate, the Postal Service would have enjoyed an operating surplus over the previous 3 years. AGA Comments at 2. GCA states that "removal of the impracticable schedule for prefunding" might do more to improve the effectiveness of the PAEA than any other single change. GCA Comments at 1. Yao characterizes the prefunding requirement as "a mistake by Congress, which has severely constrained access to capital by the USPS." Yao Comments at 1.

Other commenters suggest changes to the prefunding schedule and other modifications regarding the RHBF, rather than elimination in its entirety. The PAEA requires the Postal Service to prefund 100 percent of its retiree health benefits liability. 5 U.S.C. § 8909a. The Postal Service, citing lower funding-level targets in the private sector, state governments, and other federal agencies, proposes a target of 80 percent. USPS Comments at 22-23.[100] NALC notes that it has previously proposed a prefunding target that matches private industry best practice, between 33 and 50 percent or, alternatively, a funding target

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[99] "Total factor productivity (TFP) measures the change in the relationship between outputs (weighted workload) and inputs (resources used) over a period of time. Total workload is calculated using weighted mail volumes, miscellaneous output, and the change in delivery points. Resources consist of labor, materials (including purchased transportation), and deployed capital assets. Workload growth, less growth in resources used, equals TFP growth." FY 2015 Financial Report at 18.

[100] The Postal Service's comments echo a set of proposed reforms already presented to Congress by Megan J. Brennan, Postmaster General and Chief Executive Officer. *See* House Oversight and Government Reform Committee Hearing, *"Reforming the Postal Service: Finding a Viable Solution,"* 114th Congress (May 11, 2016).

contingent upon the Postal Service's profitability. NALC Comments at 3. The Public Representative proposes a cancellation of RHBF payments which have already been defaulted on by the Postal Service. PR Comments at 33.

Additionally, the Postal Service has proposed full Medicare integration of the Federal Employees Health Benefits Program (FEHBP). USPS Comments at 20. It notes that 9 percent of Medicare-eligible annuitants and dependents do not take advantage of Medicare Part A, and 27 percent do not take advantage of Medicare Part B. *Id.* It suggests that "[n]o rational self-funding employer would pay Medicare taxes, yet continue to pay the full costs of health benefits that could be covered by Medicare in the first instance." *Id.* The Postal Service proposes the creation of a separately-rated Postal Service plan within FEHBP, appropriately assigning claims costs to Medicare, and establishing an Employer Group Waiver Plan for Medicare Part D prescription drug benefits. It asserts this would eliminate 94 percent ($54 billion) of the current unfunded RHB liability. USPS Comments at 20-21.

Valpak also supports full Medicare integration. Valpak Comments at 6. PostCom considers the prefunding requirement to be an "artificial" obligation, and suggests that its removal coupled with requiring Postal Service retirees to participate in Medicare would lead to an even greater reduction in liabilities. PostCom Comments at 4. MPA considers unused contributions to Medicare an "unjustified subsidy of the Treasury by the Postal Service and its customers." MPA Comments at 1.

The Postal Service also notes that the PAEA requires it to invest 100 percent of RHBF assets in low-yield Treasury securities. USPS Comments at 21. It points to other post-retirement funds for private-sector employees and for other public-sector employees that invest assets for growth in order to lower unfunded employer liability. *Id.* The Postal Service states that if RHBF assets had been allocated according to the Thrift Savings Plan's (TSP's) L 2040 portfolio, the unfunded liability would have been 18.4 percent lower in FY 2015. *Id.* at 22. The Postal Service proposes that 50 percent, and possibly up to 75 percent, of the fund's assets be invested with TSP's longest-term lifecycle fund. *Id.*

NALC also discusses RHBF fund investment in its comments, concluding that more diverse investment will "over the long run, improve the balance sheet of the OPM and reduce the cost of pre-funding for the Postal Service" allowing for affordable postage rates and better service to America's mailers and citizens. NALC Comments at 8.

Postmaster General Brennan's plan, which includes the three proposals outlined in the Postal Service's comments: a reduced funding target, full Medicare integration, and less restrictive investment is supported by PSA and NAPM. *See* PSA Comments at 2; NAPM Comments at 2-3.

In the 2011 Report, the Commission recommended that any excess CSRS funds caused by an overstated liability be transferred into the RHBF. *See* 2011 Report at 25. Both the Public Representative and Pitney Bowes support re-adopting the recommendation as a means of improving the overall financial situation. *See* PR Comments at 35; Pitney Bowes Comments at 1-2.

c. Borrowing Authority

As noted above, the Postal Service exhausted its statutory borrowing authority of $15 billion. FY 2015 Financial Report at 2. The Public Representative states that the Postal Service is consequently without flexibility to make necessary capital investments. PR Comments at 34. The Public Representative recommends that borrowing authority be increased to account for inflation in light of the need for financial flexibility and the need to make necessary investments. *Id.* at 35.

d. Accounting Standards

MPA suggests that "the Commission should recommend to Congress a study of the market value of the Postal Service's real estate assets." MPA Comments at 5. MPA notes that the Postal Service currently accounts for the net book value of real property, which does not reflect the Postal Service's true financial resources. *Id.* MPA goes on to assert that the net book value of the Postal Service's real estate is approximately $13.2 billion, and the fair market value has been estimated as high as $85 billion. *Id.* at 6. MPA posits that if the real estate was sold, it could yield its fair market value to satisfy its liabilities. *Id.* at 5.

Similarly, PostCom identifies property, plant, and equipment (PPE) as an area carried on balance sheets at the original cost. PostCom Comments at 5. PostCom states that because PPE often has a value far in excess of the original cost due to real estate appreciation, the PPE account of the Postal Service is a hidden strength. *Id.* It points out that the National Postal Museum Property was purchased for $47 million, but in FY 2011 had an assessed tax value of $304 million. *Id.* at 6. PostCom urges that the "true value" of Postal Service assets be accounted for in assessments of the Postal Service's financial situation. *Id.* at 5.

2. Comments on Market Dominant Rate System

a. Price Cap

Several parties noted that discussion of the price cap system is best reserved for the Section 3622 Review. USPS Comments at 26; GCA Comments at 2. Several parties, including PostCom and NAPM, express support for the current price cap system. PostCom Comments at 8; NAPM Comments at 4. However, PostCom asserts that costing and accounting methods should be improved to make the price cap system work more effective and efficiently. PostCom Comments at 9-10. In particular, PostCom asserts that the Postal Service should fully utilize data generated by the IMb system and other data systems to

evaluate the effectiveness of cost-reduction initiatives, identify cost drivers within the mail processing system, and develop more efficient pricing. *Id.* at 11.

The Postal Service, Valpak, and the Public Representative all maintain that major changes are needed to the price cap system. The Postal Service asserts that the price cap has been ineffective in allowing it to raise the revenue it needs to fulfill its statutory obligations as well as ensure the financial sustainability of universal service. USPS Comments at 26. Valpak states that the price cap does not remedy unfair pricing within a mail class, and urges Congress to amend the PAEA in a way that would prevent cross-subsidies within classes and require each Market Dominant product to cover its incremental cost in addition to making a "meaningful" contribution to institutional costs. Valpak Comments at 12, 26. The Public Representative opines that an amendment to the price cap system is necessary to factor in declining mail volumes and an increasing number of delivery points. PR Comments at 46-49. He discusses two potential amendments to the price cap previously proposed by the Postal Service's inspector general[101] — the revenue per delivery point adjustment and the hybrid cap adjustment methods — and notes that either of these methods would pose a superior alternative than the existing system. PR Comments at 50-53.

GCA and NAPM both raise a recommendation from the 2011 Report of the potential for the Postal Service to obtain increased pricing flexibility for quality of service enhancements. 2011 Report at 40. NAPM expresses support for this idea, asserting that such a credit would drive efficiencies in its operations and improve service performance. NAPM Comments at 6. GCA, however, opposes the credit, as it states that Market Dominant users would provide the majority of revenue for the benefit of Competitive users. GCA Comments at 5.

b. Exigent Surcharge

Several parties comment on the recent exigent surcharge removal. ACI asserts that the surcharge was detrimental to postal customers, and opposes any renewal or reinstatement of the surcharge because it would fail to address systemic problems of the Postal Service. ACI Comments at 1-3. APWU presents the opposite view, and states that the Commission should restore the surcharge because removal was a "boon to the major mailers . . . at a time when the Postal Service needs to restore its capital stock." APWU Comments at 4. GCA points to the surcharge as an example that the current price cap system is working and that an exigent increase can be counted on by the Postal Service in the event of another economic downturn. GCA Comments at 2. The Postal Service restates its position that

[101] United States Postal Service, Office of Inspector General, *Revisiting the CPI-Only Price Cap Formula*, Report Number: RARC-WP-13-007, April 12, 2013.

Congress reinstate the exigent surcharge and make it part of the rate base, at least pending the resolution of the Commission's Section 3622 Review. USPS Comments at 26. Valpak opposes legislative reinstatement of the surcharge and asserts that such a measure would be a repudiation of the pricing mechanism established in the PAEA. Valpak Comments at 5.

c. Worksharing

In its solicitation for comments in this docket, the Commission specifically sought public input on "the current operation of the provisions regarding workshare discounts, as well as insights on how the discounts and exceptions have functioned in practice." Order No. 3238 at 6. Of those who commented on worksharing, GCA alone stated that it was in favor of the status quo for worksharing discounts. GCA Comments at 7-8. Other commenters, including PSA, Pitney Bowes, Valpak, NAPM, the Public Representative, and APWU proposed suggestions for improvements to worksharing discounts.

PSA, NAPM, Pitney Bowes, and Valpak all express support for a requirement that worksharing passthroughs (or the amount of discount relative to avoided costs) also be prohibited from falling below 100 percent. PSA asserts that a "soft floor" for discounts would promote efficiency and ensure the work is being performed by the lowest cost provider. PSA Comments at 6. Pitney Bowes urges that several exceptions to the "soft floor" be allowed, subject to certain exceptions. Pitney Bowes Comments at 16. NAPM notes that such a rule would be consistent with statutory objectives and factors of the PAEA and would help improve operational efficiency. NAPM Comments at 8. Valpak suggests that the Commission should have the authority to adjust passthroughs upward if they fall below 100 percent. Valpak Comments at 28. The Postal Service opposes the idea of a soft floor on worksharing discounts because it states that such an approach would reduce its pricing flexibility. USPS Comments at 29.

The Public Representative recommends legislative changes to require the Postal Service to adjust workshare discounts annually to reflect its most recent cost avoided estimates. PR Comments at 55. He states that this change would ensure that discounts more accurately reflect avoided costs. *Id.*

APWU states that the Commission has been "passive" on excessive cost avoidances to date, and suggests that Congress authorize private complaints for unwarranted discounts. APWU Comments at 5.

3. Comments on Competitive Product Rate System

a. Comments on Competitive Contribution to Institutional Cost

The Commission received a number of comments pertaining to the appropriate institutional cost share requirement. Amazon, PSA, and the Postal Service oppose increasing the appropriate share from 5.5 percent of institutional costs. PSA and Amazon urge the Commission to eliminate the appropriate share requirement altogether. However, they advocate deferring consideration of the appropriate share to the next 5 year review or alternatively to the next phase of Docket No. RM2016-2. In Docket No. RM2016-2, Proposal Three, UPS proposed to increase the appropriate share of total institutional costs that Competitive products must cover.[102]

Amazon opines that "[u]nder current business conditions, the 5.5 percent minimum contribution requirement is essentially irrelevant." Amazon Comments at 5. It notes that the contribution made by Competitive products to institutional costs considerably exceeds 5.5 percent. It also suggests that if economic conditions change and the Postal Service cannot meet the contribution requirement, it "should be allowed to charge contribution-maximizing prices rather than lose the competitive business entirely." *Id.* It dismisses the notion that Competitive products would be subsidized by Market Dominant products if Competitive products didn't cover a share of the Postal Service's fixed costs. It contends that as long as the revenue of a product or a group of products covers the marginal and incremental costs of those products, the products are not subsidized. *Id.* at 6.

Amazon also notes that the Postal Service offers destination-entry prices for its Competitive services. *Id.* at 7. It asserts that the Postal Service's economies of scale, scope and density are largely in last-mile delivery. *Id.* It suggests that the fact that the Postal Service shares these advantages with its competitors by "unbundling last-mile delivery from upstream functions, and offering last-mile delivery to competitors at reasonable rates" minimizes the risk that the Postal Service's pricing could injure competition. *Id.* It observes that the Postal Service's primary competitors "enjoy healthy and growing profits." *Id.*

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[102] The Commission discussed the importance of the "appropriate share" requirement in Order No. 1449. It stated that: "[a] primary function of the appropriate share requirement is to ensure a level playing field in the competitive marketplace. The Postal Service's competitors incur certain fixed operating costs. If the Postal Service's competitive products were provided by a stand-alone enterprise, it too would incur fixed operating costs. The appropriate share requirement could be said to represent the fixed costs of the competitive enterprise and should reflect the ways in which institutional resources are spent on the competitive enterprise. If the Postal Service's competitive products were not required to contribute an appropriate share towards the institutional costs of the enterprise, this could result in the Market Dominant products cross-subsidizing the fixed costs of the stand-alone competitive enterprise. For this reason, the appropriate share requirement is an important safeguard to ensure fair competition on the part of the Postal Service." Order No. 1449 at 13.

PSA contends that the existing Competitive rate system has worked as intended. Similar to Amazon, it notes that the contribution of Competitive products to institutional costs is "substantially above 5.5 percent and growing." PSA Comments at 3. It asserts that because the contribution made by Competitive products far exceeds 5.5 percent, the current minimum contribution requirement has no effect on Postal Service pricing. It therefore advises the Commission to eliminate the minimum contribution requirement. *Id.*

The Postal Service asserts that it has been attempting to enhance contribution from Competitive products, as evidenced by the fact that Competitive products consistently outperformed the minimum 5.5 percent "appropriate share" requirement. It asserts the playing field is more likely tilted against the Postal Service than competitors. It cites a 2008 report by the FTC that concluded that the Postal Service's legal status places it at a competitive disadvantage and artificially heightens the prices of its Competitive products. USPS Comments at 15-16. It asserts that the situation is unlikely to have changed significantly in the intervening years. *Id.* at 16. It suggests that increasing the appropriate share would further tilt the playing field against the Postal Service. *Id.*

b. Comments on Competitive Products Costing

Commenters express a range of opinions regarding the proper methodology the Commission should utilize when calculating Competitive products' attributable cost. Commenters also express varied opinions regarding subsidization of the Postal Service's Competitive products by its Market Dominant products. Under the current attribution methodology, Competitive products cover their attributable cost. However, changes to the cost attribution methodology may affect the cost coverage of products.

UPS asserts that the methodology used by the Commission puts the Postal Service at a competitive advantage. UPS Comments at 3. It questions how the Postal Service allocates cost for new large investments made to develop the Postal Service's parcel business. *Id.* UPS proposes that the Postal Service "be required to provide a clear and complete disclosure of how it is accounting for new large investments, such as those requiring over $100 million in capital investment or $100 million in increased operational costs over five years, including a detailed description of how those costs are being attributed to individual products under 39 U.S.C. § 3633(a)(2)." *Id.* at 5. UPS asserts that either the Commission should impose this reporting requirement going forward or it should ask Congress to mandate it. *Id.*

Amazon and PSA opposed the methodological changes proposed by UPS in Docket No. RM2016-2. They opined that the current attributable and incremental cost tests adequately account for the marginal and incremental costs of the Postal Service. Amazon and PSA contended that Postal Service's domestic Competitive rates satisfy the prohibition against

subsidization of Competitive products by Market Dominant products. Amazon Comments at 2, PSA Comments at 3.

The Postal Service also opposed UPS's proposals. Unlike UPS, it contended it is at a competitive disadvantage compared with private carriers. It urged the Commission to "reject any call to recommend changes to the cost attribution standards in 39 U.S.C. §§ 3622(c)(2) and 3631(b)." USPS Comments at 15.

Former Utility Regulators discuss the importance of preventing the subsidization of Competitive products by "monopoly" products. FUR Comments at 1-2. It suggests that the Commission ask Congress for whatever tools it needs to prevent cross-subsidization and ensure that Competitive products cover their costs. FUR Comments at 2. With its comments, Former Utility Regulators includes a white paper titled *"Cross-Subsidization: Applying Lessons From Utility Regulation To The United States Postal Service,"* Bryan Tramont, Raymond Gifford, and Greg Sopkin, June 14, 2016 (White Paper). The White Paper provides an overview of how utility regulators, across a variety of sectors, have dealt with "issues presented when a monopoly provider of utility services also provides services in competitive markets." FUR Comments at 1. Specifically, the White Paper discusses the experience of utilities in preventing cross-subsidization of Competitive products by monopoly products and reviews several regulatory alternatives for preventing cross-subsidies including structural separation, line of business restrictions, and accounting separations. With regard to accounting separations, the White Paper emphasizes the importance of accurate and detailed cost data and transparency regarding the cost assignment methodologies employed. White Paper at 10. It concludes that "[l]essons from the utility sector demonstrate that, in order to be effective in preventing cross subsidization, accounting separation must, at a minimum: 1) be based on accurate and reliable cost data; 2) approach cost assignment and allocation in a transparent manner; and 3) direct assign costs to the maximum extent possible, leaving to allocation only those joint and common costs that are truly incapable of being direct assigned." *Id.* at 20.

Lexington Institute includes a paper with its comments titled *"Practices of the U.S. Postal Service That Imply Anti-Competitive Behavior: Historical Parallels and Remedies Across Other Regulated Sectors"*, Don Soifer, June 14, 2016 (Soifer Paper).

The Soifer Paper asserts that the cost burden assigned to regulated products is disproportionate to that imposed on Competitive products, effectively giving the latter a financial boost, if not a free ride. Soifer Paper at 1. It discusses legal and regulatory remedies based on structural separations, as well as accounting separations. *Id.* The Soifer Paper discusses the experience of monopolies in the telecommunications, electric utilities and government research sectors. *Id.*

The Soifer Paper notes that "[b]ecause mail and packages are so physically different that their processing requires separate infrastructure, some potential for structural separation between monopoly and competitive activities is possible without significant disruption to economies of scale for market-dominant mail products." *Id.* at 14. Where structural separation of activities is not practical, the Soifer Paper asserts that "accounting separation should establish a fair market value charge for utilization of shared infrastructure . . . ." *Id.*

4. Comments Summary

a. Competitive NSAs

Amazon and PSA both submitted comments in favor of the current statutory system for reviewing Competitive NSAs. Amazon expresses the view that the current review system for Competitive NSAs should remain unchanged, as the current products generate additional volume and contribution for the Postal Service. Amazon Comments at 10. PSA views Competitive NSAs as a major success of the PAEA. PSA Comments at 5.

b. Commission Procedures Regarding Non-public NSA Information

Both PSA and APWU commented on the Commission's current procedures for obtaining access to non-public materials. PSA is not opposed to the current process by which interested parties may request and be granted access, subject to protected conditions, to non-public material regarding the Postal Service's costs, but asserts that the bar for justifying access to customer-specific NSA information should be much higher. PSA Comments at 5. PSA does not propose an alternative standard for accessing customer-specific information. *Id.*

APWU takes the opposite view, asserting that the confidentiality of contract partner identity may give the contract partner an unfair advantage over its competitors, and urges Congress and the Commission to require that NSAs (both Competitive and Market Dominant) be made public "to provide for public scrutiny of deals that the Commission currently reviews in secret." APWU Comments at 6.

c. Comments on Market Dominant NSAs

No party submitted comments regarding international Market Dominant NSAs. The Public Representative, Pitney Bowes, PostCom, and Valpak all submitted comments about domestic Market Dominant NSAs.

The Public Representative maintains that the Commission's approach of using elasticities to determine if a domestic Market Dominant NSA will improve the net financial position of the Postal Service is consistent with the PAEA. PR Comments at 60. He also states that the PAEA sets the appropriate standards to ensure that the Postal Service does not engage in

unprofitable agreements, and thus recommends that the current standard remain unchanged. *Id.* at 60-61.

Pitney Bowes characterizes the current regulatory approval process for domestic Market Dominant NSAs as "expensive and uncertain" and goes on to state that the standard adopted by the Commission for establishing net financial improvement to the Postal Service's financial situation has had a chilling effect on the number of Market Dominant NSAs negotiated by the Postal Service. Pitney Bowes Comments at 19. It urges the Commission to reassess how it evaluates risk for domestic Market Dominant NSAs, stating that a lower burden of proof or a higher risk tolerance would both be justified. It also asserts that the Commission should encourage the Postal Service to pursue domestic Market Dominant NSAs that will improve the operational efficiency or enhance the performance of mail preparation, processing, transportation, and other functions. *Id.*

PostCom concurs with Pitney Bowes, stating that domestic Market Dominant NSAs have not lived up to their potential because the metrics and process employed by the Commission to evaluate NSAs discourages both mailers and the Postal Service from entering into these agreements. PostCom Comments at 13. It asserts that review of such agreements should be limited, and so long as the contract does not represent an abuse of market power and is available to similarly situated mailers on reasonably equivalent terms, it should be approved by the Commission. *Id.*

Valpak asserts that overall, domestic Market Dominant NSAs have been highly unprofitable. Valpak Comments at 30-31.

5. Comments on Post Office Closings and Consolidations

a. Comments Received in Response to Order No. 3238

The Commission received comments on post office closings that suggest these closings have contributed to the Postal Service's declining levels of service. APWU cites declining service dating back to the Postal Service's "massive program of plant closings and consolidations since [FY] 2012." APWU Comments at 6. It calls for a mandatory reversal of consolidations of the past 5 years, and cancellation of any consolidations planned for FY 2017. *Id.* at 6-7.

Commenters address both the scope of the Commission's review of appeals and the definition of the term "post office." Mittleman and Hutkins express disagreement with the

opinion issued by the U.S. Court of Appeals for the District of Columbia Circuit in *Mittleman v. Postal Regulatory Commission*,[103] which held that Commission orders concerning appeals of closings are not subject to judicial review. *See* Hutkins Comments at 3; Mittleman Comments at 15-16.

PostCom argues that as long as adequate service is maintained, the Postal Service should be allowed flexibility to close or consolidate post offices for economic efficiency. PostCom Comments at 16. It further maintains that the Postal Service should be afforded means of mitigating exogenous costs, such as co-location of additional government services in postal facilities to maximize the value of the location to the community. *Id.*

Both Hutkins and Mittleman also recommend Congress and the Commission clarify the definition of a post office. Mittleman suggests abolishing the concept of stations and branches, recommending that there be no distinction between main post offices, stations, and branches. Mittleman Comments at 15. Both Mittleman and Hutkins suggest clearer definitions of "rearrangements" of postal retail facilities in a community Hutkins Comments at 2; Mittleman Comments at 13-14.

The Public Representative proposes changes to the Postal Service's emergency suspension procedures. PR Comments at 65. His proposed changes include a mandatory feasibility study, with a deadline for the study's completion, as well as a deadline for the Postal Service to propose discontinuance of a facility to prevent an emergency suspension from operating as a *de facto* closure without any right to appeal. *Id.* He supports the Commission's 2011 Report recommendations that the Postal Service be required to provide regular reports on its plans and activities regarding its retail network, and that the scope of the Commission's appellate review be clarified to include Postal Service stations and branches. *Id.* at 66.

Cheney proposes that Congress require the Postal Service to offer mitigation measures to displaced Postal Service employees, including reemployment assistance and early retirement benefits. Cheney Comments at 1.

b. Comments Submitted in Docket No. PI2016-2

The Commission has determined in appeals cases that Postal Service decisions to relocate retail facilities within the same community are not closings or consolidations and, therefore, fall outside the scope of the Commission's jurisdiction under 39 U.S.C. § 404(d). *See* Order No. 436 at 7. Under this rationale, the Commission has dismissed several post office closing appeals and found that transfers of retail operations constituted *relocations*

[103] *Mittleman v. Postal Regulatory Commission*, Nos. 12-1095, 12-1110, 12-1157 (D.C. Cir. filed Jul. 8, 2014).

which it lacks jurisdiction to review under section 404(d). *See* Order No. 2862 at 5. Similarly, the Commission has consistently dismissed several post office closing appeals on the grounds that the Postal Service action constituted a *rearrangement* of retail facilities within a community.

The Commission received several comments on relocation and rearrangement of postal services in Docket No. PI2016-2. The comments reflected competing perspectives on the Commission's jurisdiction in appeals of post office relocations and rearrangements. Many commenters proposed a broader interpretation of the Commission's authority, suggesting that limiting jurisdiction permits the elimination of a community's access to effective or regular postal services without the statutory safeguards for process.[104] On the other hand, the Postal Service's comments argued for a more limited interpretation of the scope of 39 U.S.C. § 404(d), stating that in addition to a determination that the Commission lacks jurisdiction to review relocations and rearrangements, closings of branches and stations should likewise not be subject to review. Docket No. PI2016-2, USPS Comments at 1.

CPUs and Community Post Offices (CPOs) are types of contractor-operated (as opposed to Postal Service-operated) facilities. *See* 39 C.F.R. § 241.3(a)(2)(ii). A CPU is a contract station, contract branch, or CPO operated under contract by persons who are not postal employees in a space provided by the contractor.[105] Village Post Offices (VPOs), although operated under a contract, are not classified by the Postal Service as a CPU.[106] While CPUs generally do not fall within the scope of 39 U.S.C. § 404(d), in select circumstances when the Commission determines that a CPU is the sole source of postal retail services to a community, it has found that section 404(d) (both the statutory intent and language) justifies the Commission exercise of review authority over sole source CPU closures and consolidations.[107]

Comments on the "sole source" standard for the exercise of the Commission's review authority were mixed. The Postal Service urged that Commission review of CPU closures

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[104] *See, e.g.,* Docket No. PI2016-2, Public Representative's Comments on the Commission's Ability to Review Postal Service Determinations to Close or Consolidate Any Post Office, February 5, 2016, at 7.

[105] Postal Operations Manual section 123.126, Issue 9, July 2002, Updated With Postal Bulletin Revisions Through October 31, 2013 (POM); *see also*, Publication 32 – Glossary of Postal Terms, July 2013, *https://about.usps.com/publications/pub32/* (Glossary of Postal Terms), defining a CPU as a "postal unit that is a subordinate unit within the service area of a main Post Office. It is usually located in a store or place of business and is operated by a contractor who accepts mail from the public, sells postage and supplies, and provides selected Special Services (e.g., Postal Money Order or Registered Mail). Also called contract branch, contract station, and community Post Office unit."

[106] *See* Village Post Offices Fact Sheet, July 2011, *https://about.usps.com/news/electronic-press-kits/expandedaccess/assets/pdf/vpo-fact-sheet-110726.pdf.* VPOs, like CPUs and CPOs, are part of the Postal Service's "Approved Postal Provider" network and are retail outlets for postal products and services operated by a third party.

[107] *See* Docket No. A83-30, *In the Matter of Knob Fork*, West Virginia 26579, Commission Opinion Remanding Determination for Further Consideration 39 U.S.C § 404(b)(5), January 18, 1984, at 7.

"impedes the effective management and operational authority of the Postal Service" and is otherwise not supported by legislative history. Docket No. PI2016-2, USPS Comments at 10-11. Other commenters argue CPUs should be considered under the definition of "post office" and thus be subject to review, and that the sole source standard is applied too narrowly.[108]

6. Comments on Service Performance

The Commission received a range of comments on different areas related to service standards and performance.

Several commenters note generally that service performance has declined. APWU states that continued declining service will lead to a decline in volumes, and that Congress should restore service standards to pre-2012 levels. *See* APWU Comments at 8-9. Similarly, AGA expresses concern that the Postal Service has "slowed mail service, closed community based Post Offices and mail processing facilities, slashed hours of operations, tried ceaselessly to end six day service as well as door to door delivery." AGA Comments at 2. AGA believes that Congress should restore service standards to pre-2012 levels, and protect 6-day and door-to-door delivery. *Id.* at 3.

O'Donnell, a Postal Service employee, cited the consolidation of mail processing facilities as a cause of delayed mail. O'Donnell Comments at 1. O'Donnell also suggests reducing customers' time in line by "properly staffing post office windows" and restoring service hours. *Id.*

PostCom focuses its comments on the Commission's oversight of service standards and performance. *See* PostCom Comments at 16-17. PostCom notes that the Postal Service "cannot even meet the standards it has set for itself" and that it is imperative that the Commission oversee a move to higher quality operations that truly reduce costs and meet the needs of customers. *Id.* at 17. PostCom suggests that the Commission have ultimate authority to set and enforce service standards. *Id.* at 18.

Valpak focuses its comments on the recommendation in the Commission's 2011 Report that Congress consider providing an opportunity for the Postal Service to achieve increased pricing authority for increases in quality of service. *See* 2011 Report at 28, 40. Valpak recommends that consideration of service quality pricing authority should be deferred. Valpak Comments at 33. It states that should such a system be implemented, it should cut both ways as a financial incentive for improving service and as a penalty for declining

[108] *See, e.g.,* Docket No. PI2016-2, Reply Comments of Steve Hutkins on the Commission's Jurisdiction Over Post Office Closings, March 29, 2016, at 13-15 (Docket No. PI2016-2, Reply Comments of Steve Hutkins).

service. *Id.* at 31-32. Valpak states that until better service performance data are available, and given the Postal Service's low financial liquidity, "implementation of any meaningful penalty provision for service degradation likely would be impractical as it might threaten the Postal Service's continued financial viability." *Id.* at 32-33.

UPS comments on the relationship between service performance and the Postal Service's prioritization of certain products. Specifically, UPS notes that service performance results for Standard Mail Carrier Route, Standard Mail Flats, and Standard Mail Letters have not met their targets for several years and have not shown significant improvement, while parcels and other high density shipments "exceeded the performance targets set by the Postal Service." UPS Comments at 9. UPS maintains that these results are reflective of the Postal Service prioritizing service standards "for specific high-growth products, like parcels, over the service standards for monopoly products, like letter mail." *Id.* at 8-9. UPS urges Congress to require the Postal Service to adhere to quality of service reporting requirements of 39 U.S.C. § 3652 for its Competitive product lines as well as Market Dominant products. *Id.* at 10. UPS says "[this requirement would allow for a fair comparison of the quality of service being provided for the Postal Service's market-dominant business" against quality of service for its Competitive products business. *Id.*

7. Comments on Nonpostal Services

The Commission received comments on nonpostal services from the Postal Service, AGA, APWU, Pitney Bowes, NAPM, CAGW, CPB, Yao, and O'Donnell. The commenters fall into three general categories: those that favor expanded nonpostal services, those that oppose the expansion of nonpostal services, and those that favor limited expansion. Several of these comments offered specific nonpostal services that should be considered. Other comments suggested that the Postal Service should not offer any nonpostal services at all.

Commenters in favor of expanded nonpostal services include CPB, APWU, AGA, Yao, and O'Donnell. CPB states that 28 percent of domestic households lack access to affordable financial services and asserts that because the Postal Service is a trusted, accessible, and secure government agency with the world's largest retail network, it is in a unique position to fill the public need. CPB Comments at 1-2. CPB notes that the U.S. has a tradition of postal banking and continues to offer domestic and international money orders and wire transfers. CPB argues that permitting the Postal Service to offer financial services (*e.g.,* ATMs, savings accounts, and small dollar loans) would both serve the public and strengthen the Postal Service financial situation. *Id.* at 2.

Other commenters, including APWU, Yao, AGA, and O'Donnell, support the expansion of postal banking. APWU Comments At 3; Yao Comments at 1; AGA Comments at 3*;* O'Donnell Comments at 1.

Both NAPM and CAGW oppose the expansion of nonpostal services. NAPM expresses its concern that core competencies will suffer if the Postal Service is permitted to enter into commercial nonpostal markets, because limited resources will be diverted. *See* NAPM Comments at 8; CAGW asserts that the Postal Service "shouldn't be dabbling in financially volatile, nascent start-up services." CAGW Comments at 1.

Commenters supporting a limited expansion of Postal Services include PSA, Pitney Bowes, and the Postal Service. PSA argues that the Postal Service lacks the resources to maintain its existing services while exploring new nonpostal endeavors. PSA Comments at 7. PSA does, however, support proposals to specifically authorize the Postal Service to provide governmental services in lieu of local or state governments. Pitney Bowes shares the view that the Postal Service should be permitted to provide other governmental services to state, local, and tribal governments, but says that the offering of commercial nonpostal services would distort private markets and divert from the Postal Service's core competencies. Pitney Bowes Comments at 17.

The Postal Service recommends a "somewhat expanded" range of services, which could provide needed revenue. USPS Comments at 29-30. Specifically, the Postal Service suggests that it be permitted to enter into agreements to provide services to state, local and tribal governments. *Id.* at 30. The Postal Service mentions that it could be permitted to carry beer, wine, and distilled spirits through the mail as a potential expanded service, and says that the Commission should be allowed to approve other new nonpostal services that are consistent with the public interest, do not cause unfair competition, do not interfere with the value of postal services, comply with all applicable federal laws and regulations, and are expected to improve the Postal Service's net financial position. *Id.*

8. Comments on Advisory Opinion Process

PostCom maintains that as long as the Commission's opinion remains advisory and the Commission lacks the power to enforce its conclusions, there is no need for a hearing on the record. PostCom Comments at 18. It notes that, although valuable information may be gained during advisory opinion proceedings, so long as the Postal Service is not obligated to follow the Commission's recommendations, "the expenditure of resources to develop that information is entirely wasted." *Id.* at 19. It suggests that the advisory opinion process should either be abolished entirely or revised to provide the Commission with a means of enforcing its recommendations. *Id.*

The Public Representative opposes elimination of the hearing on the record requirement. PR Comments at 69. He asserts that the requirement "ensures that stakeholders . . . have the opportunity, through the discovery and adjudicatory hearing procedures, to explore the potential implications of the Postal Service's proposals." He notes that the Postal Service proposals are often presented to the Commission with "no established body of relevant

data and information," which distinguishes N-cases from annual compliance determinations and rate proceedings, for which a hearing on the record is not required. *Id.* He states that, for the reasons stated by the Commission in its 2011 Report, section 3661 should be amended to require that the Postal Service provide a written response to advisory opinions. *Id.* at 70.

APWU asserts that the current 90-day process does not provide the requisite level of due process for unions and customers. APWU Comments at 10. It urges Congress to change the advisory opinion process to allow for extensions to the advisory opinion process to give stakeholders the opportunity to prepare documentation and testimony. *Id.*

9. Comments on Market Tests of Experimental Products

The Commission received comments on statutes and regulations regarding market tests from the Public Representative, CAGW, and Pitney Bowes. The comments illustrate different perspectives of members of the postal community.

The Public Representative opines that the framework for the regulation of market tests is working as intended and should not be altered. PR Comments at 71.

CAGW holds the opinion that "the Postal Service shouldn't be dabbling in financially volatile, nascent start-up services." CAGW Comments at 1. The CAGW position is that the Postal Service should not "venture outside of its core mission of delivering letter mail." *Id.*

Pitney Bowes comments that no market test has had a material effect on the Postal Service's financial condition due to statutory limitations on duration and anticipated revenues. Pitney Bowes Comments at 18. Pitney Bowes suggests that the Commission recommend increases on the duration and revenue cap limitations, and commensurate increase in the Postal Service's burden to demonstrate that introduction of the experimental product "will not create an unfair or otherwise inappropriate competitive advantage for the Postal Service." *Id.* at 18-19.

10. Comments on Universal Service and the Postal Monopoly

The Postal Service asserts that many of the cost savings from improved efficiency are limited by legal and universal service constraints. USPS Comments at 12.

UPS and Amazon both commented on the FTC report. UPS asserts that the FTC report should be updated in light of the Postal Service's expansion of its parcel delivery business.

UPS Comments at 5. Additionally, UPS maintains that the FTC Report appears to have underestimated the Postal Service's competitive advantages, particularly those related to the postal monopoly. *Id.* at 6. It disagrees with the report's conclusion that worksharing and economies of scale and scope reduce the Postal Service's competitive advantage. *Id.* at 6-7. It recommends that Congress revisit the need for, and appropriate scope of, the mailbox monopoly. *Id.* at 7-8.

Amazon also comments that the FTC Report is dated, but reaches the opposite conclusion from UPS and asserts that subsequent developments, including the transfer of several Market Dominant products to the competitive product list, the substantial rise in average competitive product price, and the growing profitability of private carriers, have reduced the risk that distinct legal treatment of the Postal Service could disadvantage its competitors. Amazon Comments at 7-8. It goes on to state that the Postal Service's policies of sharing economies of scale, scope, and density through last mile delivery provide an additional layer of protection from competitive harm. *Id.* at 8. It notes that the FTC Report did not include in its estimate the cost burden associated with the Postal Service's limited ability to invest its retirement account assets in U.S. Treasury securities. *Id.*

11. Comments on the Public Representative

UPS states that the Public Representative serves a valuable role in Commission proceedings by facilitating the public's understanding of the Postal Service's practices and serving an important advocacy role for the general public. UPS Comments at 11. APWU suggests overhauling the Commission's current method of assigning Public Representatives in favor of creating an independent Consumer Advocate role at the Commission to help individuals participate in Commission dockets. APWU Comments at 11.

The Public Representative concurs with UPS, asserting that the participation of Public Representatives has contributed to better informed Commission decisions and benefits the public good by providing an experienced Commission staff member capable of presenting information and arguments in a form that is persuasive and familiar to decisional staff. PR Comments at 72.

III. CONCLUSION

The Commission appreciates the opportunity to contribute to the essential discussion of postal policy by providing its second 701 Report to measure the effectiveness of the PAEA. In this 701 Report, the Commission has identified areas where adjustments to postal laws could address key issues including the Postal Service's current liquidity crisis. It expects to conduct a more in depth review of the Postal Service's Market Dominant system of ratemaking in its Section 3622 Review.

Section 701 Report Recommendations

- The Commission recommends that Congress amend the current required RHBF prefunding level to comport with standard industry practice in both private and public sectors.
- The Commission recommends lengthening the amortization period of the current unfunded liability.
- The Commission recommends that Congress grant the Postal Service the authority to use available FERS surpluses to pay off current or future liabilities.
- With clearly defined and limited exceptions, the Commission recommends establishing a "soft floor" (a lower limit subject to certain exceptions) on worksharing discounts, which would benefit the postal community by providing appropriate pricing signals to incentivize efficient mail preparation.
- The Commission again recommends that the definition of a post office be clarified to adopt the plain meaning of the term post office, inclusive of branches and stations.
- The Commission recommends clarification on whether CPUs and nonpostal operation units also fall under the Commission's administrative review authority under section 404(d).
- The Commission recommends consideration of the duration of emergency suspensions of post offices.
- The Commission recommends that Congress consider clarifying under which circumstances the Postal Service is required to consult with the Commission when making proposed service standard changes.
- The Commission recommends that Congress clarify the meaning of section 3691 and the requirement that the Postal Service set service standards "in consultation with" the Commission.
- The Commission recommends that if the Postal Service is permitted to offer new nonpostal services, proposed nonpostal services be subject to the same regulatory review the Commission applied when reviewing existing nonpostal services pursuant to section 404(e)(3).
- The Commission recommends that where a proposed nonpostal service meets the statutory test, the Commission should have the authority to designate the service as a Market Dominant, Competitive, or experimental product.

- The Commission recommends that Congress consider adding language to 39 U.S.C. § 3661 that requires the Postal Service, upon receipt of the Commission's advisory opinion, and prior to implementation, to provide a written response to Congress addressing the Commission's recommendations.
- The Commission recommends that Congress consider raising the maximum revenue limitation on market test products thereby providing the Postal Service with more opportunities for advancement of new postal products to bolster revenue streams.
- The Commission recommends that Congress increase the maximum duration on market tests for experimental products.
- The Commission recommends Congress consider allowing the Postal Service to satisfy the requirements of section 3641(b)(2) by setting forth a reasonable basis for its belief that an experimental product would not cause market disruption.
- The Commission urges Congress to consider and balance all the features of universal service as part of any review of changes necessary to preserve a financially viable Postal Service.
- The Commission concurs with commenters that the postal industry and general public could benefit from an updated FTC Report with a more current accounting for the value of relevant legal differences between the Postal Service and its private competitors.

THOMAS J. MARSHALL
GENERAL COUNSEL
AND EXECUTIVE VICE PRESIDENT

UNITED STATES
POSTAL SERVICE

November 9, 2016

The Honorable Robert G. Taub
Acting Chairman
Postal Regulatory Commission
901 New York Avenue, NW, Suite 200
Washington, DC 20268-0001

Dear Chairman Taub:

Enclosed with this letter please find the Postal Service's comments on the report prepared by the Postal Regulatory Commission pursuant to Section 701 of the Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, 120 Stat. 3198, 3242-43. As you know, Section 701(b) requires that these comments be attached to the final report that the Commission transmits to the President and Congress. I look forward to reviewing the final report.

Sincerely,

Thomas J. Marshall

Enclosure

cc: Mr. Trissell

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POSTAL SERVICE COMMENTS TO THE COMMISSION'S SECTION 701 REPORT

The Postal Regulatory Commission's Section 701 Report is an important opportunity to apprise the President and Congress of the Postal Service's financial condition and to recommend measures "necessary to improve the effectiveness or efficiency of the postal laws of the United States."[1] The report that the Commission provided the Postal Service on October 20, 2016, takes that opportunity to highlight the Postal Service's dire financial condition, which results from a combination of declining mail volumes and legal constraints.[2] The Commission has sounded this alarm in other reports, and it does well to do so again here.

The Commission acknowledges that "the most important legislative recommendations the Commission can make relate directly to improving the financial condition of the U.S. Postal Service."[3] The Postal Service agrees. As it explained in its comments leading up to the Section 701 Report, the Postal Service must achieve financial stability in order to ensure the future of universal postal service and fulfill all of its legal obligations. However, current law leaves the Postal Service with inadequate tools to address the problems that loom before it, particularly (1) declining mail volumes, especially in high-contribution First Class Mail, coupled with rising delivery points; and (2) excessive benefits liabilities. Therefore, meaningful solutions will need to come from Congress, through the passage of postal reform legislation, and the Commission, through the replacement of the current price cap system with a more suitable regulatory structure upon conducting the ten-year review required under 39 U.S.C. § 3622(d)(3).

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[1] Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, § 701(a).

[2] Postal Regulatory Comm'n, Section 701 Report: Analysis of the Postal Accountability and Enhancement Act of 2006 (Oct. 20, 2006) [hereinafter "Section 701 Report"], at 1, 4-6.

[3] *Id.* at 1.

Regarding the topic of postal reform legislation, in its comments, and consistent with what it had "already developed and presented [to] Congress," the Postal Service offered a "a set of common-sense reforms that would put the Postal Service on a more stable financial footing, allowing for further innovation, investments, and growth for the Postal Service, and the mailing industry as a whole."[4] The reforms discussed by the Postal Service are:

1) Retiree health benefits (RHB) should be fully integrated with Medicare.
2) The RHB liability should be calculated using net claims costs, rather than premium costs, in accordance with sound actuarial practice.
3) RHB Fund assets should be invested prudently, as is the practice among other governmental retiree benefits funds.
4) The RHB funding target should be lowered from 100 percent to 80 percent.
5) Pension liabilities should be calculated on the basis of postal-specific economic and demographic assumptions.
6) Any current Federal Employees Retirement System (FERS) surplus should be used to pay down debt; future surpluses should be applied against pension or RHB liabilities or debt.
7) The amortization period for supplemental Civil Service Retirement System (CSRS) liability should be lengthened to match the period for RHB.
8) The exigent surcharge should be restored as a policy matter (regardless of whether the Commission-ordered rollback of the surcharge is a reasonable application of the current statute).
9) The Postal Service should be given increased flexibility to offer services to state and local governments, as well as new commercial nonpostal services that meet certain conditions (including approval by the Commission).[5]

[4] United States Postal Service Comments in Response to Order No. 3238, PRC Docket No. PI2016-3 (June 14, 2016) [hereinafter "USPS Comments"], at 17. Consistent with certain other parties, the Postal Service encouraged the Commission to defer matters implicated by the ten-year review to the review itself, rather than addressing such matters in its Report. *Id.* at 26-27. The Commission prudently determined to follow this course of action. Section 701 Report at 2-4, 10.

[5] USPS Comments at 16-30.

Taken together, these reforms would "constitute significant progress towards financial sustainability of the Postal Service" and would reduce "the financial gap that will have to be reckoned with in the ten-year review of the market-dominant rate regulation system."[6] Many of these proposals also enjoy the support of a broad cross-section of postal stakeholders, as reflected in other parties' comments to the Commission.[7]

Despite its acknowledgment of the importance of recommendations aimed at improving the Postal Service's financial problems, and despite the presence of these and other substantive reform proposals in the comments that the Commission had solicited,[8] the Commission's report misses the opportunity to make any such "important legislative recommendations." Instead of offering the President and Congress with an analysis and endorsement of any up-to-date proposals, the Commission largely retreads its recommendations from 2011, few of which have garnered much support in the meantime. More to the point, almost none of the Commission's 17 recommendations would meaningfully improve the Postal Service's financial condition. Most of the recommendations amount to minor tinkering with the regulatory structure governing the Postal Service, rather than reforms that would materially mitigate

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[6] *Id.* at 18.

[7] *Id.* at 17-18; *see also* Comment of the National Association of Letter Carriers, AFL-CIO, PRC Docket No. PI2016-3 (June 20, 2016), at 1-8; Comments of the American Postal Workers Union, AFL-CIO, PRC Docket No. PI2016-3 (June 14, 2016), at 4; Comments of the Association for Postal Commerce, Major Mailers Association, and Saturation Mailers Coalition, PRC Docket No. PI2016-3 (June 14, 2016), at 2-3; Comments of the National Association of Presort Mailers, PRC Docket No. PI2016-3 (June 14, 2016), at 2-3; Comments of MPA-Association of Magazine Media and Alliance of Nonprofit Mailers, PRC Docket No. PI2016-3 (June 14, 2016), at 1-6; Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. Comments on Commission Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, PRC Docket No. PI2016-3 (June 14, 2016), at 6-7.

[8] The Public Representative also offered concepts that, while different from the proposals that other commenters advanced, would similarly appear to make a significant contribution toward improving the Postal Service's financial condition. Public Representative Comments, PRC Docket No. PI2016-3 (June 15, 2016), at 33-53.

expenses or enhance revenues. Of the three recommendations aimed at the Postal Service's staggering benefits costs, one (regarding pensions) would have only theoretical benefit, and the other two (regarding RHB) would only lower funding obligations without reducing the size of the liability that the Postal Service will ultimately have to cover, even though there are straightforward ways, consistent with universal practice among other employers, for that liability to be reduced. These comments explain why those three recommendations are inadequate, and will offer additional discussion about some of the Commission's other recommendations.

I. Reform of the Retiree Health Benefit Obligation

The Postal Service's Retiree Health Benefit ("RHB") reform proposals would, by integrating the Postal Service's retiree health program with Medicare, significantly reduce its liability in the Postal Service Retiree Health Benefits Fund (PSRHBF), and hence lower the Postal Service's normal cost payments and eliminate the need for large annual amortization payments to cover the unfunded RHB liability.[9] As the Postal Service explained, this action would harmonize the Postal Service's RHB obligations with best practices of private and other public employers, which uniformly integrate benefits fully with Medicare Parts A, B, and D. As part of this proposal to integrate with Medicare, the Postal Service also proposes to change the law to accord with actuarial principles, by having the RHB liability calculated based on net claims costs (rather than premiums), and by using a discount rate based on funding assumptions (rather than accounting standards).

[9] Beginning in FY2017, the Postal Service is obligated to make two payments in to the PSRHBF: (1) a normal cost payment, and (2) an amortization payment to address the unfunded accrued actuarial liability.

Furthermore, the Postal Service also proposes to better align its RHB funding obligations with the private sector in two other ways, by investing a portion of fund proceeds in diversified portfolios rather than exclusively in low-yield Treasury securities, and by funding 80 percent of the RHB liability, rather than 100 percent. In both of these respects, the Postal Service's proposal is much more modest than what is done by other private and public employers; for instance, other employees that provide retiree health benefits prefund a far lower portion of their RHB liabilities than the Postal Service is currently required to do, or even what the Postal Service would do under its proposal.

A host of other commenters – mailing industry and labor alike – lent their support to these common-sense proposals. Inexplicably, however, the Commission has chosen not to support Medicare integration, but to recommend only two RHB reforms:

1) Lengthen the amortization period for the unfunded liability beyond the current 40-year schedule; and

2) Adjust the funding target from 100 percent of RHB liabilities to an unspecified "level in line with industry norms."[10]

Legislative reform regarding RHB that is limited solely to an extension of the amortization schedule and a reduced funding level would reduce the Postal Service's funding obligations in the near term as compared to current law, but would do nothing to address the central problem: the excessive, unaffordable, and unsustainable RHB liability. As the Postal Service pointed out in its comments, "retiree health benefits are real obligations [for which] there must be a reckoning, or else there will be no money to pay for retirees' promised benefits."[11] Under current law, the costs of the Postal Service's RHB program are excessive, due to the fact that a significant proportion of

[10] Section 701 Report at 6-7.

[11] USPS Comments at 18.

postal annuitants fail to enroll in Medicare when they become eligible, even though the Postal Service and its employees have paid into Medicare for decades. Ultimately, those costs will have to be paid by the Postal Service, either by setting money aside in the PSRHBF or by directly covering annuitant premiums after the PSRHBF is exhausted due to a lack of adequate inflows from the Postal Service's payments to the Fund (under current law, if the PSRHBF is exhausted, the obligation to pay annuitant premiums reverts back to the Postal Service).[12] However, in the future, the Postal Service will have even less mail volume than it does today, and hence less ability to cover those costs. This would, in turn, raise the prospect that at some point there will either be a cessation of promised benefits or a cash infusion from taxpayer funds to cover those benefits, contrary to the fundamental statutory policy that the Postal Service be self-sufficient. Alternatively, ratepayers will have to make up the difference.

To be sure, the Postal Service agrees that the prefunding level should be adjusted: as noted above, it is one of the elements of the Postal Service's proposal to lighten the unreasonable and crushing RHB prefunding burden. Indeed, both the Postal Service's proposed 80-percent funding level and the Commission's hypothesized 50- to 70-percent levels are far above "industry norms." Almost two-thirds of Fortune 1000 companies prefund 0 percent of their RHB liabilities, and the remaining third prefunded

[12] In its earlier comments, the Postal Service pointed out that, if it is unable to make normal cost and amortization payments into the RHB Fund, "the fund could run out of money in a little over a decade." *Id.* at 19. The Congressional Budget Office (CBO) recently underscored this point with its estimate that, under a current law baseline, the RHB Fund would exhaust Treasury balances by 2026 if 25 percent of fund assets were removed from the Treasury in 2017 for investment in non-Treasury funds. Cong. Budget Off., Cost Estimate: H.R. 5707, Postal Service Financial Improvement Act of 2016 (Oct. 20, 2016), at 2, *available at* http://go.usa.gov/xksPn. If those assets were kept in the RHB Fund (as is the expectation under current law), the CBO estimate suggests that exhaustion would likely occur in 2028. Of course, making smaller payments under a longer amortization schedule and reduced funding target would lengthen the amount of time before the PSRHBF would run out of money, but eventually it would still occur.

at a median level of only 23 to 37 percent between 2001 and 2010.[13] Thus, the overall average level of prefunding across all Fortune 1000 companies was only approximately 9 to 14 percent during that period. State governments and the Department of Defense prefund only about 30 percent of their liabilities.[14] Moreover, all of those employers have already reduced their liabilities through full Medicare integration; if normalized to the Postal Service's situation (which lacks full Medicare integration), the prefunding-level benchmarks would be even lower. Hence, "standard industry practice" would dictate funding levels well below what the Postal Service's proposal or the Commission's report contemplates.

However, simply lowering the prefunding level, without more, only kicks the can down the road without solving the underlying problem—the excessive, unaffordable costs of the Postal Service's RHB program—which cannot be ignored over the long term. That is why the Postal Service has proposed to tackle the costs of the RHB program, through Medicare integration. The Commission's approach, by contrast, elides the essential problem, which is ultimately puzzling because Medicare integration, supported by the mailing industry and labor, constitutes a straightforward and appropriate way of tackling the RHB liability itself, thereby putting the Postal Service's RHB program on a sound financial footing. Therefore, instead of implementing reforms that are limited solely to what the Commission is recommending, the President and Congress should instead implement the comprehensive combination of reforms that the Postal Service has proposed and industry and labor stakeholders have endorsed.

[13] USPS Comments at 22.

[14] *Id.*

II. Pension Reform

Another major contributor to the Postal Service's financial predicament are its artificially burdensome pension obligations. As the Postal Service explained in its earlier comments:

> The Postal Service is required to fund 100 percent of its total pension liabilities and has achieved 92.2 percent funding as of FY2015, far more than private-sector and state and local government employers and four times more than the rest of the federal government. Like the RHB Fund, assets are invested solely in low-yield Treasury securities, rather than higher-yielding diversified portfolios. Moreover, [the Office of Personnel Management (OPM)] calculates pension liabilities not on the basis of demographic and salary-growth assumptions relevant to postal employees, but on the basis of assumptions concerning the entire federal workforce. Finally, there is no provision to return overpayments in FERS to the Postal Service. Needless to say, no rational self-funded employer that still provides a defined-benefit pension plan would design such a funding scheme.[15]

The Postal Service has proposed three remedies that seek to mitigate the costs of its statutorily required participation in the Federal Employees Retirement System ("FERS") and the Civil Service Retirement System ("CSRS"):

1) Require OPM to calculate pension liabilities on the basis of postal-specific economic and demographic assumptions.

2) After recalculation of the liability, apply any current FERS surplus against outstanding debt, and any future surpluses against pension or RHB liabilities or debt.

3) Lengthen the amortization period for the supplemental CSRS liability to match the RHB amortization period. This measure alone would cut the annual CSRS payment almost in half.

[15] *Id.* at 23.

Instead of this comprehensive, common-sense, and consensus set of reforms, the Commission's report contemplates only the second measure: using FERS surpluses to offset other obligations.[16]

The asymmetry in FERS between the treatment of supplemental liabilities (which must be covered by the Postal Service through a series of amortization payments) and surpluses (which cannot be recouped by the Postal Service in any way) is undoubtedly important. By itself, however, this reform would no longer offer any real relief. Over the past few years, what was once a projected FERS surplus has turned into a supplemental liability to be amortized at an estimated $0.2 billion per year, as calculated by OPM using government-wide assumptions.[17]

The bigger issue with pensions is that the FERS liability and the greater CSRS liability are calculated unfairly on the basis of the federal workforce as a whole. No reasonable employer would calculate its pension liabilities by reference to other employers' workforce. It is therefore critical that any legislative reform require OPM to utilize postal-specific assumptions when calculating the Postal Service's pension liabilities, to ensure that the Postal Service is not obligated to pay more than is necessary.[18] In addition, the amortization period for CSRS should be lengthened to at least a period consistent with the RHB amortization schedule established in current law, in the interest of consistency among the Postal Service's post-retirement benefits

[16] Section 701 Report at 7.

[17] USPS Comments at 7, 24.

[18] Even if postal-specific assumptions were used to calculate the Postal Service's liabilities, the FERS surplus would now be modest. Therefore, a move to postal-specific assumptions would not lead to a large infusion of cash. Rather, the primary benefit of moving to postal-specific assumptions is to ensure that, moving forward, the Postal Service's pension liabilities are appropriately calculated, and payments to OPM are no larger than necessary.

obligations. Without these reforms – which the Commission's report neglects – the Postal Service will bear $3.2 billion more in expenses over the next five years than if Congress adopted the Postal Service's legislative proposal.

III. Product and Pricing Issues

The Postal Service is disappointed that the Commission declined the opportunity to urge the President and Congress to restore the recently expired exigent surcharge, at least pending the outcome of the ten-year review. As the Postal Service explained in its initial comments, Commissioners themselves have recognized that it would make sense for Congress, as a policy matter, to ameliorate the Postal Service's financial distress by allowing a longer exigent price increase.[19] The point of disagreement has always been over whether such a price increase is consistent with the specific terms of the current exigency provision, but Congress, unlike the Commission, is free to change the statute in the interest of providing much-needed financial relief.

Beyond this critical omission, the Postal Service agrees with many of the Commission's recommendations on products and pricing. The Postal Service agrees with the Commission's determination that the problems with the market-dominant price cap can and will be addressed in the upcoming ten-year review.[20] The Postal Service also appreciates that the Commission's recommendation that any new authority to offer nonpostal services be subject to reasonable regulation[21] aligns with the consensus proposal advanced by the Postal Service and numerous other labor and industry stakeholders. The President and Congress would also do well to consider the

[19] USPS Comments at 27-28.

[20] Section 701 Report at 2, 10.

[21] *Id.* at 26-27.

Commission's recommendations to allow the Postal Service greater leeway to experiment through market tests.[22]

However, the Postal Service believes that the Commission's recommendation on workshare discounts is counterproductive, for the reasons noted below. In addition, the recommendations on negotiated service agreements (NSAs) bear some clarification.

A. Workshare Discounts

The Commission's report identifies the current statute's prohibition on workshare discounts that exceed 100 percent of the Postal Service costs avoided through the worksharing activity (subject to certain exceptions).[23] The Commission goes on to recommend that Congress add a "soft floor": that is, a prohibition on workshare discounts less than 100 percent of avoided costs (subject to unspecified but "limited" exceptions).[24] In other words, the Postal Service would have to set (and periodically adjust) workshare discounts to pass through exactly 100 percent of avoided costs, with no room for business judgment, in almost all cases.

Despite the Commission's appeal to efficiency, the true effect of such a mechanistic requirement would be to dramatically reduce the Postal Service's pricing flexibility, without enhancing revenue or contribution. It is possible that raising discounts (in other words, lowering prices) further might lead some new actors to engage in worksharing, which would promote some efficiency in the market. However, any modest incremental gain would be overwhelmed by the enormous subsidy that the Postal Service would be forced to hand over to businesses that already find it

[22] *Id.* at 32-34.

[23] *Id.* at 9-11.

[24] *Id.* at 10-11.

worthwhile to workshare at current prices, even with less than 100 percent of avoided costs being passed on to them.

Such a recommendation is hard to square with the Commission's professed appreciation for the overwhelming importance of improving the Postal Service's financial condition – particularly given that the Commission's report devotes little space to recommendations that would actually make a meaningful contribution to that goal.[25] So long as the Postal Service's condition is so dire, then the time is simply not ripe to entertain (let alone focus disproportionately on) ways for Congress to hem in the Postal Service's ability to maintain revenue and contribution.

B. Negotiated Service Agreements

The Postal Service agrees with the Commission's assessment of the current process and legal standards for competitive Negotiated Service Agreements ("NSAs") and the treatment of non-public information: namely that the status quo is adequate and requires no statutory change.[26]

With respect to domestic market-dominant NSAs, the Commission proposes that Congress "clarify whether the more stringent standard set forth in 39 U.S.C. § 3622(c)(10) that the agreement 'improve the net financial position' of the Postal Service is still intended."[27] Instead, the Commission suggests that the standard could be harmonized with the attributable-cost-coverage standard for competitive NSAs, which the Commission views as less onerous and as "providing the Postal Service with increased opportunities to experiment with its pricing, with a goal towards designing

[25] *Id.* at 1.

[26] *Id.* at 17-18.

[27] *Id.* at 18.

domestic Market Dominant NSAs that ultimately result in an improved financial position."[28]

The Postal Service takes no position on this recommendation. However, it wishes to emphasize that any benefits of the Commission's recommendation only apply in the context of domestic market-dominant NSAs. For international market-dominant NSAs, the existing "improve net financial position" standard is clearly appropriate, and a "cover attributable costs" standard would actually be counterproductive, not liberating. International market-dominant NSAs consist of agreements with foreign posts to exchange mail at negotiated rates, rather than the default rates established in treaty instruments of the Universal Postal Union. Those default rates have historically failed to cover the Postal Service's costs of delivering inbound international mail. Therefore, the Postal Service has sought to improve its financial condition by negotiating higher rates for inbound international mail (in exchange for accepting higher rates for outbound international mail).[29] Given the lower default rates, however, the Postal Service is ill-positioned to achieve negotiated rates that fully achieve attributable-cost coverage. If the Postal Service were required to do so, the paradoxical result would be that foreign posts would prefer to stick with non-remunerative default rates rather than agreeing to the high price increases necessary for the Postal Service to cover attributable costs. Thus, a "cover attributable costs" standard for international market-dominant NSAs would actually worsen the Postal Service's net financial position.

[28] *Id.*

[29] Under longstanding practice since the PAEA, only the inbound half of this reciprocal rate relationship is subject to regulation as an NSA "product." The outbound rates represent costs to the Postal Service and are reflected in the financial analysis of outbound international products like First-Class Mail International.

IV. Service Issues

A. Contractor-Operated Retail Facilities

The Commission's report recommends "clarification on whether [Contract Postal Units] and nonpostal operation units also fall under the Commission's administrative review authority under [39 U.S.C. §] 404(d)."[30] There is a good reason why Post Office discontinuance laws and procedures have not been broadly expanded to contractor-operated facilities. As the Postal Service has repeatedly warned the Commission, doing so would interfere with the Postal Service's operational efficiency and business relationships by giving contractors undue leverage in negotiations. Congress has never intended the Commission to function as a board of contract appeals, overseeing the Postal Service's relationships with its suppliers. The Postal Service would only support "clarification" if it maintains these well-established boundaries.

B. Consultation Regarding Service Standard Changes

The Commission's report recommends that "Congress should clarify [39 U.S.C. § 3691] as to whether consultations with the Commission are required for proposals to change service standards," or only for proposals to establish new service standards. The Commission would also prefer clarification as to what degree of "consultation" is required.[31]

Whatever theoretical ambiguities might exist, actual practice should dispel any concern. Since the Postal Accountability and Enhancement Act (PAEA) introduced the relevant provision, the Postal Service has sought advisory opinions from the Commission under 39 U.S.C. § 3661 for all changes to service standards for its market-

[30] *Id.* at 21.

[31] *Id.* at 24-25.

dominant products, all of which affected service on a "nationwide or substantially nationwide" basis. Whatever "consultation" might mean, the process of a months-long back-and-forth between the Postal Service and Commission and the eventual issuance of an advisory opinion obviously fulfills that standard; if anything, it far exceeds it.

Thus, the ambiguities to which the Commission adverts only affect changes in service standards for market-dominant products that would have a purely local effect (for instance, a hypothetical change in the service standard for First-Class Mail between Hawaii and Guam). This scenario has not arisen in the decade since the PAEA. If it were to arise in the future, the Commission would be made aware of it and have an opportunity to present its views to the Postal Service. As such, it is difficult to see why this issue merits inclusion in the Commission's report.

C. Advisory Opinion Proceedings

The Commission asks Congress to require the Postal Service to provide a written response to Commission advisory opinions on nationwide service changes.[32] In essence, the Commission would like Congress to single out one preferred piece of the threefold reforms that the Senate passed in 2011 and that Senator Thomas Carper has included in more recent postal reform bills.[33] These provisions would (1) impose a statutory 90-day time limit on advisory opinion proceedings, (2) eliminate the antiquated requirement for a hearing on the record, and (3) require a Postal Service response to the Commission's advisory opinion. The Commission's exclusive focus on the third element would elevate the desire for additional regulation of the Postal Service over the

[32] *Id.* at 30.

[33] *See* S. 1789, 112th Cong. § 208 (passed Senate 2012); S. 2051, § 407 (introduced 2015).

equal, if not greater, need for reforms that would make the entire advisory opinion exercise more timely and relevant.

In an apparent attempt to obviate the need for a statutory time limit, the Commission touts its own undertaking to streamline advisory opinion proceedings.[34] The Commission's rules have yet to be tested in practice, but the Postal Service is hopeful that they will have the intended effect of allowing for more timely and relevant advisory opinions. However, what the Commission's report fails to acknowledge are the numerous loopholes that threaten to allow advisory opinion proceedings to extend well beyond the aspirational 90-day goal. That concern is particularly palpable for situations when the issue is the very sort of significant network changes that have drawn out advisory opinion proceedings in the past and, consequently, drawn frustration from the Postal Service and Members of Congress seeking more timely analysis. Thus, it may well be that the Commission's rule changes will not result in any real improvement in advisory opinions' timeliness. A statutory time limit is essential, and it would be in keeping with the firm statutory deadlines on most other Commission proceedings.[35]

Equally essential is the elimination of the requirement for formal hearings on the record. Although the Commission's report acknowledges the difficulty of streamlining proceedings under a formal-hearing requirement,[36] the Commission fails to take the logical next step of recommending that that requirement be abolished. This degree of formality is a relic from the pre-PAEA regulatory model, whereas the PAEA updated and

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[34] Section 701 Report at 29-30.

[35] *E.g.*, 39 U.S.C. § 404(d)(5) (120 days for Post Office closing appeals); *id.* § 3622(d)(1)(C) (45 days for market-dominant price adjustments); *id.* at (d)(1)(E) (90 days for exigent price adjustments); *id.* § 3632(b)(3) (15 days for competitive rates or classes not of general applicability); *id.* § 3641(c)(1) (30 days for market tests); *id.* § 3653 (90 days for annual compliance determination).

[36] Section 701 Report at 30.

streamlined every other form of postal regulatory proceeding.[37] If notice-and-comment procedures provide adequate due process on such complex matters as exigent rate increases and annual compliance determinations, which result in binding orders, then it is baffling why more burdensome and time-consuming procedures should be necessary for the Commission to issue a non-binding advisory opinion. Removing the requirement for a formal hearing on the record would update this outlier provision of postal law to allow for more timely and relevant advisory opinions while ensuring the same level of due process that has sufficed in all other postal regulatory settings.

V. Conclusion

The Postal Service's dire financial condition puts in peril its ability to provide universal service to the nation and meet its other legal obligations, absent legislative and regulatory change. Significant revisions to the PAEA are needed to enable the Postal Service to restore itself to financial solvency. Improving the Postal Service's financial stability in both the short-term and the long-term requires more comprehensive changes than are discussed in the Commission's report.

[37] Indeed, formal-hearing requirements appear to be antiquated in general. A search of post-PAEA Acts of Congress revealed not a single instance (other than in enforcement contexts) where Congress saw fit to introduce a requirement for an agency to hold hearings on the record.

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EXECUTIVE SUMMARY

This marks the Postal Regulatory Commission's (Commission) second report under section 701 of the Postal Accountability and Enhancement Act (PAEA) of 2006. Every 5 years the Commission is required to issue a report and its first one was submitted to Congress and the President in 2011 (2011 Report). In general, the reports are to reflect the Commission's assessment of how well the PAEA is operating and is an opportunity to recommend legislation or other measures necessary to improve the effectiveness and efficiency of our Nation's postal laws.

The Commission's 2016 report, like its 2011 Report, emphasizes the starkly different environment faced by the Postal Service since the PAEA's enactment in 2006 – a time when volume was growing and the Postal Service was earning revenues that exceeded costs. Today, the Postal Service faces the reverse: mail volume that has declined more than 25 percent since 2006 coupled with a total net loss of $5.1 billion in FY 2015 - despite an exigent surcharge that generated an additional $2.1 billion in revenue.

Twice this year, the Commission was invited to provide testimony at congressional hearings focused on the steadily deteriorating financial condition of the U.S. Postal Service. Specifically, the Commission was asked to share with the Senate and House oversight committees key findings of its annual *Financial Analysis of U.S. Postal Service Financial Results.* Testimony delivered by Acting Chairman Taub described the fundamental problems facing the Postal Service: a growing liability for retiree health benefits; an inability to borrow for needed capital investments, such as new delivery vehicles and package sortation equipment; and the continued loss of high margin First-Class Mail revenues.

This fiscal year total net loss as of June 30, 2016, was $3.3 billion compared to a net loss of $2.8 billion for the same period last year, a deterioration of $0.5 billion. For this same time period, the Postal Service's total liabilities exceeded the total value of its assets by $53.7 billion. The Postal Service has recorded monthly net operating losses since the expiration of the exigent surcharge in April this year; and working capital for the 9 months which ended June 30, 2016, was negative $43.3 billion. The net deterioration of $2.3 billion in working capital from the beginning of the fiscal year was largely due to the growth in employee-related liabilities, including the statutory accruals for payments into the Retirement Health Benefits Fund (RHBF).

It is clear, the most important legislative recommendations the Commission can make relate directly to improving the financial condition of the U.S. Postal Service. While this year's 701 report will again discuss and make recommendations related to certain rate and

service matters, along with improvements to Commission processes, the Commission places a particular emphasis upon the following recommendations:

- The Commission renews its recommendation from its 2011 Report that Congress modify the retiree health benefits fund prefunding level and payment schedule as a measure to improve Postal Service sustainability. Decreasing the funding target to one more in line with industry norms would provide much needed improvement in the Postal Service's assets to liabilities ratio.
- The Commission recommends lengthening the amortization period of the current unfunded liability. The current amortization period is 40 years. Extending the amortization period would free significant capital by reducing Postal Service annual payments.
- Further improvement in liquidity could be provided by allowing the Postal Service to use any available Federal Employees Retirement System (FERS) surplus, rather than requiring the surplus to be transferred to the RHBF. The Commission, therefore, recommends that Congress grant the Postal Service the authority to use available FERS surpluses to pay off current or future liabilities, including debt to the U.S. Treasury, pension liabilities, and retiree health benefit liabilities.

Finally, it must be noted that the timing of this report coincides closely with a significant Commission undertaking. By law, after December 20, 2016, the Commission shall commence a review of the price cap system for regulating Market Dominant products. The purpose is to determine whether the system is achieving its statutory objectives and if it is not, to "make such modification or adopt such alternative system" to achieve the objectives. Considering the breadth of this review, certain postal rate matters that would normally be addressed in this report will be deferred for consideration in December's review.

In this report, the Commission also details a variety of other recommendations for possible changes to discreet rate, service, and regulatory matters or processes. All of the Commission's recommendations are listed in Appendix A.

On October 20, 2016, the Commission sent its report to the Postal Service for review and an opportunity to comment, consistent with Section 701 of PAEA. On November 9, 2016, the Postal Service sent back its comments, which are attached at Appendix B.

I. EVALUATION OF THE PAEA AMENDMENTS AND RECOMMENDATIONS FOR LEGISLATIVE CHANGE

A. Introduction

Every 5 years, the Postal Regulatory Commission (Commission) is required to:

> (a) [S]ubmit a report to the President and Congress concerning—(1) the operation of the amendments made by [PAEA]; and (2) recommendations for any legislation or other measures necessary to improve the effectiveness or efficiency of the postal laws of the United States.

Pub. L. 109-435, 120 Stat. 3198 (2006).[1] Additionally, PAEA section 701(b) requires the Commission to afford the Postal Service a reasonable opportunity to review the report and submit written comments.

This report marks the second section 701 report to the President and Congress. The first section 701 report was submitted in 2011 (2011 Report).[2] The recommendations of the 2011 Report are summarized in section II, below. In addition, on April 14, 2016, the Commission issued a notice seeking public comment on issues the Commission should consider in the current 701 report, and those comments are reviewed in section II as well.[3] Because we are in the tenth year since the passage of the PAEA, the timing of this report occurs adjacent to another significant Commission undertaking, the review of the system for regulating rates and classes for Market Dominant products required by 39 U.S.C. § 3622(d)(3) (Section 3622 Review). As a result, some of the areas previously addressed by

[1] Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006), section 701.

[2] *Postal Regulatory Commission, Section 701 Report*, Analysis of the Postal Accountability and Enhancement Act of 2006, September 22, 2011 (2011 Report).

[3] Docket No. PI2016-3, Notice and Order Seeking Comments on Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, April 14, 2016 (Order No. 3238).

the Commission in the 2011 Report will instead be covered during the Section 3622 Review.

B. Postal Service Financial Situation

1. Introduction and Background

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

The Commission requires the Postal Service to file monthly, quarterly, and annual reports regarding its financial results. *See* 39 C.F.R. part 3050. Until FY 2014, the Commission addressed the overall financial health of the Postal Service in the Annual Compliance Determination (ACD). However, given the time frame for conducting the ACD, the Commission determined that a detailed analysis of Postal Service financial data would be better served by a separate analysis. In FY 2013, the Commission developed a separate annual financial analysis report to provide a more detailed analysis of the Postal Service's financial position. The annual financial report reviews the overall financial position of the Postal Service, as well as volumes, revenues, and costs of both Market Dominant products and Competitive products.[4] The report also analyzes the Postal Service's profitability, solvency, activity, and financial stability using accounting ratios.[5]

As reported in the Commission's FY 2015 Financial Report, the Postal Service had a net loss of $5.1 billion in FY 2015. FY 2015 Financial Report at 7. This marks the ninth consecutive net loss posted since FY 2007, increasing the cumulative net deficit since FY 2007 to $56.8 billion.[6] These losses have reduced the Postal Service's liquidity. *See* FY 2015 Financial Report at 25. At the end of FY 2015, the Postal Service's current net assets totaled $7.9 billion, while its current liabilities totaled $48.9 billion.[7] This gap is the result of a multitude of factors including the continuing decline in the volume of Market Dominant products, and high personnel-related expenses.

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[4] *See* Postal Regulatory Commission, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement*, Fiscal Year 2015, March 29, 2016 (FY 2015 Financial Report).

[5] The *Financial Analysis Report* examines the Postal Service's Altman-Z score, which is a compilation of financial ratios developed by New York University Professor Edward Altman, as a tool to gauge an entity's long-term viability. *See* FY 2015 Financial Report at 84.

[6] *See* United States Postal Service, *Annual Report on Form 10-K for the Fiscal Year Ended September 30, 2015*, at 32 (Annual Report on Form 10-K).

[7] *Id.* at 24. Table 11-7. $6.9 billion of the current net assets was cash or cash equivalents. *Id.*

From FY 2007, the total volume for Market Dominant products has declined by 60.4 billion pieces. *Id.* at 37, Figure III-1. The volume decline was precipitated by a long-term trend of mail migrating to electronic media and exacerbated by the economic recession that began in December of 2007. The Postal Service states that the volume lost to electronic media is not expected to return, as the migration represents a fundamental and permanent change in mail use by households and businesses.[8] The decline in First-Class Mail volume, a 4.3 percent average annual rate of decline since FY 2007, is particularly troubling because First-Class Mail contributes the most revenue to the Postal Service's total overhead costs. *See* FY 2015 Financial Report at 37; Appendix A.

The Postal Services also faces the challenge that its personnel-related obligations include off-balance sheet items not recognized in the Postal Service's financial statements. FY 2015 Financial Report at 30. These items include costs for unfunded liabilities in both the Civil Service Retirement and Disability Fund (CSRDF) and the Postal Service's Retirement Health Benefits Fund (RHBF). *Id.*

The CSRDF provides pension benefits to retired and disabled Federal employees, including Postal Service employees covered by the Civil Service Retirement System (CSRS) and Federal Employee Retirement System (FERS). Both the CSRS and FERS pension plans had unfunded Postal Service liabilities in FY 2014. *Id.* at 31.[9] In FY 2015, OPM directed the Postal Service to pay an additional $241 million per year for 30 years to eliminate the unfunded portion of the FERS liability. Annual Report on Form 10-K at 22. Beginning in FY 2018, the Postal Service must begin making actuarial payments on the unfunded CSRDF liability. 5 U.S.C. § 8348(h)(2)(B).

The PAEA established the RHBF to fund the long-term retiree health benefits for postal employees, retirees, and their survivors. Like CSRS and FERS, the RHBF is administered by OPM. *See* 2011 Report at 19-20. The initial funding of $17.1 billion was transferred from the CSRS surplus at the end of FY 2006. FY 2015 Financial Report at 32. The PAEA requires the Postal Service to contribute annual payments to the fund averaging $5.2 billion per year, added to the annual government share of retiree health benefit premiums. *Id.* at 31. The Postal Service has not made its annual contribution to the fund since FY 2010. *Id.* at 32. Each year since FY 2007, OPM has determined the increase in the retiree health benefit liability and the funding status of the RHBF. The defaulted payments are accrued and reported as a current liability on the Postal Service's balance sheets. Through FY 2015, the

[8] United States Postal Service, Ensuring a Viable Postal Service for America: An Action Plan for the Future, March 2, 2010, at 4.

[9] In 2017, the Office of Personnel Management (OPM) must determine the funding status of CSRS, and any surplus must be transferred to the RHBF. However, if there is an unfunded liability, which appears to be increasingly likely, OPM must develop a 30 year amortization of the unfunded liability, which the Postal Service will have to begin paying in FY 2017.

Postal Service missed a total of $28.1 billion in payments, and owes $5.8 billion for FY 2016. *Id.* This current liability contributes significantly to the Postal Service's negative working capital. As of FY 2015, the defaulted RHBF payments made up 57 percent of the Postal Service's current liabilities, substantially impacting the Postal Service's liquidity and overall sustainability. *Id.* at 77.

In FY 2017, the funding of the RHBF will change by law. The Postal Service will be required to fund the RHBF with amortized payments consisting of the normal cost, plus the unfunded portion of the RHBF liability. 5 U.S.C. § 8909a(d)(3)(b). With this change, the RHBF, rather than the Postal Service, will pay the annual government share of the postal retiree health benefit premiums. FY 2015 Financial Report at 32.

2. Commission Recommendations

In the 2011 Report, the Commission recommended that Congress adjust the current RHBF payment schedule. 2011 Report at 21. The Commission noted that the financial condition of the Postal Service had dramatically changed since the passage of the PAEA. *Id.* Five years later, the Postal Service remains unable to achieve the financial stability contemplated by the PAEA. The Commission urges Congress to consider the Postal Service's current financial situation, as fully discussed in the Commission's annual financial analysis reports.

The Commission renews its recommendation from the 2011 Report that Congress modify the retiree health benefits prefunding level and payment schedule as a measure to improve Postal Service sustainability. As noted by several commenters, the Postal Service is faced with a unique requirement to fund 100 percent of its retiree health benefits liability. The Commission supports decreasing the funding target to one more in line with industry norms as a means of improving Postal Service liquidity and solvency. The Commission recommends that Congress amend the current required prefunding level to comport to standard industry practice in both private and public sectors.

In its 2011 Report, the Commission provided estimated statutory payments for FY 2011 through FY 2016 for funding levels of 50, 60, and 70 percent. 2011 Report at 24. The forecasted scenarios resulted in higher funding levels than private sector and other public entities, while also provided a significant reduction in estimated liabilities. *Id.* at 23-24. If Congress adjusts the prefunding level in the near term, the Postal Service would likely receive a comparable cash benefit. While the Commission does not endorse a particular funding level in line with industry norms, it anticipates that any reduction in the RHBF prefunding target would provide needed improvement in the Postal Service's assets to liabilities ratio.

Relief from the 100 percent prefunding target would provide the Postal Service some flexibility to make needed capital investments.[10] In addition to reducing the prefunding target, the Commission further recommends lengthening the amortization period of the current unfunded liability. The new payment schedule for the current unfunded liability begins in FY 2017. The current amortization period is 40 years. FY 2015 Financial Report at 31-32. Extending the amortization period would free significant capital by reducing Postal Service annual payments.

Further improvement in liquidity could be provided by allowing the Postal Service to use any available FERS surplus, rather than requiring the surplus to be transferred to the RHBF. The Commission recommends that Congress provide this flexibility, as it may help restore the Postal Service's borrowing capability. A FERS surplus could first be paid toward the Postal Service's debt to the U.S. Treasury, and after that debt was paid off, any remaining or future surplus could be applied to pension liabilities, retiree health benefit liabilities, or other general debt. The Commission recommends that Congress grant the Postal Service the authority to use available FERS surpluses to pay off current or future liabilities. 2011 Report at 19-21.

C. Market Dominant Rate System

1. Introduction and Background

The Commission analyzes three general categories of the Market Dominant rate system: the price cap, the recent exigent surcharge removal, and workshare discounts.

a. Price Cap

The PAEA created a new system for regulating rates and classes for Market Dominant products, a departure from the previous cost-of-service ratemaking system under the Postal Reorganization Act of 1970 (PRA). The current system provides for an annual limitation in the percentage change in rates for each class of Market Dominant mail. 39 U.S.C. § 3622(d)(1). In general, the average rate increase for mail within a class cannot exceed the increase in the Consumer Price Index for All Urban Consumers (CPI-U) unadjusted for seasonal variation in a given year (Annual Limitation). 39 U.S.C. § 3622(d)(1),(2). When the Postal Service elects to use less than its full authority in a given price adjustment, it may "bank" unused rate adjustment authority. It may subsequently use banked authority to adjust prices by more than the Annual Limitation. Any unused banked

[10] "The FY 2015 Integrated Financial Plan (IFP) included a capital investment budget of $1.5 billion for mail processing equipment, vehicles, and information technology." Total actual capital investments were $0.4 billion less than planned. *See* FY 2015 Financial Report at 2-3, n.9.

authority expires after 5 years. Banked authority must be used on a first-in-first-out basis, and for any class or service the rate adjustment authority used must not exceed the Annual Limitation by more than 2 percent. 39 U.S.C. § 3622(d)(2)(C).

The Postal Service must provide a schedule for rate changes at regular intervals and by predictable amounts. 39 U.S.C. § 3622(d)(1)(B). However, if no sufficient banked authority exists, the Postal Service may request a rate increase greater than the Annual Limitation on an expedited basis due to either extraordinary or exceptional circumstances. The Commission must determine whether the exigent price adjustment request is reasonable, equitable, and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. 39 U.S.C. § 3622(d)(1)(E).

b. History of Exigent Requests

The Postal Service first filed a request for exigent price adjustment in FY 2010 seeking to increase rates for Market Dominant products by 5.6 percent, on average.[11] After a public hearing and an analysis of the record, the Commission denied the exigent request.[12] The Commission found that although the Great Recession and its impact were an "extraordinary or exceptional circumstance", the Postal Service failed to demonstrate that the proposed rate adjustments were "due to" the Great Recession and also failed to quantify the impact of the recession on postal finances and relate that impact to the requested price adjustment. Order No. 547 at 50, 64. The Postal Service appealed the Commission's order to the U.S. Court of Appeals for the District of Columbia Circuit. Although the court concluded that the Commission correctly construed "due to" to require a causal relationship between the exigent circumstances' effects on the Postal Service and the amount of the above-cap rate increases, it remanded the exigent price adjustment decision, in part, for the Commission to address how closely an exigent price adjustment must financially offset the triggering extraordinary or exigent circumstance.[13] On remand,[14] the Commission concluded "that exigent rate adjustments are permitted only if, and to the extent that, they compensate for the net adverse financial impact of the exigent circumstances." Order No. 864 at 45. It also clarified the level of proof sufficient to demonstrate the causal nexus of the "due to" clause of section 3622(d)(1)(E) at 46-55.

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[11] Docket No. R2010-4, Exigent Request of the United States Postal Service, July 6, 2010.

[12] Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010 (Order No. 547).

[13] *United States Postal Service v. Postal Regulatory Commission*, 640 F.3d 1263 at 1264, 1268 (D.C. Cir. 2011).

[14] Docket No. R2010-4R, Order Resolving Issues on Remand, September 20, 2011 (Order No. 864).

The Postal Service subsequently renewed its request for an exigent rate adjustment on September 26, 2013.[15] This time, the Postal Service requested a 4.3 percent across-the-board increase to restore contribution lost as a result of the Great Recession. On December 24, 2013, the Commission found that the Postal Service was entitled to collect $2.766 billion in 2014 after-rates contribution as a result of losses incurred due to the Great Recession.[16] The Postal Service again petitioned the U.S. Court of Appeals for the District of Columbia Circuit for review of the Commission's order. The court's order largely affirmed the Commission's finding in Order No. 1926 but vacated the Commission's method for accounting for mail volume lost due to the exigent circumstance and it remanded the case to the Commission.[17] On remand,[18] the Commission found that the Postal Service was entitled to recover $1.191 billion in additional contribution in addition to the amount originally authorized. On August 28, 2015, the Postal Service filed a petition with the U.S. Court of Appeals for the District of Columbia Circuit for review of Order No. 2623. That petition is currently pending before the court.[19] On February 25, 2016, the Postal Service filed notice of its intention to remove the exigent surcharge from existing Market Dominant rates effective April 10, 2016.[20] The Commission approved the Postal Service's planned removal of the exigent surcharge on March 29, 2016.[21] The exigent surcharge was removed April 10, 2016.

c. Worksharing

Workshare discounts refer to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail. 39 U.S.C. § 3622(e)(1). These discounts provide reduced rates for mail prepared or entered to avoid certain activities that the Postal Service would otherwise have to perform. The amount of each discount is based on the estimated avoided costs that result from the mailer performing that activity. The Commission is responsible for ensuring that workshare discounts do not exceed the costs that the Postal Service avoids as a result of the worksharing activity. 39 U.S.C. § 3622(e)(2).

The passthrough, or the amount of discount relative to the cost avoided, may exceed 100 percent in four instances: if the discount is associated with a new postal service, change to

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[15] *See* Docket No. R2013-11, Renewed Exigent Request of the United States Postal Service in Response to Commission Order No. 1059, September 26, 2013.

[16] *See* Docket No. R2013-11, Order Granting Exigent Price Increase, December 24, 2013 (Order No. 1926).

[17] *Alliance of Nonprofit Mailers v. Postal Regulatory Commission*, 790 F.3d 186 (D.C. Cir. 2015).

[18] *See* Docket No. R2013-11R, Order Resolving Issues on Remand, July 29, 2015 (Order No. 2623).

[19] *United States Postal Service v. Postal Regulatory Commission*, No. 15-1297 (D.C. Cir. filed Aug. 28, 2015).

[20] *See* Docket No. R2013-11, Notice of the United States Postal Service of Removal of the Exigent Surcharge, February 25, 2016.

[21] *See* Docket No. R2013-11, Order No. 3186, Order on Removal of the Exigent Surcharge and Related Changes to the Mail Classification Schedule, March 29, 2016.

existing postal service, or with a new workshare initiative related to an existing postal service and is necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discounts in excess of the cost avoided will be phased out over time; if the amount of the discount above avoided costs is necessary to mitigate rate shock and will be phased out over time; if the discount is provided in connection with mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value; or if reducing or eliminating the discount would impede the efficient operation of the Postal Service. 39 U.S.C. § 3622(e)(2)(A)-(D).

2. Commission Recommendation

The Commission is required by statute to conduct a review, 10 years after enactment of the PAEA, of the modern system of regulating rates and classes for Market Dominant products pursuant to 39 U.S.C. § 3622(d)(3). The Commission intends to consider matters related to the Market Dominant system of rate making during its Section 3622 Review, including discussions regarding the price cap and other related matters.[22]

As for worksharing, the Commission recognizes that establishing a "soft floor" (a lower limit subject to certain exceptions) on worksharing discounts may eliminate inefficiencies caused by the Postal Service performing work that mailers may perform at a lower cost. If Congress chooses to establish such a requirement, the Commission notes that the Postal Service's concerns about pricing flexibility may be balanced with the goal of increased efficiency by allowing limited statutory exceptions to the soft floor requirement. These statutory exceptions would be modeled on the exceptions that currently exist for the worksharing discount "soft ceiling" (an upper limit subject to certain exceptions). Currently, the Postal Service may claim an exception for workshare discounts exceeding the costs avoided if:

> (A) the discount is (i) associated with a new postal service, a change to an existing postal service, or with a new work share initiative related to an existing postal service; and (ii) necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discount in excess of the cost that the Postal Service avoids as a result of the workshare activity will be phased out over a limited period of time;

[22] Press Release, Postal Regulatory Commission, PRC Announces Plan for 10-year Review of System of Regulating Rates and Classes for Market Dominant Products (September 1, 2016).

> (B) the amount of the discount above costs avoided (i) is necessary to mitigate rate shock; and (ii) will be phased out over time;
>
> (C) the discount is provided in connection with the subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value; or
>
> (D) reduction or elimination of the discount would impede the efficient operation of the Postal Service.

39 U.S.C. § 3622(e)(2).

With clearly defined and limited exceptions similar to those already in place for the workshare discount ceiling, the Commission notes that establishing a soft floor would be an enhancement to the PAEA that would benefit the postal community by providing appropriate pricing signals to incentivize efficient mail preparation.

D. Competitive Product Rate System

1. Introduction and Background

The PAEA tasks the Commission with determining whether a product offered by the Postal Service is Competitive or Market Dominant. Pursuant to 39 U.S.C. § 3642(b)(1), the Commission must consider whether "the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products." Products over which the Postal Service exercises such power are categorized as Market Dominant while all others are categorized as Competitive.[23] Competitive product prices are subject to Commission review for compliance with 39 U.S.C. § 3633.

The remainder of this section discusses three issues relevant to these statutory requirements including the "appropriate share" that Competitive products must contribute towards the Postal Service's institutional cost and the cost attribution methodologies used to determine compliance with 39 U.S.C. § 3633.

[23] Any product covered by the letter monopoly is categorized as Market Dominant regardless of market analysis, pursuant to 39 U.S.C. § 601 *et seq*.

a. Competitive Contribution to Institutional Cost

Pursuant to 39 U.S.C. § 3633(a), the Postal Service's Competitive prices must not result in those products' subsidization by Market Dominant products; ensure that each Competitive product covers its attributable costs; and ensure that all Competitive products collectively contribute an appropriate share of the institutional costs of the Postal Service. With regard to the third criterion, the Commission promulgated regulations to ensure that Competitive products, collectively, bear an "appropriate share" of the Postal Service's institutional costs. *See* 39 C.F.R. § 3015.7(c). At a minimum, every 5 years, the Commission is required to review its "appropriate share" regulation. 39 U.S.C. § 3633(b). The Commission may also eliminate the contribution requirement. *Id.* In Order No. 1449, the Commission conducted its first review of that regulation and determined the "appropriate share" should remain 5.5 percent of total institutional costs as initially set in FY 2007.[24]

b. Competitive Product Costing

Underlying the Commission's review pursuant to 39 U.S.C. § 3633(a) are the costs used by the Commission in its evaluation of cost coverages. Additionally, it relies upon the Postal Service's reported costs to ensure that the prices set by the Postal Service for its competitive products satisfy the prohibition against subsidization of Competitive products by Market Dominant products. The Commission has reviewed and implemented numerous methodological changes since FY 2007. Recently, in Docket No. RM2016-2, the Commission considered a cost attribution methodology proposed by United Parcel Service (UPS). UPS's proposed methodology in that docket sought to increase the costs attributed to products and, consequently, raise the price floor for Competitive products. The Commission's final decision on UPS's proposal is discussed in the recommendation section below.

2. Commission Recommendations

There have been several significant changes to Competitive products since the Commission's last review of the appropriate institutional cost share. The Commission has approved numerous additions to the competitive product list and transfers from the market dominant product list to the competitive product list (*e.g.,* Inbound Surface Parcel Post (at Universal Postal Union (UPU) rates),[25] Parcel Post,[26] Commercial Standard Mail

[24] *See* Docket No. RM2012-3, Order Reviewing Competitive Products' Appropriate Share Contribution to Attributable Costs, August 23, 2012 (Order No. 1449).

[25] Docket No. MC2014-28, Order No. 2160, Order Approving Product List Transfer, August 19, 2014.

[26] Docket No. MC2012-13, Order No. 1411, Order Conditionally Granting Request to Transfer Parcel Post to the Competitive Product List, July 20, 2012.

Parcels,[27] and Commercial First-Class Mail Parcels[28]). Additionally, since FY 2007, Competitive product volume and revenue have grown significantly.[29] Moreover, Competitive products represent a greater share of total volume than in FY 2007, when the appropriate share was set. As the Commission stated in Order No. 3506,[30] the Commission intends to consider changes to the appropriate share in the next 5-year review. No legislative change is necessary at this time on the issue of the appropriate institutional cost share as the Commission intends to review the appropriate share during FY 2016.

As for cost attribution methodology, the Commission considered the efficacy of the methodologies used to attribute costs to products in Docket No. RM2016-2. In Order No. 3506, the Commission concluded its consideration of the cost attribution proposals put forth by UPS. The Commission did not adopt UPS's proposal to incorporate all the variable costs in the costs attributable to individual products. Order No. 3506 at 3. However, the Commission recognized additional costs that are reliably identified and causally related but have not been previously attributed. In that Order, the Commission found that product-level and class-level incremental costs are attributable costs. *Id.* As a result, the Commission makes no recommendations requiring potential statutory changes to the cost attribution methodology.[31]

E. Negotiated Service Agreements

1. Introduction and Background

The Postal Service is empowered by the PAEA to enter into special agreements with mailers, including negotiated service agreements (NSA). From FY 2008 through July 2016, the Commission has reviewed 29 Market Dominant NSAs (4 domestic and 26 international) and 630 Competitive NSAs (265 domestic and 365 international). The Commission reiterates its statement from the 2011 Report that both Competitive and Market Dominant NSAs offer many potential benefits to the Postal Service and the mailing community. Below, the Commission discusses its experience with different types of NSAs, its current methods for providing access to non-public NSA information, and recommends a potential change to the Market Dominant NSA standard.

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[27] Docket No. MC2010-36, Order No. 689, Order Conditionally Granting Request to Transfer Commercial Standard Mail Parcels to the Competitive Product List, March 2, 2011.

[28] *See* Docket No. MC2011-22, Order No. 710, Order Adding Lightweight Commercial Parcels to the Competitive Product List, April 6, 2011.

[29] *See* Docket No. ACR2007, Annual Compliance Determination, March 27, 2008, at 24 (FY 2007 ACD); FY 2015 Financial Report at 71.

[30] 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 123 (Order No. 3506).

[31] *United Parcel Service, Inc., v. Postal Regulatory Commission*, No. 16-1354 (D.C. Cir. filed Oct. 12, 2016).

a. Competitive NSAs

As with any proposed Competitive product, before adding an NSA to the competitive product list, the Commission must determine that the Postal Service does not exercise sufficient market power that it can effectively set the price of the product substantially above costs, raise prices significantly, decrease quality, or decrease output, without the risk of losing a significant level of business to other firms offering similar products. *See* 39 U.S.C. § 3642(b)(1); 39 C.F.R. § 3020.34. It must also consider the availability and nature of private sector enterprises engaged in delivering the product, the views of those who use the product, and the likely impact on small business concerns. *See* 39 U.S.C. § 3642(b)(3); 39 C.F.R. §§ 3020.32(f), (g), and (h).

Finally, once the Commission determines that an NSA meets all the above requirements, prior to approving the NSA, it must determine that the agreement covers its attributable costs, does not cause Market Dominant products to subsidize Competitive products, and contributes to the Postal Service's institutional costs. 39 U.S.C. § 3622(a); 39 C.F.R. §§ 3015.5 and 3015.7.

b. Commission Procedures Regarding Non-Public NSA Information

Many of the terms of NSAs are customized based on specific details of the customer's use of the mail and are considered non-public. The Commission's rules for obtaining access to non-public materials are currently set forth in 39 C.F.R. §§ 3007.1 through 3007.62. Any party who wishes to obtain access to non-public materials in a Commission docket (including all NSA filings) must file a motion setting forth a detailed justification for access and a list of relevant affiliations of the party requesting access. 39 C.F.R. § 3007.40.

To determine whether to grant a party access to non-public material, the Commission applies the balancing test based on Federal Rule of Civil Procedure 26, which balances the need of the requesting party to have access to participate effectively in a Commission proceeding against the Postal Service or a third party with a proprietary interest in the materials.[32]

[32] *See* Docket No. RM2008-1, Order No. 225, Final Rules Establishing Appropriate Confidentiality Procedures, June 19, 2009, at 16-17; 39 C.F.R. § 3007.42.

c. Market Dominant NSAs

(1) International Market Dominant NSAs

As an alternative to UPU terminal dues, the Postal Service enters into bilateral NSAs with foreign postal operators that include negotiated rates for some or all of their inbound letter post items.

International Market Dominant NSAs are composed largely of agreements with foreign postal operators. By the Postal Service's own estimate, these have lost approximately $25 million in net revenue in FY 2012.[33] 2013 GAO Report at 12. However, the mail sent under these NSAs would have generated even greater losses if the volumes were sent under UPU rates. *Id.*

(2) Domestic Market Dominant NSAs

When the Postal Service submits a proposed domestic Market Dominant NSA for approval by the Commission, the Commission must first independently determine whether the product is properly categorized as Market Dominant. The Commission does so by evaluating whether "the Postal Service exercises sufficient market power that it can effectively set the price of such product substantially above costs, raise prices significantly, decrease quality, or decrease output, without risk of losing a significant level of business to other firms offering similar products." 39 U.S.C. § 3642(b)(1). If a product meets these specifications or is covered by the postal monopoly, then it is categorized as Market Dominant. 39 U.S.C. § 3642(b)(2). All other products are categorized as Competitive.[34]

When evaluating the new product, the Commission is required to give "due regard" to:

> (A) the availability and nature of enterprises in the public sector engaged in the delivery of the product involved;
>
> (B) the views of those who use the product involved on the appropriateness of the proposed action; and
>
> (C) the likely impact of the proposed action on small business concerns (within the meaning of section 3641(h)).

39 U.S.C. § 3642(b)(3).

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[33] United States Government Accountability Office, *U.S. Postal Service: Opportunities to Increase Revenue Exist with Competitive Products; Reviewing Long-Term Results Could Better Inform Promotions Decisions*, GAO-13-578, June 2013 (2013 GAO Report).

[34] Any product covered by the letter monopoly is categorized as Market Dominant regardless of market analysis, pursuant to 39 U.S.C. § 601 *et seq*.

If the Commission determines that the proposed NSA is properly classified as Market Dominant, it must then determine that the NSA will either: (i) improve the net financial position of the Postal Service through reducing costs or increasing overall contribution to institutional costs or (ii) enhance the performance of mail preparation, processing, transportation, or other functions. It must also find that the NSA will not cause unreasonable harm to the marketplace. 39 U.S.C. § 3622(c)(10). The NSA must also be made available "on public and reasonable terms to similarly situated mailers." 39 C.F.R. § 3010.40(c).

Since the PAEA has been in effect, the Commission has evaluated four domestic Market Dominant NSAs, approving three and denying one.[35] Domestic Market Dominant NSAs have collectively had a negative impact on net revenue. Table I-1, below, sets forth the net effect on Postal Service contribution for each domestic Market Dominant NSA approved after the passage of the PAEA. The Commission has encouraged the Postal Service to identify a more reliable method for evaluating the financial impact of Market Dominant NSAs.

[35] *See* Docket Nos. MC2011-19 and R2011-3, Order No. 694, Order Adding Discover Financial Services 1 Negotiated Service Agreement to the Market Dominant Product List, March 15, 2011; Docket Nos. MC2012-14 and R2012-8, Order No. 1448, Order Approving Addition of Valassis Direct Mail, Inc. Negotiated Service Agreement to the Market Dominant List, August 23, 2012; Docket Nos. MC2014-21 and R2014-6, Order No. 20197, Order Adding PHI Acquisitions Inc. Negotiated Service Agreement to the Market Dominant Product List, June 19, 2014; Docket Nos. MC2015-3 and R2015-2, Order No. 2410, Order Rejecting the Postal Service's Request to Add Discover Negotiated Services Agreement to the Market Dominant Product List, March 24, 2015.

Table I-1

Net Effect on Postal Service Contribution

Contract Partner	($ Thousands)	Source
Discover	-25,378	FY 2014 ACD, at 59
Valassis	100	FY 2015 ACD, at 75
PHI Acquisitions	112	FY 2015 ACD, at 74

The Commission's current accepted methodology for estimating volume changes due to the Postal Service's pricing incentive programs uses price elasticity. Order No. 738 at 1. In Docket RM2010-9, the Commission sought public comment on potential "new methods to estimate volume changes resulting from pricing incentive programs of the Postal Service" but after receiving comments, determined that it was unpersuaded "that the alternatives offer a demonstrable improvement over the current method" and opted to retain the elasticity-based methodology.[36]

The Postal Service continues to take the position that it "should have the flexibility to determine and employ relevant and appropriate methodologies compatible with its business model."[37] It contends that no statutory requirement mandates the use of any one methodology. *Id.* In the FY 2014 ACD, the Commission directed the Postal Service to use the elasticity-based accepted analytical principle when estimating volume changes resulting from its pricing incentive programs unless the Commission accepts an alternative analytical principle.[38]

2. Commission Recommendations

The Commission continues to have a positive view of the Competitive NSA process, which has proven beneficial to both the Postal Service and the mailing community.

[36] *See* Docket No. RM2010-9, Order No. 469, Notice of Proposed Rulemaking Concerning Methods to Estimate Volume Changes Caused by Pricing Incentive Programs, June 8, 2010; Docket No. RM2010-9, Order No. 738, Order Terminating Proceeding, May 27, 2011, at 1.

[37] Docket No. ACR2014, Reply Comments of the United States Postal Service, February 18, 2015, at 11 (Docket No. ACR2014, USPS Reply Comments).

[38] Docket No. ACR2014, Annual Compliance Determination, March 27, 2015, at 60 (FY 2014 ACD).

While commenters offer divergent views on the current treatment of non-public material, the Commission maintains that the current approach to granting access to non-public material strikes the appropriate balance between the public interest in transparency and the Postal Service's and contract partner's need to keep certain information confidential. Any party may petition the Commission at any time to consider modification or improvement of the rules and the balance they strike. The Commission does not at this time recommend any legislative changes related to Competitive NSAs or procedures for seeking access to non-public material.

For domestic Market Dominant NSAs, these have not consistently performed up to expectations. Several commenters remarked that the current statutory standard has a chilling effect on domestic Market Dominant NSAs. Congress should clarify whether the more stringent standard set forth in 39 U.S.C. § 3622 (c)(10) that the agreement "improve the net financial position" of the Postal Service is still intended, rather than the standard for Competitive NSAs which are only required to cover their attributable costs.

This approach would have the advantage of providing the Postal Service with increased opportunities to experiment with its pricing, with a goal towards designing domestic Market Dominant NSAs that ultimately result in an improved financial position. However, the disadvantages of this approach include the likelihood that the Postal Service will continue to lose money on these agreements while it searches for the correct pricing formula. Given the inelastic demand for Market Dominant products, price reductions on these products have rarely proven to be profitable in the past. In addition, the Commission notes that if Congress chooses to implement this new standard, the Commission's review would be limited to the consideration of whether the proposed domestic Market Dominant NSA would improve the Postal Service's position from a cost coverage perspective, rather than its current holistic analysis of whether the Postal Service would be financially better off overall with the NSA than it would be otherwise.

F. Post Office Closings and Consolidations

1. Introduction and Background

The PAEA sets forth the requirements for Postal Service determinations to close or consolidate post offices. *See* 39 U.S.C. § 404(d). Section 404(d) also delineates the Commission's jurisdiction to review such determinations upon appeal by any person served by the post office subject to the determination. 39 U.S.C. § 404(d)(5).

In deciding whether or not to close or consolidate a post office, the Postal Service must consider: (i) the effect on the community served by the post office; (ii) the effect on the employees of the post office; (iii) consistency with a policy of providing a maximum degree

of effective and regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining; (iv) economic savings to the Postal Service from the closing or consolidation; and (v) other factors as the Postal Service determines are necessary. 39 U.S.C. § 404(d)(2)(A).

Section 404(d)(5) authorizes any person served by the post office subject to the determination of closure or consolidation to file an appeal with the Commission within 30 days of the determination. When considering an appeal, the Commission must set aside a determination found to be arbitrary or capricious, without observance of procedure required by law, or unsupported by substantial evidence on the record. The Commission must complete its administrative review no later than 120 days after receiving the appeal.

In the 2011 Report, the Commission did not recommend changes to the statutory procedural requirements under 39 U.S.C. § 404(d). However, the Commission did recommend that Congress consider requiring the Postal Service to provide regular reports to the Commission on plans and activities regarding the Postal Service's retail network. *See* 2011 Report at 77. The Commission noted that such reporting would enhance the PAEA's goals of transparency and accountability. *Id.* The Commission's 2011 Report also included a recommendation that the scope of the Commission's administrative review be clarified to adopt the plain meaning of the term "post office". *Id.*

The Commission recently concluded Docket No. PI2016-2 concerning post office consolidations and closings.[39] The Commission opened PI2016-2 to seek input as to what, in commenters' views, constitutes a relocation or rearrangement of postal services and is thus exempt from Commission review pursuant to section 404(d); and when or if the Commission should have jurisdiction to review the closing or consolidation of a contract postal unit (CPU).[40] The comments are summarized in section II with the public comments received as input to this report.

2. Commission Recommendations

There is disagreement on the Commission's authority to review post office closings on appeal over what is, and what is not, a "post office" under 39 U.S.C. § 404(d).

The Postal Service maintains that it should be extended substantial deference in defining the terms in 39 U.S.C. § 404(d) because it claims that it should retain substantial discretion

[39] Docket No. PI2016-2, Order No. 3456, Order Concluding Proceeding, August 8, 2016.

[40] Docket No. PI2016-2, Notice and Order Seeking Comments on Commission Jurisdiction Over Postal Service Determinations to Close or Consolidate Post Offices, December 10, 2015, at 4 (Order No. 2862).

concerning closures and consolidations of post offices.[41] The Postal Service suggests that the plain language of section 404(d), read in accordance with Congress's interpretation and legislative intent, suggests that the term "post office" does not include stations or branches. *Id.* at 9. The Postal Service's regulations provide that "[p]ost [o]ffices are established and maintained at locations deemed necessary to ensure that regular and effective postal services are available to all customers within specified geographic boundaries." 39 C.F.R. § 241.1. The Postal Service considers this definition to include only "Postal Service-operated retail facilities operated or staffed by a postmaster, or by an employee at the direction of a postmaster. . . ." Docket No. PI2016-2, USPS Comments at 6.

The Postal Service notes that nearly all stations and branches are found within urban areas where a central facility or main post office is located in the same community, and customers have multiple options for retail service. Thus, according to the Postal Service, the stations and branches within the geographic boundary of the post office are not post offices themselves. Similarly, the Postal Service also takes the position that CPUs are not post offices under section 404(d), asserting that designating a termination of a CPU contract as a closing would restrict the Postal Service's ability to function as a business. *Id.* at 12.

Other members of the postal community urge a broader definition of a post office. They suggest that the Commission's jurisdiction regarding appeals should include closings of *all* types of post office, including independent post offices, stations, branches, and contract post offices. They argue that appeals procedures should be similar for all types of retail facilities.

The Commission, for its part, has long held that the term "post office" includes not only postal facilities covered by the Postal Service's organizational unit definition, but stations and branches as well.[42] The opposing interpretations of the term "post office" continue to create uncertainty and confusion among the public. Legislative clarification of the definition of a post office would remove ambiguity as to which closings or consolidations are subject to administrative review by the Commission. The Commission again recommends that the definition of a post office be clarified to adopt the plain meaning of

[41] *See* Docket No. PI2016-2, United States Postal Service Comments on the Interpretation of Terms Related to 39 U.S.C§ 404(d), February 5, 2016, at 2-3 (Docket No. PI2016-2, USPS Comments).

[42] Docket No. A2013-5, Order No. 1866, Order Affirming Determination, October 31, 2013, at 11. "The Commission has repeatedly held that 39 U.S.C§ 404(d) provides appeal rights to persons served by post offices that are labeled for administrative purposes as stations or branches." *See*, *e.g.*, Order No. 436, Docket No. A82-10, *In re Oceana Station, Virginia Beach, Virginia*, June 25, 1982, at 4 (*Oceana Station);* Order No. 1480, Docket No. A2006-1, *In re Observatory Finance Station Pittsburg, PA* 15214-0651, September 29, 2006, at 6-12; Order No. 748, Docket No. A2011-16, Akron-East Station, Akron, Ohio, June 17, 2011, at 2; Order No 865, Docket No. A2011-18, Order Affirming Determination (Valley Falls Station), September 20, 2011; Order No. 1037, Docket No. A2011-49, Order Affirming Determination (Village Station), December 12, 2011; Order No. 1317, Docket No. A2012-108, Order Remanding Determination (South Valley Station), April 18, 2012. *Id.* at n.13.

the term post office, inclusive of branches and stations. The Commission further recommends clarification on whether CPUs and nonpostal operation units also fall under the Commission's administrative review authority under section 404(d).

As discussed in the Commission's 2011 Report, the Postal Service utilizes emergency suspensions of post offices in certain situations. The Postal Service defines an emergency as "an occurrence that constitutes a threat to the safety and health of Postal Service employees or customers or to the security of mail or revenue."[43] These occurrences include natural disasters, termination of a lease or rental agreement, lack of personnel to operate the facility, severe health or safety hazard, severe damage to the office, or lack of measures to safeguard the office or revenues. Postal Service Discontinuance Handbook, section 611.

Many emergency suspensions represent genuine emergencies requiring the suspension of operations. The Postal Service's reliance on anticipated terminations of leases, however, are more problematic. In Docket No. PI2010-1, the Commission sought to investigate the number and duration of emergency suspensions.[44] The Commission recognized that the Postal Service could suspend operations of a post office as a means of avoiding the discontinuance process indefinitely, and imposing a *de facto* closing of the office.

Following the 2011 report, the Postal Service changed its regulations regarding closing and consolidations, located at 39 C.F.R. part 241. The regulations provided that where an anticipated lease expiration was the reason for the emergency suspension, "responsible personnel should initiate [an] initial feasibility study sufficiently in advance of the circumstance prompting the emergency suspension to allow a meaningful opportunity for public input to be taken into account." 39 C.F.R. 241.3(a)(5)(iv). The initial feasibility study is intended to "assist the district manager in determining whether to proceed in with a written proposal to discontinue the facility." 39 C.F.R. 241.3(a)(5).

Congress may wish to consider a maximum time a post office may remain in suspension status. The Commission has previously recommended that the Postal Service "proceed expeditiously in either discontinuing offices under suspension or reopening them." *See* FY 2013 ACD at 121; FY 2014 ACD at 121; FY 2015 ACD at 150. In the FY 2015 ACD, the Commission directed the Postal Service "to reduce the number of facilities under suspension in FY 2016" and, "if it was unable to do so . . . include a detailed explanation of why it was unable to do so in the FY 2016 Annual Compliance Report." FY 2015 ACD at 150.

[43] Post Office Discontinuous Guide, Handbook PO 101, Chapter 6 – Special Considerations, Subchaper 61 – Emergency Suspensions (Postal Service Discontinuous Handbook).

[44] Docket No. PI2010-1, Order No. 335, Notice and Order Providing an Opportunity to Comment, November 9, 2009.

G. Service Standards

1. Introduction and Background

The PAEA requires that the Postal Service, in consultation with the Commission, to establish service standards for Market Dominant products. 39 U.S.C. § 3691(a). Each year, the Postal Service is required to report to the Commission on each Market Dominant product's "level of service (described in terms of speed of delivery and reliability)" and the degree of customer satisfaction. 39 U.S.C. § 3652(a)(2)(B). The Commission reviews the Postal Service's service performance in accordance with the regulations set forth at 39 C.F.R. part 3055. The PAEA intended this review to ensure that quality of service does not deteriorate as a result of cost-cutting measures implemented to comply with the consumer price index (CPI) price cap.

The Postal Service uses a variety of measuring systems to measure service performance for its various products, including: External First-Class Measurement System (EXFC); Intelligent Mail Accuracy and Performance System (iMAPS); Product Tracking System (PTS); Seamless Acceptance and Service Performance (SASP); International Mail Measurement System (IMMS); and Intelligent Mail Barcode (IMb).[45] The Postal Service utilizes these systems and compares the collected transit times against service performance targets for its respective products. For reporting service performance to the Commission, service performance must be measured by an objective external performance measurement system unless the Commission approves the use of an internal measurement system. *See* 39 U.S.C. § 3691(b)(1)(D) and (b)(2). Currently before the Commission is a public inquiry docket regarding proposals to develop new internal service performance measurement systems. The Commission's evaluation of the new systems has included reviews of the systems' performance data, as well as technical conferences wherein the Postal Service has detailed the operation of the internal systems. The Commission has requested further information from the Postal Service, which is necessary to review the proposed internal systems.[46]

The Postal Service generally makes its performance goals available to the public via its website[47] and also includes its performance data in quarterly reports and in its Annual

[45] For a detailed description of the abovementioned measurement systems, *see* Docket No. ACR2015, Annual Compliance Determination, March 28, 2016, at 95-98 (FY 2015 ACD).

[46] *See* Docket No. PI2015-1, Order No. 2336, Notice of Request for Comments and Scheduling of Technical Conference Concerning Service Performance Measurement Systems for Market Dominant Products, January 29, 2015.

[47] *See* United States Postal Service, Service Performance Targets FY 2016 Market Dominant Products, *http://about.usps.com/what-we-are-doing/service-performance/fy2016-targets-page.html.*

Compliance Report. Speed of delivery is evaluated based on a mailpiece reaching its destination within a given service window. FY 2015 ACD at 94. Reliability refers to consistency of delivery. *Id.*

In September 2015, the Government Accountability Office (GAO) published a report recommending that the Commission hold a public hearing to address how the Postal Service may improve the completeness of its service data.[48] In response to the 2015 GAO Report, the Commission opened a public inquiry docket pertaining to potential improvements in service performance measurement data.[49] The Commission found that additional reporting by the Postal Service is necessary to enhance the quality and completeness of service performance data.[50] The Commission directed the Postal Service to provide descriptions of the methodologies used to verify accuracy, reliability and representativeness of all current measurement systems and to regularly report on mail excluded from measurement and mail volumes measured and unmeasured by Full Service IMb. Order No. 3490 at 24-25.

The Commission's Annual Compliance Determination analyzes the yearly service performance data. In FY 2015, for the first time since the Postal Service began reporting service performance for all Market Dominant mail products, no First-Class Mail product met or exceeded its service performance targets. *See* FY 2015 ACD at 131-138. This decline in service performance coincided with a shift to longer processing periods. *Id.* at 135.

The Commission found that the Postal Service met service performance targets for Standard Mail High Density and Saturation Letters, but noted concern with slippage in the performance of Standard Mail Letters and the failure to meet targets for Every Door Direct Mail – Retail and Standard Mail High Density and Saturation Flats/Parcels. *Id.* at 141. The Commission also found that Standard Mail Carrier Route and Standard Mail Flats fell substantially below performance targets. *Id.* at 142. The Commission directed the Postal Service to provide a report on long-term difficulties in processing and delivering flats in a timely and cost-effective manner. *Id.* at 180-181. On July 27, 2016, the Postal Service submitted its report.[51] On September 27, 2016, the Commission requested additional information from the Postal Service.[52] The Commission held an off-the-record technical

[48] United States Government Accountability Office, *U.S. Postal Service: Actions Needed to Make Delivery Performance Information More Complete, Useful, and Transparent*, GAO-15-756, September 30, 2015 (2015 GAO Report).

[49] Docket No. PI2016-1, Order No. 2791, Notice Establishing Docket Concerning Service Performance Measurement Data, October 29, 2015.

[50] Docket No. PI2016-1, Order Enhancing Service Performance Reporting Requirements and Closing Docket, August 26, 2016 (Order No. 3490).

[51] Docket No ACR2015, Third Response of the United States Postal Service to Commission Requests for Additional Information in the FY 2015 Annual Compliance Determination, July 26, 2016.

[52] Docket No. ACR2015, Commission Information Request No. 1, September 27, 2016.

conference on October 21, 2016, during which the Postal Service provided a presentation on the status of its proposed method to measure, track, and report cost and service performance issues with Flats delivery.[53]

Service performance results for Periodicals in FY 2015 decreased for the second consecutive year, and fell below performance targets for the fourth straight year. *Id.* at 142. Package Services were inconsistent, as Media Mail/Library Mail and Bound Printed Mail Parcels exceeded performance targets, while Bound Printed Matter Flats fell substantially below other Package Services products for the fourth straight year. *Id.* at 144. All Special services met or exceeded performance targets with the exception of Post Office Box Service. *Id.*

2. Commission Recommendations

The Commission recognizes its statutory role in setting and enforcing service standards has created challenges for the postal community. Accordingly, the Commission reiterates and expands upon its recommendations from the 2011 Report.

The first of these recommendations is that Congress consider clarifying under which circumstances the Postal Service is required to consult with the Commission. *See* 2011 Report at 64-65. There is no dispute that the Postal Service must consult with the Commission when establishing service standards. *See* 39 U.S.C. § 3691(a). However, the law is silent as to whether the Postal Service must consult with the Commission when it changes service standards. Currently, the Postal Service does not formally consult with the Commission when it changes service standards, although the Commission has interpreted section 3691 as a requirement that the Postal Service do so. 2011 Report at 64. To eliminate potential confusion and the conflicting interpretations, Congress should clarify the provision as to whether or not consultations with the Commission are required for proposals to change service standards.

Perhaps equally ambiguous is the section 3691 requirement to establish standards "in consultation with" the Commission. There is substantial room for interpretation as to what the term "in consultation with" actually requires of the Postal Service. For example, a narrowly construed interpretation of the term "in consultation with" may simply obligate the Postal Service to notify the Commission of proposed service standards. A broader interpretation would suggest that the Postal Service might be required to receive and respond to Commission recommendations and input. The Commission recommends that Congress clarify the responsibilities of the Postal Service inherent in its requirement to

[53] Docket No. ACR2015, Order No. 3539, Order Scheduling Technical Conference, September 27, 2016.

consult with the Commission. These clarifications would provide more meaningful consultation in setting service standards, while promoting the transparency and accountability of the Postal Service.

The Commission's 2011 Report recommendations included a proposal for service price adjustments as an incentive for the Postal Service to improve its service performance. *See* 2011 Report at 65. The Commission appreciates that commenters maintain interest for or against such a proposal. However, the relationship between service performance and price cap authority has not been fully explored. The Commission may review the relationship between service performance and pricing authority in its Section 3622 Review.

H. Nonpostal Services

1. Introduction and Background

The passage of the PAEA revoked the Postal Service's authority to offer new nonpostal services. *See* 39 U.S.C. § 404(e)(2). It required the Commission to review each existing nonpostal service offered and determine whether those services should continue. 39 U.S.C. § 404(e)(3). The Commission was required to consider the public's need for each service and the ability of the private sector to meet the public need.

The Commission established Docket No. MC2008-1 to review and evaluate existing nonpostal services.[54] The Commission sought and received evidence and arguments of interested participants in evaluating whether the existing nonpostal services should continue. In Order No. 154, the Commission identified the nonpostal services that should be continued.[55]

[54] Docket No. MC2008-1, Order No. 50, Notice and Order Concerning Review of Nonpostal Services, December 20, 2007.

[55] S*ee* Docket No. MC2008-1, Review of Nonpostal Services under the Postal Accountability and Enhancement Act, December 19, 2008 (Order No. 154).Order No. 154 left open the issue of whether to allow the following nonpostal activities to continue: the licensing of mailing and shipping supplies; the warranty repair program; and the sale of CDs and DVDs. *See* Order No. 154 at 4, 35. The Commission initiated Phase II of Docket No. MC2008-1 to resolve those three services. *See* Docket No. MC2008-1 (Phase II), Notice and Order Initiating Phase II Proceedings (Order No. 168), January 9, 2009. The Commission concluded that: licensing of mailing and shipping supplies should not be part of the competitive nonpostal service of licensing; warranty repair should be discontinued; and sales of CDs and DVDs should be discontinued. On appeal, the United States Court of Appeals for the District of Columbia Circuit remanded to the Commission for further consideration the issue of licensing the Postal Service's logo for use on mailing and shipping supplies. *LePage's 2000, Inc. and LePage's Products., Inc. v. Postal Regulatory Commission*, 642 F.3d 225 (D.C. Cir. Jun. 7, 2011), slip op. at 1. On remand, the Commission concluded that mailing and shipping licensing could continue because it serves a public need that the private sector cannot meet. Docket No. MC2008-1 (Phase IIR), Order Resolving Issues on Remand, April 30, 2012, at 2 (Order No. 1326).

The current list of Postal Service nonpostal service offerings and their descriptions was approved in Order No. 1575.[56] Currently, the Postal Service's nonpostal offerings include two Market Dominant services:[57]

- Alliances with the Private Sector to Defray Cost of Key Public Functions
- Philatelic Sales

In FY 2015, these two services generated net revenue of $62 million, representing a 13 percent increase from FY 2014. FY 2015 ACD at 75.

The mail classification schedule also includes nine Competitive nonpostal services:[58]

- Advertising
- Licensing of Intellectual Property other than Officially Licensed Retail Products(OLRP)
- Mail Services Promotion
- Officially Licensed Retail Products (OLRP)
- Passport Photo Service
- Photocopying Service
- Rental, Leasing, Licensing or Other Non-Sale Disposition of Tangible Property
- Training Facilities and Related Services
- USPS Electronic Postmark Service (EPM) Program

In FY 2015, Competitive nonpostal services generated net revenue of $89 million, representing a 4 percent increase from FY 2014. FY 2015 ACD at 92.

2. Commission Recommendations

The Commission reiterates the recommendations in the 2011 Report regarding new offerings of nonpostal services. If Congress decides to allow the Postal Service to offer nonpostal services, it should include adequate safeguards to reduce the risks of:

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[56] *See* Docket No. MC2010-24, Order Approving Mail Classification Schedule Descriptions and Prices for Nonpostal Service Products, December 11, 2012 (Order No. 1575).

[57] Mail Classification Schedule, section 1700.2.

[58] Mail Classification Schedule, section 2700.2.

unprofitable business ventures; distortion of private markets for nonpostal services; and diversion of Postal Service resources from core responsibilities. *See* 2011 Report at 50.

The Commission recommends that if the Postal Service is permitted to offer new nonpostal services, proposed offerings should be subject to the same regulatory review the Commission applied when reviewing existing nonpostal services pursuant to section 404(e)(3). Applying such review would require the Commission to consider the public need and the ability of the private sector to meet the need for proposed new nonpostal services. Proposed nonpostal services should also primarily utilize existing Postal Service assets to minimize risk. The Commission would not approve new nonpostal service offerings that did not meet these statutory tests.

Similarly, the Commission recommends that where a proposed offering meets the statutory test for new nonpostal services, the Commission should have the authority to designate the service as a Market Dominant, Competitive, or experimental product. *See* 39 U.S.C. § 404(e)(5). Regulatory oversight of approved new nonpostal services would operate in the same way it does currently for existing services.

Implementation of these changes would safeguard against market distortion and the diversion of Postal Service resources.

I. Advisory Opinion Process

1. Introduction and Background

Any change made by the Postal Service that will generally affect service on a nationwide or substantially nationwide basis requires the Postal Service to seek an advisory opinion from the Commission pursuant to 39 U.S.C. § 3661.

Since the PAEA was enacted, the Postal Service has filed seven requests for advisory opinions with the Commission. These cases are commonly referred to as "N-cases."[59] As the Postal Service's financial situation has deteriorated, the number of N-cases has increased. Of the requests filed since FY 2006, four have required 200 days or more to complete.[60] Table I-2, below, illustrates the number of days taken to complete N-cases since the passage of the PAEA.

[59] Where "N" stands for "Nature of Service."

[60] Docket No. RM2012-4, Order Adopting Amended Rules of Procedure for Nature of Service Proceedings Under 39 U.S.C. 3661, May 20, 2014, at 4-5 (Order No. 2080).

Table I-2

Time to Complete Nature of Service Dockets

Docket No.	Subject	Days
N2006-1	Evolutionary Network Development Service Changes, 2006	308
N2009-1	Station and Branch Optimization and Consolidation Initiative, 2009	251
N2010-1	Six-Day to Five-Day Street Delivery and Related Service Changes, 2010	359
N2011-1	Retail Access Optimization Initiative, 2011	149
N2012-1	Mail Processing Network Rationalization Service Changes, 2012	259
N2012-2	Post Office Structure Plan	87
N2014-1	DSCF Standard Mail Load Leveling	89

In the 2011 Report, the Commission recommended that Congress consider adding statutory language allowing the Postal Service to request expedited consideration for time-sensitive N-Cases and requiring the Postal Service to submit a written response to the advisory opinion prior to implementing its changes in service. 2011 Report at 84. The Postal Service's written response would include an explanation of how the Commission's recommendations would be implemented or, in the alternative, why it disagrees with the Commission's recommendations. The Commission suggested that the proposed changes not be implemented until the Postal Service's written response was provided to Congress. *Id.*

In its response to the 2011 Report, the Postal Service expressed support for a legislative proposal pending at the time which would require the Commission to issue an advisory opinion within 90 days and remove the formal hearing requirement from the advisory opinion process.[61] The Postal Service did not comment on the requirement of a formal written response.

After the 2011 Report was issued, the Commission opened Docket No. RM2012-4, proposing and ultimately adopting amended rules of procedure for N-cases to address the need for more timely completion of the advisory opinion process. The Commission cited several considerations for prescribing a 90-day time frame for its advisory opinion process, including the need for more prompt resolution of N-cases given the Postal Service's current financial situation. Order No. 2080 at 13.

[61] United States Postal Service Response to Commission's Draft Section 701 Report, September 16, 2011, at 22 (USPS Response to 2011 Report).

The most significant change adopted in Docket No. RM2012-4 was the establishment of a pro forma procedural schedule for N-cases that contemplates issuance of an advisory opinion by the Commission within 90 days of the Postal Service's proposal. Order No. 2080 at 7. Other modifications to the regulations affecting N-cases were established to streamline procedures while still providing the requisite level of due process to participants. These ancillary changes included:

- The establishment of a pre-filing phase intended to inform interested persons of the Postal Service's proposal and to provide the Postal Service with feedback useful in preparing a final proposal less likely to require substantial revisions after commencement of formal Commission proceedings;
- A limitation on the scope of the proceeding to the Postal Service's proposal with an opportunity for participants to explore related subjects by means of special Commission studies or public inquiry proceedings;
- The adoption of expedited deadlines for filing and responding to motions;
- The adoption of new discovery procedures that provide for a mandatory technical conference and a limitation on the number of written interrogatories;
- Expedited filing of rebuttal and surrebuttal testimony, if any;
- Revised hearing procedures that provide for back-to-back hearings on the Postal Service's direct case; rebuttal testimony, if any; and surrebuttal testimony, if any;
- An expedited briefing schedule and limitations on the length of initial and reply briefs; and
- The adoption of a policy of issuing advisory opinions targeted to the Postal Service's proposal and, when appropriate, the institution of special studies or a public inquiry proceeding to explore related subjects.

Order No. 2080 at 7.

2. Commission Recommendations

39 U.S.C. § 3661 prohibits the Commission from issuing an advisory opinion "until an opportunity for a hearing on the record under sections 556 and 557 of title 5 has been accorded to the Postal Service, users of the mail, and an officer of the Commission who shall be required to represent the interests of the general public." 39 U.S.C. § 3661(c). In Docket No. RM2012-4, the Commission adopted new procedural rules that, to date, have not been tested because the Postal Service has not filed a new request for an advisory opinion with the Commission after its adoption of the new rule. The Commission's approach in its regulations attempted to balance the desirability and utility of an expeditious advisory opinion with the statutory mandate for a hearing on the record under the Administrative

Procedure Act. As long as the requirement for the hearing on the record exists, so will the potential for scheduling difficulties and delays in the advisory opinion process.

However, notwithstanding the new back-to-back hearing schedule in the new procedures, the Commission noted the potential logistical challenges inherent in maintaining the opportunity for back-to-back hearings on the record in Order No. 2080. It noted that other procedural changes designed to increase transparency regarding the Postal Service's proposal may minimize potential logistical challenges.

Some commenters oppose elimination of the hearing on the record requirement because they maintain that a hearing would provide a valuable avenue for stakeholders to explore the potential implications of the Postal Service's proposal. Pursuant to the pro forma procedural schedule for N-cases, however, the hearing on the record would occur between the 42nd-56th day of the pro forma procedural schedule, depending on whether any rebuttal or surrebuttal cases were filed. Order No. 2080 at 83. Other stages of the procedure, such as the pre-filing conference, technical conference, and discovery stage, all provide opportunities for stakeholders to question the Postal Service and alert the Commission about potential implications to the proposal at an earlier stage of the advisory opinion process. The updated procedures include various safeguards to ensure that ample opportunities are provided to stakeholders well in advance of the hearing stage to discover problems with the Postal Service's proposal.

Congress should consider that the hearing on the record requirement affords the highest form of due process available in an administrative proceeding. The hearing on the record requirement is a key signifier of legislative intent to provide participants with all the protections of a formal adjudicatory proceeding. *See City of W. Chicago, Ill. v. U.S. Nuclear Regulatory Comm'n*, 701 F.2d 632, 644 (7th Cir. 1983); *Izaak Walton League of Am. v. Marsh*, 655 F.2d 346, 341 (D.C. Cir. 1981). The Commission emphasizes that a delicate balance exists between its obligations to provide stakeholders with sufficient opportunities to identify and discuss the potential impacts of Postal Service proposals to substantially change service within a formal adjudicatory structure and the need for expedition in the advisory opinion process.

The Commission notes its recommendation from the 2011 Report that Congress consider adding language to 39 U.S.C. § 3661 that requires, upon receipt of the Commission's advisory opinion, the Postal Service provide a written response to Congress, prior to implementation, addressing the Commission's recommendations.

J. Market Tests of Experimental Products

1. Introduction and Background

Under the PAEA, the Postal Service has the authority to conduct market tests of experimental products. *See* 39 U.S.C. § 3641. The provision allowing for such market tests was driven by Congress' recognition of the Postal Service's need to "innovate and develop new products and services" to "meet the evolving needs of its customers." S. Rep. 108-318, at 16 (2004).

Section 3641(b) sets forth the requirements for market tests of experimental products. First, the subject product must be, from the viewpoint of mail users, significantly different from all products offered by the Postal Service within the 2 year period preceding the start of the market test. 39 U.S.C. § 3641(b)(1). Second, the product must not create an unfair or otherwise inappropriate competitive advantage for the Postal Service or any mailer. 39 U.S.C. § 3641(b)(2). Finally, the product must be correctly classified as either a Market Dominant or Competitive product. 39 U.S.C. § 3641(b)(3).

Market tests are subject to a 24 month limit in duration, though the Commission may grant an extension up to an additional 12 months. 39 U.S.C. § 3641(d). Revenues for products introduced in a market test, either anticipated or actually received by the Postal Service, may not exceed $10 million in any year, subject to inflation. 39 U.S.C. § 3641(e).

The Postal Service must file a notice of a market test with the Commission and publish the notice in the *Federal Register* at least 30 days prior to the market test's initiation. 39 U.S.C. § 3641(c)(1). The notice must describe the nature and scope of the market test and set forth the basis for the Postal Service's determination that the market test meets the statutory requirements. In reviewing market tests for compliance, the Commission considers public comments from interested persons, mailers, and other stakeholders in the postal community. The Commission also reviews Postal Service responses to specific requests for information issued by the Commission.

Since the submission of the 2011 Report, the Postal Service has filed five notices of market tests of experimental products: Docket No. MT2012-1, First-Class Tracer; Docket No. MT2013-1, Metro Post; Docket No. MT2013-2, International Merchandise Return Service Non-Published Rates; Docket No. MT2014-1, Customized Delivery; and Docket No. MT2016-1, Global eCommerce Marketplace (GeM) Non-Published Rates. The Commission ultimately approved the First-Class Tracer, Metro Post, International Merchandise Return

Service Non-Published Rates, Customized Delivery, and GeM market tests. The Postal Service requested, and the Commission granted, a one year extension of the Metro Post market test.[62] The Commission granted a request for a one year extension of the International Merchandise Return Service market test to accommodate one year negotiated service agreements executed in the second year of the market test.[63]

2. Commission Recommendations

The Commission maintains its position that the statutory authority and rules under the PAEA governing market tests of experimental products are working as intended and providing the Postal Service increased flexibility in the development of new postal products. *See* 2011 Report at 70.

a. Increases on Maximum Revenue and Duration

In its 2011 Report, the Commission recommended Congress consider raising the maximum revenue limitation on market test products. 2011 Report at 70. The Commission continues to support this change, which would provide the Postal Service more opportunities for advancement of new postal products to bolster revenue streams. Accordingly, the Commission reiterates its 2011 Report recommendation that Congress consider raising the maximum revenue limitation for market tests. The Commission also recommends that Congress increase the maximum duration limitation on market tests for experimental products. As with an increase in the revenue limitation, an increased maximum duration should encourage more innovation by giving the Postal Service flexibility to advance more ideas to bolster revenue streams.

b. Modification of "Market Disruption" Requirement

The Commission has identified one potentially problematic area in the PAEA's conditions for market tests. The PAEA requires experimental products to be "significantly different from all products offered by the Postal Service" within the 2 years preceding the start of a market test 39 U.S.C. § 3641(b)(1). The Postal Service is required to show that the introduction of the product will not cause market disruption. 39 U.S.C. § 3641(b)(2). In practice, the juxtaposition between these two requirements creates a challenge for the Postal Service in implementing market tests.

On one hand, the introduction of the product must not create an unfair advantage for the Postal Service or any mailer. The Commission's rules require that, in a notice of a market test, the Postal Service establish that the product will not create a market disruption. 39

[62] Docket No. MT2013-1, Order No. 2243, Order Approving Request for Extension and Expansion of Metro Post Market Test, November 7, 2014.

[63] Docket No. MT2013-2, Order No. 1806, Order Authorizing Market Test to Proceed and Granting Extension, August 12, 2013.

C.F.R. § 3035.3(a)(1)(ii). On the other hand, the product must be one that is significantly different from any product the Postal Service has offered within the last 2 years. Because experimental products necessarily must not have been offered recently by the Postal Service, the Postal Service generally lacks the relevant data necessary to determine the experimental product's potential impact on the market. Without having offered a similar product itself, the Postal Service's determination that the product would not create an unfair advantage is highly speculative. The Postal Service generally does not, prior to implementation of a market test, have access to revenues and volumes of similar products offered by individual competitors, or revenue and volume for the market for similar products as a whole. As a result, the determination that an experimental product would not cause market disruption is often hypothetical.

For example, in establishing that the GeM experimental product would not cause market disruption, the Postal Service was unable to rely on its own data, as it had not offered a similar product.[64] As a result, the Postal Service was forced to speculate that while at least four companies offered similar services, the offering would not create an unfair advantage. *Id.* Without specific information as to the competitors and market disruption, the Commission sought additional information from the Postal Service.[65] The information requests provided the Commission more information about the nature of the experimental product, and about competitors offering similar services.

UPS filed comments regarding the notice of market test.[66] UPS argued that introduction of the GeM product would indeed cause market disruption, because the Postal Service enjoys monopoly privileges as a state-owned enterprise and UPU designated operator. Docket No. MT2016-1, UPS Comments at 3-4. Lacking sufficient market information, the Commission was compelled to issue a Notice of Inquiry, requesting from interested parties volume and revenue information for the previous 3 years, and for the related market as a whole.[67] This information-gathering process requires the expenditure of significant resources, while still providing only limited market information. The GeM market test request illustrates the difficulty in balancing the requirements of insuring against market disruption while offering a substantially new product.

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[64] Docket No. MT2016-1, Notice of the United States Postal Service of Market Test of Experimental Product – Global eCommerce Marketplace (GeM) Merchant Solution and Notice of Filing GeM Merchant Model Contract and Application for Non-Public Treatment of Materials Filed Under Seal, March 16, 2016, at 5 (Docket No. MT2016-1, Notice).

[65] *See* Docket No. MT2016-1, Chairman's Information Request No. 1, March 30, 2016 (Docket No. MT2016-1, CHIR No. 1); Docket No. MT2016-1, Chairman's Information Request No. 2, April 5, 2016 (Docket No. MT2016-1, CHIR No. 2);Docket No. MT2016-1, Commission Information Request No. 1, April 29, 2016 (Docket No. MT2016-1, CIR No. 1).

[66] Docket No. MT2016-1, Comments of United Parcel Service on Postal Service Notice of Global eCommerce Marketplace Proposed Market Test, April 19, 2016 (Docket No. MT2016-1, UPS Comments).

[67] Docket No. MT2016-1, Notice of Inquiry No. 1, April 29, 2016 (Docket No. MT2016-1, NOI No. 1).

Congress may consider modifying the standard of proof for section 3641(b)(2) to instead require the Postal Service to set forth to the Commission its reasonable basis for belief that the introduction of the proposed experimental product will not cause market disruption. This proposed standard would be less onerous than the current requirement that the Postal Service attempt to demonstrate that no market disruption will occur (for an experimental product that is substantially different than anything the Postal Service has offered within 2 years) before the test. Congress could safeguard the potential for market disruption of an experimental product by allowing an avenue to challenge the experimental product, if during the market test a user of the mail believed such a product created an unfair or otherwise inappropriate competitive advantage for the Postal Service or other mailer (especially small business concerns). This approach would be similar to the avenue made available by 39 U.S.C. § 404a(a)(1) for rules or regulations of the Postal Service that may have an anticompetitive effect. This would provide the Postal Service with the appropriate flexibility in its market test offerings while still safeguarding the interests of the market as a whole.

K. Universal Service and the Postal Monopoly

1. Introduction and Background

The Commission is required to report to the President and Congress estimates of costs incurred by the Postal Service in providing universal service on an annual basis. 39 U.S.C. § 3651(b)(1)(A). Additionally, in December 2008, the Commission provided a report to the President and Congress detailing the current status of the Postal Service's Universal Service Obligation (USO) and the postal monopoly, including any deficiencies in universal service; and options for considering how to change both in the future.[68] The USO Report was mandated in section 702(a)(2) of the PAEA.[69] The Commission's subsequent annual reports contain yearly estimates of the costs of the USO and postal monopoly. The recommendations in the USO Report and the estimates in the FY 2015 Annual Report are discussed in more detail below.

a. USO Report

In drafting its USO Report, the Commission sought public input by holding three field hearings, sponsoring an open workshop, and soliciting formal and informal written comments. The Commission found, as a threshold matter, that both senders and recipients were generally satisfied with the level of universal service, no geographic areas were

[68] Postal Regulatory Commission, *Report on Universal Postal Service and the Postal Monopoly*, December 19, 2008 (USO Report).

[69] Pub. L. 109-435, 120 Stat. 3198 (2006), section 701(a)(2).

unserved by the Postal Service, and no service was deficient in scope or quality. USO Report at 1. However, the report noted that the still unfolding Great Recession was having a substantial impact on postal revenues and recognized that the Postal Service would have to assess and evaluate its options in the near future in response to its financial challenges. *Id.* at 2.

In the USO Report, the Commission found that the Postal Service's obligation to provide service to all persons in all parts of the nation, as well as its territories and possessions, remains paramount and should not be altered. It also found that the USO was applicable to both Market Dominant and Competitive products, and included seven relevant attributes: Geographic scope; Range of Products; Access to Postal Facilities; Delivery Frequency; Prices and Affordability; Quality of Service; and Users' Rights of Enforcement. *Id.* at 19-21; 25. Its initial estimate of the annual cost of the USO, based on FY 2007 data, was $4.4 billion. *Id.* at 5. Its initial estimate of the values of the combined letter mail and mailbox monopolies, based on the same data, was $3.5 billion. *Id.* These estimates have been updated and refined in subsequent annual reports.

Finally, the USO Report included the following recommendations:

- That Congress consider and balance all the features of universal service as part of any review of changes necessary to preserve a financially viable Postal Service.
- That the Postal Service be directed to develop information on the probable impact on mail usage by large volume mailers in reaction to potential alternative changes in the seven features of universal service.
- That, before any decisions to adjust or eliminate universal service or the monopoly are made, the resulting impact on the societal benefits of a Federal postal service should be carefully addressed.

Id. at 6.

b. Annual Reports

The estimated cost of the USO and value of the postal monopoly, provided in the Commission's annual reports, are summarized in Table I-3 below:

Table I-3[70]

Annual Estimates of the Cost of the Universal Service Obligation (USO) and the Value of the Monopoly

Fiscal Year	Estimated Cost of the USO ($ Billions)	Value of the Postal Monopoly ($ Billions)
FY 2014	4.13	4.61
FY 2013	4.52	3.93
FY 2012	4.81	3.28
FY 2011	5.17	3.34
FY 2010	5.03	3.33

Source: FY 2015 Annual Report

c. Federal Trade Commission Report

Pursuant to section 703(a)[71] in the PAEA, the Federal Trade Commission (FTC) was tasked with submitting a separate report, which was to identify federal and state laws that applied differently to the Postal Service in comparison to private carriers and include, as appropriate, an accounting of the net economic effects provided by the legal differences, as well as recommendations for bringing such legal differences to an end.[72]

The FTC report included the following conclusions:

- The Postal Service's unique legal status likely provides it with a net competitive disadvantage as compared to private carriers — legal and political restraints on the Postal Service increase its costs from between $330 million - $782 million annually, which is slightly mitigated by an implicit subsidy of its Competitive products estimated as $39 million - $117 million a year.
- The costs and benefits of the Postal Service's distinct legal obligations should be viewed as two market distortions that compound each other and negatively affect the provision of Competitive products.

[70] Postal Regulatory Commission, *Annual Report to the President and Congress*, Fiscal Year 2015, January 2016, at 41, 48.

[71] Pub. L. 109-435, 120 Stat. 3198 (2006), section 703(a).

[72] Federal Trade Commission, *Accounting for Laws that Apply Differently to the USPS and its Private Competitors*, December 2007 (FTC Report).

- Congress should consider acting to reduce the legal constraints on the Postal Service's Competitive product operations.
- The Commission should consider requiring the Postal Service to account for its implicit subsidies when making pricing and production decisions.
- Worksharing and the requirement that the Competitive products cover 5.5 percent of institutional costs may reduce any advantage that the postal monopoly provides in the delivery of competitive products.
- Long term options for addressing the distinct legal treatment between the Postal Service's competitive business and its private carrier competitors include relaxing the current mailbox monopoly; narrowing the scope of the postal monopoly; or establishing the Postal Service's Competitive products division as a separate corporate entity.

FTC Report at 8-11.

2. Commission Recommendations

The Commission notes that the challenges the Postal Service currently faces are similar to those discussed in the USO Report. *See* USO Report at 191-192. The attributes of the USO do not exist in a vacuum, and specific mandates for one or more attributes, such as the price cap on Market Dominant products or the annual appropriations requirement that delivery levels remain at 1983 levels, may impact how the Postal Service must consider and achieve other attributes. *See id*. at 193, 196-197. Given a flexible USO, how the Postal Service achieves each attribute does not remain fixed. The range of products offered may expand or contract to meet the needs of users of the mail. The quality of service provided for different products may be recalibrated to meet changing demand. Access to facilities and offerings may change as populations and technologies evolve. *See id.* at 194-198, 201. Comprehensive review and action on all attributes of the USO would allow for any changes to be considered in light of the potential effects on other attributes.

Given the continued financial and other challenges the Postal Service currently faces, and the discussion above, the Commission reiterates the principal findings of its USO Report, and emphasizes that all of its findings remain important for Congress to consider. In particular, it urges Congress to consider and balance all the features of universal service as part of any review of changes necessary to preserve a financially viable Postal Service. *Id.* at 6.

The Commission also concurs with commenters and notes that the postal industry and general public could benefit from an updated FTC Report with a more current accounting for the value of relevant legal differences between the Postal Service and its private competitors.

L. Public Representative

The Commission is statutorily required to designate an officer to represent the interests of the general public in all public proceedings. 39 U.S.C. § 505. The current process employed by the Commission involves appointing a member of its staff from the Office of General Counsel or Office of Accountability and Compliance as the public representative (Public Representative) in a given docket. Depending on the complexity of the docket, one or more other staff members may be assigned to assist the Public Representative in his or her analysis of the issues presented. The Public Representative then files comments on behalf of the general public in the docket to which he or she is assigned. The Public Representative is prohibited by both the Commission's *ex parte* rules and Commission policy from discussing substantive matters with Commission decision-making personnel for the dockets on which the individual is serving as Public Representative.

In FY 2016, the Commission evaluated 299 Competitive NSAs. Each of those routine cases requires a 7 day window for comments for all interested persons, which includes a Public Representative, to ensure expeditious Commission review. For each of these cases the Commission assigns an advisory team of an attorney and analyst as well as a second analyst to serve as a Public Representative. The Public Representative teams are staffed from the total Commission pool of 19 analysts, who also serve to staff each Commission docket requiring analytical expertise. To adequately staff each Competitive NSA in FY 2016, therefore, there were 598 analyst assignments from that pool. Public Representative responsibilities for larger cases are also assigned to Commission attorneys and analysts on the basis of expertise.

However, the Commission recognizes the value of the Public Representative program and appreciates the dedication of staff members assigned as Public Representatives. The Public Representative's insight has consistently proven valuable to the Commission in its decision-making process. Commenters have reiterated the importance of the Public Representative and the value provided to members of the postal community by the program.

II. 2011 REPORT RECOMMENDATIONS AND COMMENTS ON CURRENT 701 REPORT

A. 2011 Report Recommendations

The 2011 Report focused its recommendations and review on three main areas: the Postal Service's financial condition; postal rate and service matters; and improvements to Commission processes. 2011 Report at 1-2.

In its analysis of the Postal Service's financial condition in FY 2011, the Commission recommended that Congress adjust the schedule of payments to the Postal Service RHBF and suggested several alternative payment options intended to alleviate Postal Service liquidity issues. *Id.* at 21-25. The 2011 Report also included a discussion of the Postal Service's annual financial reporting requirements and Sarbanes-Oxley Act compliance, finding that the PAEA requirements resulted in improved transparency and greater cost savings. *Id.* at 25-27.

The 2011 Report also included several recommendations regarding rate and service matters. First, the Commission recommended that the PAEA be amended to allow the Postal Service to add new Market Dominant classes of mail. *Id.* at 44. Second, the Commission noted that if Congress approves the introduction of new nonpostal services, there be adequate safeguards to reduce the potential for introducing unprofitable products. *Id.* at 50. The Commission also suggested that any new nonpostal products be subject to review under 39 U.S.C. § 404(e)(3), the same regulatory review applied to determining whether to "grandfather" in a nonpostal service. *Id.*

Although the Commission found that the PAEA constraints on market tests were effective and not unduly burdensome, the 2011 Report included as its third recommendation that Congress consider raising the maximum revenue limitation on experimental market test products to further bolster Postal Service revenue streams. *Id.* at 70. Fourth, the Commission recommended that Congress clarify the PAEA to require the Postal Service to consult with the Commission not only in establishing service standards for market dominant products, but also when seeking to change existing service standards. *Id.* at 64-65. The Commission did not recommend any changes to existing procedures for price

adjustments but instead recommended that Congress consider allowing the Postal Service increased pricing flexibility based on improvements to quality of service. *Id.* at 40.

Finally, the Commission made three major recommendations aimed at developing enhancements to improve Commission processes. The first was a recommendation that Congress require the Postal Service to provide the Commission with regular reports on retail network plans and activities. *Id.* at 77. The second recommendation was to clarify the scope of the Commission's appellate review of post office closings, including a definition of "post office" that would encompass all Postal Service-operated retail facilities. *Id.* at 77-78. The third recommendation was that Congress consider allowing the Postal Service to obtain expedited consideration of requests for advisory opinions by the Commission. *Id.* at 83-84.

B. Comments Regarding Current 701 Report

On April 14, 2016, the Commission issued a Notice seeking public comment on the current 701 Report. Order No. 3238. The following parties submitted comments:

- The American Consumer Institute Center for Citizen Research (ACI)[73]
- A Grand Alliance to Save Our Public Postal Service (AGA)[74]
- Amazon Fulfillment Services, Inc. (Amazon)[75]
- American Postal Workers Union, AFL-CIO (APWU)[76]
- Citizens Against Government Waste (CAGW)[77]
- Don Cheney (Cheney)[78]
- Campaign for Postal Banking (CPB)[79]
- Former Utility Regulators (FUR)[80]
- Greeting Card Association (GCA)[81]
- Steven Hutkins (Hutkins)[82]

[73] Comments of the American Consumer Institute Center for Consumer Research, June 14, 2016 (ACI Comments).

[74] Comments of A Grand Alliance to Save Our Public Postal Service, June 14, 2016 (AGA Comments).

[75] Comments of Amazon Fulfillment Services, Inc., June 14, 2016 (Amazon Comments).

[76] Comments of American Postal Workers Union, AFL-CIO, June 14, 2016 (APWU Comments).

[77] Comments of the Citizens Against Government Waste, June 14, 2016 (CAGW Comments).

[78] Comments of Don Cheney, June 15, 2016 (Cheney Comments). Don Cheney concurrently filed a Motion from Don Cheney for Late Acceptance of Comments, June 15, 2016 (Cheney Motion). The Cheney Motion is granted.

[79] Comments of Campaign for Postal Banking, June 14, 2016 (CPB Comments).

[80] Comments of Former Utility Regulators, June 15, 2016 (FUR Comments). Former Utility Regulators concurrently filed a Motion for Late Acceptance of Comments of Former Utility Regulators, June 15, 2016 (FUR Motion). The FUR Motion is granted.

[81] Comments of the Greeting Card Association, June 14, 2016 (GCA Comments).

- Lexington Institute (Lexington Institute)[83]
- Elaine Mittleman (Mittleman)[84]
- MPA-Association of Magazine Media and Alliance of Nonprofit Mailers (MPA)[85]
- National Association of Letter Carriers, AFL-CIO (NALC)[86]
- National Association of Presort Mailers (NAPM)[87]
- National Taxpayers Union (NTU)[88]
- Linda O'Donnell (O'Donnell)[89]
- The Parcel Shippers Association (PSA)[90]
- Pitney Bowes Inc. (Pitney Bowes)[91]
- United States Postal Service (Postal Service)[92]
- The Association for Postal Commerce, Major Mailers Association, and Saturation Mailers Coalition (PostCom)[93]
- Public Representative[94]
- R Street Institute (R Street)[95]
- United Parcel Service, Inc. (UPS)[96]

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[82] Initial Comments by Steven Hutkins Regarding the Commission's Section 701 Report, June 14, 2016 (Hutkins Comments).

[83] Comments of the Lexington Institute, June 14, 2016 (Lexington Institute Comments).

[84] Comments of Elaine Mittleman on the Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, June 14, 2016 (Mittleman Comments). Elaine Mittleman filed Supplemental Comments on the Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act Comments about Historic Venice, California, Post Office Building and Biberman Mural, July 6, 2016 (Mittleman Supplemental Comments).

[85] Comments of MPA–Association of Magazine Mailers and Alliance of Nonprofit Mailers, June 14, 2016 (MPA Comments).

[86] Comment of the National Association of Letter Carriers, AFL-CIO, June 20, 2016 (NALC Comments). NALC also filed a Motion by the National Association of Letter Carriers, AFL-CIO for Extension of Time to File Comment, June 14, 2016 (NALC Motion). In Order No. 3372, the Commission denied NALC's request for a one week extension of time to file comments, but granted NALC an extension of 3 days to file its comments. Order No. 3372, Order Granting Extension of Time to File Comments, June 15, 2016, at 3. Concurrently with its comments, NALC filed a Motion by the National Association of Letter Carriers, AFL-CIO for Late Acceptance of Comment, June 20, 2016 (June 20, 2016, NALC Motion). The June 20, 2016, NALC Motion is granted.

[87] Comments of the National Association of Presort Mailers, June 14, 2016 (NAPM Comments).

[88] Comments of the National Taxpayer Union, June 14, 2016 (NTU Comments).

[89] Comments of Linda O'Donnell, June 14, 2016 (O'Donnell Comments).

[90] Comments of the Parcel Shippers Association, June 14, 2016 (PSA Comments).

[91] Comments of Pitney Bowes Inc., June 14, 2016 (Pitney Bowes Comments).

[92] United States Postal Service Comments in Response to Order 3238, June 14, 2016 (USPS Comments).

[93] Comments of the Association for Postal Commerce, Major Mailers Association, and Saturation Mailers Coalition, June 14, 2016 (PostCom Comments).

[94] Public Representative Comments, June 15, 2016 (PR Comments). The Public Representative concurrently filed a Motion of the Public Representative for Late Acceptance of Comments, June 15, 2016 (PR Motion). The PR Motion is granted.

[95] Comments of R Street Institute, June 14, 2016 (R Street Comments).

[96] Comments of the United Parcel Service, Inc. on the Section 701 Report, June 14, 2016 (UPS Comments).

- Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. (Valpak)[97]
- David Yao, (Yao)[98]

1. Comments on Postal Service Financial Situation

a. Financial Position and Liquidity

In Order No. 3238, the Commission requested comments on the PAEA's impact on the Postal Service's overall financial position, and suggestions for legislative recommendations. Order No. 3238 at 5. The Commission received comments from the Postal Service, APWU, AGA, PSA, GCA, NAPM, Yao, NALC, PostCom, Pitney Bowes, MPA, and the Public Representative. These commenters collectively discuss a number of areas related to the Postal Service's financial situation, including the RHBF, the expansion of Postal Service borrowing authority, and improvements to accounting methods.

The Postal Service states that it has sustained net losses each year since the PAEA was implemented. USPS Comments at 4. It notes that even when discounting RHBF liabilities, it sustained losses from FY 2009 through FY 2013, and would have continued to do so in FY 2014 and FY 2015 but for an exigent surcharge which has since expired. *Id.* In describing its own financial challenges, the Postal Service cites low liquidity, exhaustion of U.S. Treasury credit, and a lack of cash to meet current obligations and for much needed capital investments. *Id.* at 5-6. The Postal Service attributes its ability to maintain sufficient liquidity only to its default on legally mandated RHBF payments. *Id.* at 7.

The Postal Service lists four factors as the cause of its financial difficulties. First, it notes the decline in total mail volumes and a shift in mail mix from high- to low-margin products. *Id.* at 8-9. Second, it points to the price cap required by the PAEA. The Postal Service notes its inability to raise prices above the CPI-U based price cap, emphasizing that the remaining mail volumes do not generate enough to cover the Postal Service's costs. *Id.* at 9. Third, it points to its own fixed or growing infrastructure costs, which are inflexible. Declining volumes dictate that there is less and less revenue to pay for the infrastructure costs required to maintain a delivery network of 155 million delivery points. *Id.* at 9-10. Fourth, the Postal Service suggests that the PAEA limits its flexibility concerning cost structure, particularly with respect to personnel-related costs. *Id.* at 10-11.

[97] Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. Comments on Commission Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, June 14, 2016 (Valpak Comments).

[98] Comments of David Yao, June 15, 2016 (Yao Comments).

The Postal Service states that despite its constraints, it has been successful in reducing operating costs in response to declining volumes. *Id.* at 11. It notes that it has reduced its cost base by approximately $15 billion annually through rationalization of its retail, processing, transportation, and delivery networks, as well as labor cost reductions. *Id.* It cites increased total factor productivity (TFP)[99] in each of the past 6 years, despite declining volume. *Id.* at 11-12. However, the Postal Service suggests that it has taken advantage of most cost-cutting initiatives available to it in light of its universal service obligation. *Id.* at 12.

b. Postal Service Retiree Health Benefits Fund

Several commenters suggest changes regarding the funding of the RHBF, including removal of any funding requirement. For example, APWU suggests that while "the Postal Service is required to fully pre-fund future retiree health benefits 75 years in advance over a ten-year period," no other public or private entity does so. APWU Comments at 1-2. APWU suggests Congress eliminate the prefunding mandate and legislate a refund of payments to allow the Postal Service the necessary cash flow to "make the Postal Service viable again." *Id.* at 2.

AGA characterizes the PAEA's prefunding requirement as "an unfair crushing financial mandate" that no other government agency is forced to bear, and notes that without the mandate, the Postal Service would have enjoyed an operating surplus over the previous 3 years. AGA Comments at 2. GCA states that "removal of the impracticable schedule for prefunding" might do more to improve the effectiveness of the PAEA than any other single change. GCA Comments at 1. Yao characterizes the prefunding requirement as "a mistake by Congress, which has severely constrained access to capital by the USPS." Yao Comments at 1.

Other commenters suggest changes to the prefunding schedule and other modifications regarding the RHBF, rather than elimination in its entirety. The PAEA requires the Postal Service to prefund 100 percent of its retiree health benefits liability. 5 U.S.C. § 8909a. The Postal Service, citing lower funding-level targets in the private sector, state governments, and other federal agencies, proposes a target of 80 percent. USPS Comments at 22-23.[100] NALC notes that it has previously proposed a prefunding target that matches private industry best practice, between 33 and 50 percent or, alternatively, a funding target

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[99] "Total factor productivity (TFP) measures the change in the relationship between outputs (weighted workload) and inputs (resources used) over a period of time. Total workload is calculated using weighted mail volumes, miscellaneous output, and the change in delivery points. Resources consist of labor, materials (including purchased transportation), and deployed capital assets. Workload growth, less growth in resources used, equals TFP growth." FY 2015 Financial Report at 18.

[100] The Postal Service's comments echo a set of proposed reforms already presented to Congress by Megan J. Brennan, Postmaster General and Chief Executive Officer. *See* House Oversight and Government Reform Committee Hearing, *"Reforming the Postal Service: Finding a Viable Solution,"* 114th Congress (May 11, 2016).

contingent upon the Postal Service's profitability. NALC Comments at 3. The Public Representative proposes a cancellation of RHBF payments which have already been defaulted on by the Postal Service. PR Comments at 33.

Additionally, the Postal Service has proposed full Medicare integration of the Federal Employees Health Benefits Program (FEHBP). USPS Comments at 20. It notes that 9 percent of Medicare-eligible annuitants and dependents do not take advantage of Medicare Part A, and 27 percent do not take advantage of Medicare Part B. *Id.* It suggests that "[n]o rational self-funding employer would pay Medicare taxes, yet continue to pay the full costs of health benefits that could be covered by Medicare in the first instance." *Id.* The Postal Service proposes the creation of a separately-rated Postal Service plan within FEHBP, appropriately assigning claims costs to Medicare, and establishing an Employer Group Waiver Plan for Medicare Part D prescription drug benefits. It asserts this would eliminate 94 percent ($54 billion) of the current unfunded RHB liability. USPS Comments at 20-21.

Valpak also supports full Medicare integration. Valpak Comments at 6. PostCom considers the prefunding requirement to be an "artificial" obligation, and suggests that its removal coupled with requiring Postal Service retirees to participate in Medicare would lead to an even greater reduction in liabilities. PostCom Comments at 4. MPA considers unused contributions to Medicare an "unjustified subsidy of the Treasury by the Postal Service and its customers." MPA Comments at 1.

The Postal Service also notes that the PAEA requires it to invest 100 percent of RHBF assets in low-yield Treasury securities. USPS Comments at 21. It points to other post-retirement funds for private-sector employees and for other public-sector employees that invest assets for growth in order to lower unfunded employer liability. *Id.* The Postal Service states that if RHBF assets had been allocated according to the Thrift Savings Plan's (TSP's) L 2040 portfolio, the unfunded liability would have been 18.4 percent lower in FY 2015. *Id.* at 22. The Postal Service proposes that 50 percent, and possibly up to 75 percent, of the fund's assets be invested with TSP's longest-term lifecycle fund. *Id.*

NALC also discusses RHBF fund investment in its comments, concluding that more diverse investment will "over the long run, improve the balance sheet of the OPM and reduce the cost of pre-funding for the Postal Service" allowing for affordable postage rates and better service to America's mailers and citizens. NALC Comments at 8.

Postmaster General Brennan's plan, which includes the three proposals outlined in the Postal Service's comments: a reduced funding target, full Medicare integration, and less restrictive investment is supported by PSA and NAPM. *See* PSA Comments at 2; NAPM Comments at 2-3.

In the 2011 Report, the Commission recommended that any excess CSRS funds caused by an overstated liability be transferred into the RHBF. *See* 2011 Report at 25. Both the Public Representative and Pitney Bowes support re-adopting the recommendation as a means of improving the overall financial situation. *See* PR Comments at 35; Pitney Bowes Comments at 1-2.

c. Borrowing Authority

As noted above, the Postal Service exhausted its statutory borrowing authority of $15 billion. FY 2015 Financial Report at 2. The Public Representative states that the Postal Service is consequently without flexibility to make necessary capital investments. PR Comments at 34. The Public Representative recommends that borrowing authority be increased to account for inflation in light of the need for financial flexibility and the need to make necessary investments. *Id.* at 35.

d. Accounting Standards

MPA suggests that "the Commission should recommend to Congress a study of the market value of the Postal Service's real estate assets." MPA Comments at 5. MPA notes that the Postal Service currently accounts for the net book value of real property, which does not reflect the Postal Service's true financial resources. *Id.* MPA goes on to assert that the net book value of the Postal Service's real estate is approximately $13.2 billion, and the fair market value has been estimated as high as $85 billion. *Id.* at 6. MPA posits that if the real estate was sold, it could yield its fair market value to satisfy its liabilities. *Id.* at 5.

Similarly, PostCom identifies property, plant, and equipment (PPE) as an area carried on balance sheets at the original cost. PostCom Comments at 5. PostCom states that because PPE often has a value far in excess of the original cost due to real estate appreciation, the PPE account of the Postal Service is a hidden strength. *Id.* It points out that the National Postal Museum Property was purchased for $47 million, but in FY 2011 had an assessed tax value of $304 million. *Id.* at 6. PostCom urges that the "true value" of Postal Service assets be accounted for in assessments of the Postal Service's financial situation. *Id.* at 5.

2. Comments on Market Dominant Rate System

a. Price Cap

Several parties noted that discussion of the price cap system is best reserved for the Section 3622 Review. USPS Comments at 26; GCA Comments at 2. Several parties, including PostCom and NAPM, express support for the current price cap system. PostCom Comments at 8; NAPM Comments at 4. However, PostCom asserts that costing and accounting methods should be improved to make the price cap system work more effective and efficiently. PostCom Comments at 9-10. In particular, PostCom asserts that the Postal Service should fully utilize data generated by the IMb system and other data systems to

evaluate the effectiveness of cost-reduction initiatives, identify cost drivers within the mail processing system, and develop more efficient pricing. *Id.* at 11.

The Postal Service, Valpak, and the Public Representative all maintain that major changes are needed to the price cap system. The Postal Service asserts that the price cap has been ineffective in allowing it to raise the revenue it needs to fulfill its statutory obligations as well as ensure the financial sustainability of universal service. USPS Comments at 26. Valpak states that the price cap does not remedy unfair pricing within a mail class, and urges Congress to amend the PAEA in a way that would prevent cross-subsidies within classes and require each Market Dominant product to cover its incremental cost in addition to making a "meaningful" contribution to institutional costs. Valpak Comments at 12, 26. The Public Representative opines that an amendment to the price cap system is necessary to factor in declining mail volumes and an increasing number of delivery points. PR Comments at 46-49. He discusses two potential amendments to the price cap previously proposed by the Postal Service's inspector general[101] — the revenue per delivery point adjustment and the hybrid cap adjustment methods — and notes that either of these methods would pose a superior alternative than the existing system. PR Comments at 50-53.

GCA and NAPM both raise a recommendation from the 2011 Report of the potential for the Postal Service to obtain increased pricing flexibility for quality of service enhancements. 2011 Report at 40. NAPM expresses support for this idea, asserting that such a credit would drive efficiencies in its operations and improve service performance. NAPM Comments at 6. GCA, however, opposes the credit, as it states that Market Dominant users would provide the majority of revenue for the benefit of Competitive users. GCA Comments at 5.

b. Exigent Surcharge

Several parties comment on the recent exigent surcharge removal. ACI asserts that the surcharge was detrimental to postal customers, and opposes any renewal or reinstatement of the surcharge because it would fail to address systemic problems of the Postal Service. ACI Comments at 1-3. APWU presents the opposite view, and states that the Commission should restore the surcharge because removal was a "boon to the major mailers . . . at a time when the Postal Service needs to restore its capital stock." APWU Comments at 4. GCA points to the surcharge as an example that the current price cap system is working and that an exigent increase can be counted on by the Postal Service in the event of another economic downturn. GCA Comments at 2. The Postal Service restates its position that

[101] United States Postal Service, Office of Inspector General, *Revisiting the CPI-Only Price Cap Formula*, Report Number: RARC-WP-13-007, April 12, 2013.

Congress reinstate the exigent surcharge and make it part of the rate base, at least pending the resolution of the Commission's Section 3622 Review. USPS Comments at 26. Valpak opposes legislative reinstatement of the surcharge and asserts that such a measure would be a repudiation of the pricing mechanism established in the PAEA. Valpak Comments at 5.

c. Worksharing

In its solicitation for comments in this docket, the Commission specifically sought public input on "the current operation of the provisions regarding workshare discounts, as well as insights on how the discounts and exceptions have functioned in practice." Order No. 3238 at 6. Of those who commented on worksharing, GCA alone stated that it was in favor of the status quo for worksharing discounts. GCA Comments at 7-8. Other commenters, including PSA, Pitney Bowes, Valpak, NAPM, the Public Representative, and APWU proposed suggestions for improvements to worksharing discounts.

PSA, NAPM, Pitney Bowes, and Valpak all express support for a requirement that worksharing passthroughs (or the amount of discount relative to avoided costs) also be prohibited from falling below 100 percent. PSA asserts that a "soft floor" for discounts would promote efficiency and ensure the work is being performed by the lowest cost provider. PSA Comments at 6. Pitney Bowes urges that several exceptions to the "soft floor" be allowed, subject to certain exceptions. Pitney Bowes Comments at 16. NAPM notes that such a rule would be consistent with statutory objectives and factors of the PAEA and would help improve operational efficiency. NAPM Comments at 8. Valpak suggests that the Commission should have the authority to adjust passthroughs upward if they fall below 100 percent. Valpak Comments at 28. The Postal Service opposes the idea of a soft floor on worksharing discounts because it states that such an approach would reduce its pricing flexibility. USPS Comments at 29.

The Public Representative recommends legislative changes to require the Postal Service to adjust workshare discounts annually to reflect its most recent cost avoided estimates. PR Comments at 55. He states that this change would ensure that discounts more accurately reflect avoided costs. *Id.*

APWU states that the Commission has been "passive" on excessive cost avoidances to date, and suggests that Congress authorize private complaints for unwarranted discounts. APWU Comments at 5.

3. Comments on Competitive Product Rate System

a. Comments on Competitive Contribution to Institutional Cost

The Commission received a number of comments pertaining to the appropriate institutional cost share requirement. Amazon, PSA, and the Postal Service oppose increasing the appropriate share from 5.5 percent of institutional costs. PSA and Amazon urge the Commission to eliminate the appropriate share requirement altogether. However, they advocate deferring consideration of the appropriate share to the next 5 year review or alternatively to the next phase of Docket No. RM2016-2. In Docket No. RM2016-2, Proposal Three, UPS proposed to increase the appropriate share of total institutional costs that Competitive products must cover.[102]

Amazon opines that "[u]nder current business conditions, the 5.5 percent minimum contribution requirement is essentially irrelevant." Amazon Comments at 5. It notes that the contribution made by Competitive products to institutional costs considerably exceeds 5.5 percent. It also suggests that if economic conditions change and the Postal Service cannot meet the contribution requirement, it "should be allowed to charge contribution-maximizing prices rather than lose the competitive business entirely." *Id.* It dismisses the notion that Competitive products would be subsidized by Market Dominant products if Competitive products didn't cover a share of the Postal Service's fixed costs. It contends that as long as the revenue of a product or a group of products covers the marginal and incremental costs of those products, the products are not subsidized. *Id.* at 6.

Amazon also notes that the Postal Service offers destination-entry prices for its Competitive services. *Id.* at 7. It asserts that the Postal Service's economies of scale, scope and density are largely in last-mile delivery. *Id.* It suggests that the fact that the Postal Service shares these advantages with its competitors by "unbundling last-mile delivery from upstream functions, and offering last-mile delivery to competitors at reasonable rates" minimizes the risk that the Postal Service's pricing could injure competition. *Id.* It observes that the Postal Service's primary competitors "enjoy healthy and growing profits." *Id.*

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[102] The Commission discussed the importance of the "appropriate share" requirement in Order No. 1449. It stated that: "[a] primary function of the appropriate share requirement is to ensure a level playing field in the competitive marketplace. The Postal Service's competitors incur certain fixed operating costs. If the Postal Service's competitive products were provided by a stand-alone enterprise, it too would incur fixed operating costs. The appropriate share requirement could be said to represent the fixed costs of the competitive enterprise and should reflect the ways in which institutional resources are spent on the competitive enterprise. If the Postal Service's competitive products were not required to contribute an appropriate share towards the institutional costs of the enterprise, this could result in the Market Dominant products cross-subsidizing the fixed costs of the stand-alone competitive enterprise. For this reason, the appropriate share requirement is an important safeguard to ensure fair competition on the part of the Postal Service." Order No. 1449 at 13.

PSA contends that the existing Competitive rate system has worked as intended. Similar to Amazon, it notes that the contribution of Competitive products to institutional costs is "substantially above 5.5 percent and growing." PSA Comments at 3. It asserts that because the contribution made by Competitive products far exceeds 5.5 percent, the current minimum contribution requirement has no effect on Postal Service pricing. It therefore advises the Commission to eliminate the minimum contribution requirement. *Id.*

The Postal Service asserts that it has been attempting to enhance contribution from Competitive products, as evidenced by the fact that Competitive products consistently outperformed the minimum 5.5 percent "appropriate share" requirement. It asserts the playing field is more likely tilted against the Postal Service than competitors. It cites a 2008 report by the FTC that concluded that the Postal Service's legal status places it at a competitive disadvantage and artificially heightens the prices of its Competitive products. USPS Comments at 15-16. It asserts that the situation is unlikely to have changed significantly in the intervening years. *Id.* at 16. It suggests that increasing the appropriate share would further tilt the playing field against the Postal Service. *Id.*

b. Comments on Competitive Products Costing

Commenters express a range of opinions regarding the proper methodology the Commission should utilize when calculating Competitive products' attributable cost. Commenters also express varied opinions regarding subsidization of the Postal Service's Competitive products by its Market Dominant products. Under the current attribution methodology, Competitive products cover their attributable cost. However, changes to the cost attribution methodology may affect the cost coverage of products.

UPS asserts that the methodology used by the Commission puts the Postal Service at a competitive advantage. UPS Comments at 3. It questions how the Postal Service allocates cost for new large investments made to develop the Postal Service's parcel business. *Id.* UPS proposes that the Postal Service "be required to provide a clear and complete disclosure of how it is accounting for new large investments, such as those requiring over $100 million in capital investment or $100 million in increased operational costs over five years, including a detailed description of how those costs are being attributed to individual products under 39 U.S.C. § 3633(a)(2)." *Id.* at 5. UPS asserts that either the Commission should impose this reporting requirement going forward or it should ask Congress to mandate it. *Id.*

Amazon and PSA opposed the methodological changes proposed by UPS in Docket No. RM2016-2. They opined that the current attributable and incremental cost tests adequately account for the marginal and incremental costs of the Postal Service. Amazon and PSA contended that Postal Service's domestic Competitive rates satisfy the prohibition against

subsidization of Competitive products by Market Dominant products. Amazon Comments at 2, PSA Comments at 3.

The Postal Service also opposed UPS's proposals. Unlike UPS, it contended it is at a competitive disadvantage compared with private carriers. It urged the Commission to "reject any call to recommend changes to the cost attribution standards in 39 U.S.C. §§ 3622(c)(2) and 3631(b)." USPS Comments at 15.

Former Utility Regulators discuss the importance of preventing the subsidization of Competitive products by "monopoly" products. FUR Comments at 1-2. It suggests that the Commission ask Congress for whatever tools it needs to prevent cross-subsidization and ensure that Competitive products cover their costs. FUR Comments at 2. With its comments, Former Utility Regulators includes a white paper titled *"Cross-Subsidization: Applying Lessons From Utility Regulation To The United States Postal Service,"* Bryan Tramont, Raymond Gifford, and Greg Sopkin, June 14, 2016 (White Paper). The White Paper provides an overview of how utility regulators, across a variety of sectors, have dealt with "issues presented when a monopoly provider of utility services also provides services in competitive markets." FUR Comments at 1. Specifically, the White Paper discusses the experience of utilities in preventing cross-subsidization of Competitive products by monopoly products and reviews several regulatory alternatives for preventing cross-subsidies including structural separation, line of business restrictions, and accounting separations. With regard to accounting separations, the White Paper emphasizes the importance of accurate and detailed cost data and transparency regarding the cost assignment methodologies employed. White Paper at 10. It concludes that "[l]essons from the utility sector demonstrate that, in order to be effective in preventing cross subsidization, accounting separation must, at a minimum: 1) be based on accurate and reliable cost data; 2) approach cost assignment and allocation in a transparent manner; and 3) direct assign costs to the maximum extent possible, leaving to allocation only those joint and common costs that are truly incapable of being direct assigned." *Id.* at 20.

Lexington Institute includes a paper with its comments titled *"Practices of the U.S. Postal Service That Imply Anti-Competitive Behavior: Historical Parallels and Remedies Across Other Regulated Sectors"*, Don Soifer, June 14, 2016 (Soifer Paper).

The Soifer Paper asserts that the cost burden assigned to regulated products is disproportionate to that imposed on Competitive products, effectively giving the latter a financial boost, if not a free ride. Soifer Paper at 1. It discusses legal and regulatory remedies based on structural separations, as well as accounting separations. *Id.* The Soifer Paper discusses the experience of monopolies in the telecommunications, electric utilities and government research sectors. *Id.*

The Soifer Paper notes that "[b]ecause mail and packages are so physically different that their processing requires separate infrastructure, some potential for structural separation between monopoly and competitive activities is possible without significant disruption to economies of scale for market-dominant mail products." *Id.* at 14. Where structural separation of activities is not practical, the Soifer Paper asserts that "accounting separation should establish a fair market value charge for utilization of shared infrastructure . . . ." *Id.*

4. Comments Summary

a. Competitive NSAs

Amazon and PSA both submitted comments in favor of the current statutory system for reviewing Competitive NSAs. Amazon expresses the view that the current review system for Competitive NSAs should remain unchanged, as the current products generate additional volume and contribution for the Postal Service. Amazon Comments at 10. PSA views Competitive NSAs as a major success of the PAEA. PSA Comments at 5.

b. Commission Procedures Regarding Non-public NSA Information

Both PSA and APWU commented on the Commission's current procedures for obtaining access to non-public materials. PSA is not opposed to the current process by which interested parties may request and be granted access, subject to protected conditions, to non-public material regarding the Postal Service's costs, but asserts that the bar for justifying access to customer-specific NSA information should be much higher. PSA Comments at 5. PSA does not propose an alternative standard for accessing customer-specific information. *Id.*

APWU takes the opposite view, asserting that the confidentiality of contract partner identity may give the contract partner an unfair advantage over its competitors, and urges Congress and the Commission to require that NSAs (both Competitive and Market Dominant) be made public "to provide for public scrutiny of deals that the Commission currently reviews in secret." APWU Comments at 6.

c. Comments on Market Dominant NSAs

No party submitted comments regarding international Market Dominant NSAs. The Public Representative, Pitney Bowes, PostCom, and Valpak all submitted comments about domestic Market Dominant NSAs.

The Public Representative maintains that the Commission's approach of using elasticities to determine if a domestic Market Dominant NSA will improve the net financial position of the Postal Service is consistent with the PAEA. PR Comments at 60. He also states that the PAEA sets the appropriate standards to ensure that the Postal Service does not engage in

unprofitable agreements, and thus recommends that the current standard remain unchanged. *Id.* at 60-61.

Pitney Bowes characterizes the current regulatory approval process for domestic Market Dominant NSAs as "expensive and uncertain" and goes on to state that the standard adopted by the Commission for establishing net financial improvement to the Postal Service's financial situation has had a chilling effect on the number of Market Dominant NSAs negotiated by the Postal Service. Pitney Bowes Comments at 19. It urges the Commission to reassess how it evaluates risk for domestic Market Dominant NSAs, stating that a lower burden of proof or a higher risk tolerance would both be justified. It also asserts that the Commission should encourage the Postal Service to pursue domestic Market Dominant NSAs that will improve the operational efficiency or enhance the performance of mail preparation, processing, transportation, and other functions. *Id.*

PostCom concurs with Pitney Bowes, stating that domestic Market Dominant NSAs have not lived up to their potential because the metrics and process employed by the Commission to evaluate NSAs discourages both mailers and the Postal Service from entering into these agreements. PostCom Comments at 13. It asserts that review of such agreements should be limited, and so long as the contract does not represent an abuse of market power and is available to similarly situated mailers on reasonably equivalent terms, it should be approved by the Commission. *Id.*

Valpak asserts that overall, domestic Market Dominant NSAs have been highly unprofitable. Valpak Comments at 30-31.

5. Comments on Post Office Closings and Consolidations

a. Comments Received in Response to Order No. 3238

The Commission received comments on post office closings that suggest these closings have contributed to the Postal Service's declining levels of service. APWU cites declining service dating back to the Postal Service's "massive program of plant closings and consolidations since [FY] 2012." APWU Comments at 6. It calls for a mandatory reversal of consolidations of the past 5 years, and cancellation of any consolidations planned for FY 2017. *Id.* at 6-7.

Commenters address both the scope of the Commission's review of appeals and the definition of the term "post office." Mittleman and Hutkins express disagreement with the

opinion issued by the U.S. Court of Appeals for the District of Columbia Circuit in *Mittleman v. Postal Regulatory Commission*,[103] which held that Commission orders concerning appeals of closings are not subject to judicial review. *See* Hutkins Comments at 3; Mittleman Comments at 15-16.

PostCom argues that as long as adequate service is maintained, the Postal Service should be allowed flexibility to close or consolidate post offices for economic efficiency. PostCom Comments at 16. It further maintains that the Postal Service should be afforded means of mitigating exogenous costs, such as co-location of additional government services in postal facilities to maximize the value of the location to the community. *Id.*

Both Hutkins and Mittleman also recommend Congress and the Commission clarify the definition of a post office. Mittleman suggests abolishing the concept of stations and branches, recommending that there be no distinction between main post offices, stations, and branches. Mittleman Comments at 15. Both Mittleman and Hutkins suggest clearer definitions of "rearrangements" of postal retail facilities in a community Hutkins Comments at 2; Mittleman Comments at 13-14.

The Public Representative proposes changes to the Postal Service's emergency suspension procedures. PR Comments at 65. His proposed changes include a mandatory feasibility study, with a deadline for the study's completion, as well as a deadline for the Postal Service to propose discontinuance of a facility to prevent an emergency suspension from operating as a *de facto* closure without any right to appeal. *Id.* He supports the Commission's 2011 Report recommendations that the Postal Service be required to provide regular reports on its plans and activities regarding its retail network, and that the scope of the Commission's appellate review be clarified to include Postal Service stations and branches. *Id.* at 66.

Cheney proposes that Congress require the Postal Service to offer mitigation measures to displaced Postal Service employees, including reemployment assistance and early retirement benefits. Cheney Comments at 1.

b. Comments Submitted in Docket No. PI2016-2

The Commission has determined in appeals cases that Postal Service decisions to relocate retail facilities within the same community are not closings or consolidations and, therefore, fall outside the scope of the Commission's jurisdiction under 39 U.S.C. § 404(d). *See* Order No. 436 at 7. Under this rationale, the Commission has dismissed several post office closing appeals and found that transfers of retail operations constituted *relocations*

[103] *Mittleman v. Postal Regulatory Commission*, Nos. 12-1095, 12-1110, 12-1157 (D.C. Cir. filed Jul. 8, 2014).

which it lacks jurisdiction to review under section 404(d). *See* Order No. 2862 at 5. Similarly, the Commission has consistently dismissed several post office closing appeals on the grounds that the Postal Service action constituted a *rearrangement* of retail facilities within a community.

The Commission received several comments on relocation and rearrangement of postal services in Docket No. PI2016-2. The comments reflected competing perspectives on the Commission's jurisdiction in appeals of post office relocations and rearrangements. Many commenters proposed a broader interpretation of the Commission's authority, suggesting that limiting jurisdiction permits the elimination of a community's access to effective or regular postal services without the statutory safeguards for process.[104] On the other hand, the Postal Service's comments argued for a more limited interpretation of the scope of 39 U.S.C. § 404(d), stating that in addition to a determination that the Commission lacks jurisdiction to review relocations and rearrangements, closings of branches and stations should likewise not be subject to review. Docket No. PI2016-2, USPS Comments at 1.

CPUs and Community Post Offices (CPOs) are types of contractor-operated (as opposed to Postal Service-operated) facilities. *See* 39 C.F.R. § 241.3(a)(2)(ii). A CPU is a contract station, contract branch, or CPO operated under contract by persons who are not postal employees in a space provided by the contractor.[105] Village Post Offices (VPOs), although operated under a contract, are not classified by the Postal Service as a CPU.[106] While CPUs generally do not fall within the scope of 39 U.S.C. § 404(d), in select circumstances when the Commission determines that a CPU is the sole source of postal retail services to a community, it has found that section 404(d) (both the statutory intent and language) justifies the Commission exercise of review authority over sole source CPU closures and consolidations.[107]

Comments on the "sole source" standard for the exercise of the Commission's review authority were mixed. The Postal Service urged that Commission review of CPU closures

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[104] *See, e.g.,* Docket No. PI2016-2, Public Representative's Comments on the Commission's Ability to Review Postal Service Determinations to Close or Consolidate Any Post Office, February 5, 2016, at 7.

[105] Postal Operations Manual section 123.126, Issue 9, July 2002, Updated With Postal Bulletin Revisions Through October 31, 2013 (POM); *see also*, Publication 32 – Glossary of Postal Terms, July 2013, *https://about.usps.com/publications/pub32/* (Glossary of Postal Terms), defining a CPU as a "postal unit that is a subordinate unit within the service area of a main Post Office. It is usually located in a store or place of business and is operated by a contractor who accepts mail from the public, sells postage and supplies, and provides selected Special Services (e.g., Postal Money Order or Registered Mail). Also called contract branch, contract station, and community Post Office unit."

[106] *See* Village Post Offices Fact Sheet, July 2011, *https://about.usps.com/news/electronic-press-kits/expandedaccess/assets/pdf/vpo-fact-sheet-110726.pdf.* VPOs, like CPUs and CPOs, are part of the Postal Service's "Approved Postal Provider" network and are retail outlets for postal products and services operated by a third party.

[107] *See* Docket No. A83-30, *In the Matter of Knob Fork*, West Virginia 26579, Commission Opinion Remanding Determination for Further Consideration 39 U.S.C § 404(b)(5), January 18, 1984, at 7.

"impedes the effective management and operational authority of the Postal Service" and is otherwise not supported by legislative history. Docket No. PI2016-2, USPS Comments at 10-11. Other commenters argue CPUs should be considered under the definition of "post office" and thus be subject to review, and that the sole source standard is applied too narrowly.[108]

6. Comments on Service Performance

The Commission received a range of comments on different areas related to service standards and performance.

Several commenters note generally that service performance has declined. APWU states that continued declining service will lead to a decline in volumes, and that Congress should restore service standards to pre-2012 levels. *See* APWU Comments at 8-9. Similarly, AGA expresses concern that the Postal Service has "slowed mail service, closed community based Post Offices and mail processing facilities, slashed hours of operations, tried ceaselessly to end six day service as well as door to door delivery." AGA Comments at 2. AGA believes that Congress should restore service standards to pre-2012 levels, and protect 6-day and door-to-door delivery. *Id.* at 3.

O'Donnell, a Postal Service employee, cited the consolidation of mail processing facilities as a cause of delayed mail. O'Donnell Comments at 1. O'Donnell also suggests reducing customers' time in line by "properly staffing post office windows" and restoring service hours. *Id.*

PostCom focuses its comments on the Commission's oversight of service standards and performance. *See* PostCom Comments at 16-17. PostCom notes that the Postal Service "cannot even meet the standards it has set for itself" and that it is imperative that the Commission oversee a move to higher quality operations that truly reduce costs and meet the needs of customers. *Id.* at 17. PostCom suggests that the Commission have ultimate authority to set and enforce service standards. *Id.* at 18.

Valpak focuses its comments on the recommendation in the Commission's 2011 Report that Congress consider providing an opportunity for the Postal Service to achieve increased pricing authority for increases in quality of service. *See* 2011 Report at 28, 40. Valpak recommends that consideration of service quality pricing authority should be deferred. Valpak Comments at 33. It states that should such a system be implemented, it should cut both ways as a financial incentive for improving service and as a penalty for declining

[108] *See, e.g.,* Docket No. PI2016-2, Reply Comments of Steve Hutkins on the Commission's Jurisdiction Over Post Office Closings, March 29, 2016, at 13-15 (Docket No. PI2016-2, Reply Comments of Steve Hutkins).

service. *Id.* at 31-32. Valpak states that until better service performance data are available, and given the Postal Service's low financial liquidity, "implementation of any meaningful penalty provision for service degradation likely would be impractical as it might threaten the Postal Service's continued financial viability." *Id.* at 32-33.

UPS comments on the relationship between service performance and the Postal Service's prioritization of certain products. Specifically, UPS notes that service performance results for Standard Mail Carrier Route, Standard Mail Flats, and Standard Mail Letters have not met their targets for several years and have not shown significant improvement, while parcels and other high density shipments "exceeded the performance targets set by the Postal Service." UPS Comments at 9. UPS maintains that these results are reflective of the Postal Service prioritizing service standards "for specific high-growth products, like parcels, over the service standards for monopoly products, like letter mail." *Id.* at 8-9. UPS urges Congress to require the Postal Service to adhere to quality of service reporting requirements of 39 U.S.C. § 3652 for its Competitive product lines as well as Market Dominant products. *Id.* at 10. UPS says "[this requirement would allow for a fair comparison of the quality of service being provided for the Postal Service's market-dominant business" against quality of service for its Competitive products business. *Id.*

7. Comments on Nonpostal Services

The Commission received comments on nonpostal services from the Postal Service, AGA, APWU, Pitney Bowes, NAPM, CAGW, CPB, Yao, and O'Donnell. The commenters fall into three general categories: those that favor expanded nonpostal services, those that oppose the expansion of nonpostal services, and those that favor limited expansion. Several of these comments offered specific nonpostal services that should be considered. Other comments suggested that the Postal Service should not offer any nonpostal services at all.

Commenters in favor of expanded nonpostal services include CPB, APWU, AGA, Yao, and O'Donnell. CPB states that 28 percent of domestic households lack access to affordable financial services and asserts that because the Postal Service is a trusted, accessible, and secure government agency with the world's largest retail network, it is in a unique position to fill the public need. CPB Comments at 1-2. CPB notes that the U.S. has a tradition of postal banking and continues to offer domestic and international money orders and wire transfers. CPB argues that permitting the Postal Service to offer financial services (*e.g.,* ATMs, savings accounts, and small dollar loans) would both serve the public and strengthen the Postal Service financial situation. *Id.* at 2.

Other commenters, including APWU, Yao, AGA, and O'Donnell, support the expansion of postal banking. APWU Comments At 3; Yao Comments at 1; AGA Comments at 3*;* O'Donnell Comments at 1.

Both NAPM and CAGW oppose the expansion of nonpostal services. NAPM expresses its concern that core competencies will suffer if the Postal Service is permitted to enter into commercial nonpostal markets, because limited resources will be diverted. *See* NAPM Comments at 8; CAGW asserts that the Postal Service "shouldn't be dabbling in financially volatile, nascent start-up services." CAGW Comments at 1.

Commenters supporting a limited expansion of Postal Services include PSA, Pitney Bowes, and the Postal Service. PSA argues that the Postal Service lacks the resources to maintain its existing services while exploring new nonpostal endeavors. PSA Comments at 7. PSA does, however, support proposals to specifically authorize the Postal Service to provide governmental services in lieu of local or state governments. Pitney Bowes shares the view that the Postal Service should be permitted to provide other governmental services to state, local, and tribal governments, but says that the offering of commercial nonpostal services would distort private markets and divert from the Postal Service's core competencies. Pitney Bowes Comments at 17.

The Postal Service recommends a "somewhat expanded" range of services, which could provide needed revenue. USPS Comments at 29-30. Specifically, the Postal Service suggests that it be permitted to enter into agreements to provide services to state, local and tribal governments. *Id.* at 30. The Postal Service mentions that it could be permitted to carry beer, wine, and distilled spirits through the mail as a potential expanded service, and says that the Commission should be allowed to approve other new nonpostal services that are consistent with the public interest, do not cause unfair competition, do not interfere with the value of postal services, comply with all applicable federal laws and regulations, and are expected to improve the Postal Service's net financial position. *Id.*

8. Comments on Advisory Opinion Process

PostCom maintains that as long as the Commission's opinion remains advisory and the Commission lacks the power to enforce its conclusions, there is no need for a hearing on the record. PostCom Comments at 18. It notes that, although valuable information may be gained during advisory opinion proceedings, so long as the Postal Service is not obligated to follow the Commission's recommendations, "the expenditure of resources to develop that information is entirely wasted." *Id.* at 19. It suggests that the advisory opinion process should either be abolished entirely or revised to provide the Commission with a means of enforcing its recommendations. *Id.*

The Public Representative opposes elimination of the hearing on the record requirement. PR Comments at 69. He asserts that the requirement "ensures that stakeholders . . . have the opportunity, through the discovery and adjudicatory hearing procedures, to explore the potential implications of the Postal Service's proposals." He notes that the Postal Service proposals are often presented to the Commission with "no established body of relevant

data and information," which distinguishes N-cases from annual compliance determinations and rate proceedings, for which a hearing on the record is not required. *Id.* He states that, for the reasons stated by the Commission in its 2011 Report, section 3661 should be amended to require that the Postal Service provide a written response to advisory opinions. *Id.* at 70.

APWU asserts that the current 90-day process does not provide the requisite level of due process for unions and customers. APWU Comments at 10. It urges Congress to change the advisory opinion process to allow for extensions to the advisory opinion process to give stakeholders the opportunity to prepare documentation and testimony. *Id.*

9. Comments on Market Tests of Experimental Products

The Commission received comments on statutes and regulations regarding market tests from the Public Representative, CAGW, and Pitney Bowes. The comments illustrate different perspectives of members of the postal community.

The Public Representative opines that the framework for the regulation of market tests is working as intended and should not be altered. PR Comments at 71.

CAGW holds the opinion that "the Postal Service shouldn't be dabbling in financially volatile, nascent start-up services." CAGW Comments at 1. The CAGW position is that the Postal Service should not "venture outside of its core mission of delivering letter mail." *Id.*

Pitney Bowes comments that no market test has had a material effect on the Postal Service's financial condition due to statutory limitations on duration and anticipated revenues. Pitney Bowes Comments at 18. Pitney Bowes suggests that the Commission recommend increases on the duration and revenue cap limitations, and commensurate increase in the Postal Service's burden to demonstrate that introduction of the experimental product "will not create an unfair or otherwise inappropriate competitive advantage for the Postal Service." *Id.* at 18-19.

10. Comments on Universal Service and the Postal Monopoly

The Postal Service asserts that many of the cost savings from improved efficiency are limited by legal and universal service constraints. USPS Comments at 12.

UPS and Amazon both commented on the FTC report. UPS asserts that the FTC report should be updated in light of the Postal Service's expansion of its parcel delivery business.

UPS Comments at 5. Additionally, UPS maintains that the FTC Report appears to have underestimated the Postal Service's competitive advantages, particularly those related to the postal monopoly. *Id.* at 6. It disagrees with the report's conclusion that worksharing and economies of scale and scope reduce the Postal Service's competitive advantage. *Id.* at 6-7. It recommends that Congress revisit the need for, and appropriate scope of, the mailbox monopoly. *Id.* at 7-8.

Amazon also comments that the FTC Report is dated, but reaches the opposite conclusion from UPS and asserts that subsequent developments, including the transfer of several Market Dominant products to the competitive product list, the substantial rise in average competitive product price, and the growing profitability of private carriers, have reduced the risk that distinct legal treatment of the Postal Service could disadvantage its competitors. Amazon Comments at 7-8. It goes on to state that the Postal Service's policies of sharing economies of scale, scope, and density through last mile delivery provide an additional layer of protection from competitive harm. *Id.* at 8. It notes that the FTC Report did not include in its estimate the cost burden associated with the Postal Service's limited ability to invest its retirement account assets in U.S. Treasury securities. *Id.*

11. Comments on the Public Representative

UPS states that the Public Representative serves a valuable role in Commission proceedings by facilitating the public's understanding of the Postal Service's practices and serving an important advocacy role for the general public. UPS Comments at 11. APWU suggests overhauling the Commission's current method of assigning Public Representatives in favor of creating an independent Consumer Advocate role at the Commission to help individuals participate in Commission dockets. APWU Comments at 11.

The Public Representative concurs with UPS, asserting that the participation of Public Representatives has contributed to better informed Commission decisions and benefits the public good by providing an experienced Commission staff member capable of presenting information and arguments in a form that is persuasive and familiar to decisional staff. PR Comments at 72.

III. CONCLUSION

The Commission appreciates the opportunity to contribute to the essential discussion of postal policy by providing its second 701 Report to measure the effectiveness of the PAEA. In this 701 Report, the Commission has identified areas where adjustments to postal laws could address key issues including the Postal Service's current liquidity crisis. It expects to conduct a more in depth review of the Postal Service's Market Dominant system of ratemaking in its Section 3622 Review.

Section 701 Report Recommendations

- The Commission recommends that Congress amend the current required RHBF prefunding level to comport with standard industry practice in both private and public sectors.
- The Commission recommends lengthening the amortization period of the current unfunded liability.
- The Commission recommends that Congress grant the Postal Service the authority to use available FERS surpluses to pay off current or future liabilities.
- With clearly defined and limited exceptions, the Commission recommends establishing a "soft floor" (a lower limit subject to certain exceptions) on worksharing discounts, which would benefit the postal community by providing appropriate pricing signals to incentivize efficient mail preparation.
- The Commission again recommends that the definition of a post office be clarified to adopt the plain meaning of the term post office, inclusive of branches and stations.
- The Commission recommends clarification on whether CPUs and nonpostal operation units also fall under the Commission's administrative review authority under section 404(d).
- The Commission recommends consideration of the duration of emergency suspensions of post offices.
- The Commission recommends that Congress consider clarifying under which circumstances the Postal Service is required to consult with the Commission when making proposed service standard changes.
- The Commission recommends that Congress clarify the meaning of section 3691 and the requirement that the Postal Service set service standards "in consultation with" the Commission.
- The Commission recommends that if the Postal Service is permitted to offer new nonpostal services, proposed nonpostal services be subject to the same regulatory review the Commission applied when reviewing existing nonpostal services pursuant to section 404(e)(3).
- The Commission recommends that where a proposed nonpostal service meets the statutory test, the Commission should have the authority to designate the service as a Market Dominant, Competitive, or experimental product.

- The Commission recommends that Congress consider adding language to 39 U.S.C. § 3661 that requires the Postal Service, upon receipt of the Commission's advisory opinion, and prior to implementation, to provide a written response to Congress addressing the Commission's recommendations.
- The Commission recommends that Congress consider raising the maximum revenue limitation on market test products thereby providing the Postal Service with more opportunities for advancement of new postal products to bolster revenue streams.
- The Commission recommends that Congress increase the maximum duration on market tests for experimental products.
- The Commission recommends Congress consider allowing the Postal Service to satisfy the requirements of section 3641(b)(2) by setting forth a reasonable basis for its belief that an experimental product would not cause market disruption.
- The Commission urges Congress to consider and balance all the features of universal service as part of any review of changes necessary to preserve a financially viable Postal Service.
- The Commission concurs with commenters that the postal industry and general public could benefit from an updated FTC Report with a more current accounting for the value of relevant legal differences between the Postal Service and its private competitors.

THOMAS J. MARSHALL
GENERAL COUNSEL
AND EXECUTIVE VICE PRESIDENT

UNITED STATES
POSTAL SERVICE

November 9, 2016

The Honorable Robert G. Taub
Acting Chairman
Postal Regulatory Commission
901 New York Avenue, NW, Suite 200
Washington, DC 20268-0001

Dear Chairman Taub:

Enclosed with this letter please find the Postal Service's comments on the report prepared by the Postal Regulatory Commission pursuant to Section 701 of the Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, 120 Stat. 3198, 3242-43. As you know, Section 701(b) requires that these comments be attached to the final report that the Commission transmits to the President and Congress. I look forward to reviewing the final report.

Sincerely,

Thomas J. Marshall

Enclosure

cc: Mr. Trissell

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POSTAL SERVICE COMMENTS TO THE COMMISSION'S SECTION 701 REPORT

The Postal Regulatory Commission's Section 701 Report is an important opportunity to apprise the President and Congress of the Postal Service's financial condition and to recommend measures "necessary to improve the effectiveness or efficiency of the postal laws of the United States."[1] The report that the Commission provided the Postal Service on October 20, 2016, takes that opportunity to highlight the Postal Service's dire financial condition, which results from a combination of declining mail volumes and legal constraints.[2] The Commission has sounded this alarm in other reports, and it does well to do so again here.

The Commission acknowledges that "the most important legislative recommendations the Commission can make relate directly to improving the financial condition of the U.S. Postal Service."[3] The Postal Service agrees. As it explained in its comments leading up to the Section 701 Report, the Postal Service must achieve financial stability in order to ensure the future of universal postal service and fulfill all of its legal obligations. However, current law leaves the Postal Service with inadequate tools to address the problems that loom before it, particularly (1) declining mail volumes, especially in high-contribution First Class Mail, coupled with rising delivery points; and (2) excessive benefits liabilities. Therefore, meaningful solutions will need to come from Congress, through the passage of postal reform legislation, and the Commission, through the replacement of the current price cap system with a more suitable regulatory structure upon conducting the ten-year review required under 39 U.S.C. § 3622(d)(3).

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[1] Postal Accountability and Enhancement Act of 2006, Pub. L. No. 109-435, § 701(a).

[2] Postal Regulatory Comm'n, Section 701 Report: Analysis of the Postal Accountability and Enhancement Act of 2006 (Oct. 20, 2006) [hereinafter "Section 701 Report"], at 1, 4-6.

[3] *Id.* at 1.

Regarding the topic of postal reform legislation, in its comments, and consistent with what it had "already developed and presented [to] Congress," the Postal Service offered a "a set of common-sense reforms that would put the Postal Service on a more stable financial footing, allowing for further innovation, investments, and growth for the Postal Service, and the mailing industry as a whole."[4] The reforms discussed by the Postal Service are:

1) Retiree health benefits (RHB) should be fully integrated with Medicare.
2) The RHB liability should be calculated using net claims costs, rather than premium costs, in accordance with sound actuarial practice.
3) RHB Fund assets should be invested prudently, as is the practice among other governmental retiree benefits funds.
4) The RHB funding target should be lowered from 100 percent to 80 percent.
5) Pension liabilities should be calculated on the basis of postal-specific economic and demographic assumptions.
6) Any current Federal Employees Retirement System (FERS) surplus should be used to pay down debt; future surpluses should be applied against pension or RHB liabilities or debt.
7) The amortization period for supplemental Civil Service Retirement System (CSRS) liability should be lengthened to match the period for RHB.
8) The exigent surcharge should be restored as a policy matter (regardless of whether the Commission-ordered rollback of the surcharge is a reasonable application of the current statute).
9) The Postal Service should be given increased flexibility to offer services to state and local governments, as well as new commercial nonpostal services that meet certain conditions (including approval by the Commission).[5]

[4] United States Postal Service Comments in Response to Order No. 3238, PRC Docket No. PI2016-3 (June 14, 2016) [hereinafter "USPS Comments"], at 17. Consistent with certain other parties, the Postal Service encouraged the Commission to defer matters implicated by the ten-year review to the review itself, rather than addressing such matters in its Report. *Id.* at 26-27. The Commission prudently determined to follow this course of action. Section 701 Report at 2-4, 10.

[5] USPS Comments at 16-30.

Taken together, these reforms would "constitute significant progress towards financial sustainability of the Postal Service" and would reduce "the financial gap that will have to be reckoned with in the ten-year review of the market-dominant rate regulation system."[6] Many of these proposals also enjoy the support of a broad cross-section of postal stakeholders, as reflected in other parties' comments to the Commission.[7]

Despite its acknowledgment of the importance of recommendations aimed at improving the Postal Service's financial problems, and despite the presence of these and other substantive reform proposals in the comments that the Commission had solicited,[8] the Commission's report misses the opportunity to make any such "important legislative recommendations." Instead of offering the President and Congress with an analysis and endorsement of any up-to-date proposals, the Commission largely retreads its recommendations from 2011, few of which have garnered much support in the meantime. More to the point, almost none of the Commission's 17 recommendations would meaningfully improve the Postal Service's financial condition. Most of the recommendations amount to minor tinkering with the regulatory structure governing the Postal Service, rather than reforms that would materially mitigate

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[6] *Id.* at 18.

[7] *Id.* at 17-18; *see also* Comment of the National Association of Letter Carriers, AFL-CIO, PRC Docket No. PI2016-3 (June 20, 2016), at 1-8; Comments of the American Postal Workers Union, AFL-CIO, PRC Docket No. PI2016-3 (June 14, 2016), at 4; Comments of the Association for Postal Commerce, Major Mailers Association, and Saturation Mailers Coalition, PRC Docket No. PI2016-3 (June 14, 2016), at 2-3; Comments of the National Association of Presort Mailers, PRC Docket No. PI2016-3 (June 14, 2016), at 2-3; Comments of MPA-Association of Magazine Media and Alliance of Nonprofit Mailers, PRC Docket No. PI2016-3 (June 14, 2016), at 1-6; Valpak Direct Marketing Systems, Inc. and the Valpak Franchise Association, Inc. Comments on Commission Report to the President and Congress Pursuant to Section 701 of the Postal Accountability and Enhancement Act, PRC Docket No. PI2016-3 (June 14, 2016), at 6-7.

[8] The Public Representative also offered concepts that, while different from the proposals that other commenters advanced, would similarly appear to make a significant contribution toward improving the Postal Service's financial condition. Public Representative Comments, PRC Docket No. PI2016-3 (June 15, 2016), at 33-53.

expenses or enhance revenues. Of the three recommendations aimed at the Postal Service's staggering benefits costs, one (regarding pensions) would have only theoretical benefit, and the other two (regarding RHB) would only lower funding obligations without reducing the size of the liability that the Postal Service will ultimately have to cover, even though there are straightforward ways, consistent with universal practice among other employers, for that liability to be reduced. These comments explain why those three recommendations are inadequate, and will offer additional discussion about some of the Commission's other recommendations.

I. Reform of the Retiree Health Benefit Obligation

The Postal Service's Retiree Health Benefit ("RHB") reform proposals would, by integrating the Postal Service's retiree health program with Medicare, significantly reduce its liability in the Postal Service Retiree Health Benefits Fund (PSRHBF), and hence lower the Postal Service's normal cost payments and eliminate the need for large annual amortization payments to cover the unfunded RHB liability.[9] As the Postal Service explained, this action would harmonize the Postal Service's RHB obligations with best practices of private and other public employers, which uniformly integrate benefits fully with Medicare Parts A, B, and D. As part of this proposal to integrate with Medicare, the Postal Service also proposes to change the law to accord with actuarial principles, by having the RHB liability calculated based on net claims costs (rather than premiums), and by using a discount rate based on funding assumptions (rather than accounting standards).

[9] Beginning in FY2017, the Postal Service is obligated to make two payments in to the PSRHBF: (1) a normal cost payment, and (2) an amortization payment to address the unfunded accrued actuarial liability.

Furthermore, the Postal Service also proposes to better align its RHB funding obligations with the private sector in two other ways, by investing a portion of fund proceeds in diversified portfolios rather than exclusively in low-yield Treasury securities, and by funding 80 percent of the RHB liability, rather than 100 percent. In both of these respects, the Postal Service's proposal is much more modest than what is done by other private and public employers; for instance, other employees that provide retiree health benefits prefund a far lower portion of their RHB liabilities than the Postal Service is currently required to do, or even what the Postal Service would do under its proposal.

A host of other commenters – mailing industry and labor alike – lent their support to these common-sense proposals. Inexplicably, however, the Commission has chosen not to support Medicare integration, but to recommend only two RHB reforms:

1) Lengthen the amortization period for the unfunded liability beyond the current 40-year schedule; and

2) Adjust the funding target from 100 percent of RHB liabilities to an unspecified "level in line with industry norms."[10]

Legislative reform regarding RHB that is limited solely to an extension of the amortization schedule and a reduced funding level would reduce the Postal Service's funding obligations in the near term as compared to current law, but would do nothing to address the central problem: the excessive, unaffordable, and unsustainable RHB liability. As the Postal Service pointed out in its comments, "retiree health benefits are real obligations [for which] there must be a reckoning, or else there will be no money to pay for retirees' promised benefits."[11] Under current law, the costs of the Postal Service's RHB program are excessive, due to the fact that a significant proportion of

[10] Section 701 Report at 6-7.

[11] USPS Comments at 18.

postal annuitants fail to enroll in Medicare when they become eligible, even though the Postal Service and its employees have paid into Medicare for decades. Ultimately, those costs will have to be paid by the Postal Service, either by setting money aside in the PSRHBF or by directly covering annuitant premiums after the PSRHBF is exhausted due to a lack of adequate inflows from the Postal Service's payments to the Fund (under current law, if the PSRHBF is exhausted, the obligation to pay annuitant premiums reverts back to the Postal Service).[12] However, in the future, the Postal Service will have even less mail volume than it does today, and hence less ability to cover those costs. This would, in turn, raise the prospect that at some point there will either be a cessation of promised benefits or a cash infusion from taxpayer funds to cover those benefits, contrary to the fundamental statutory policy that the Postal Service be self-sufficient. Alternatively, ratepayers will have to make up the difference.

To be sure, the Postal Service agrees that the prefunding level should be adjusted: as noted above, it is one of the elements of the Postal Service's proposal to lighten the unreasonable and crushing RHB prefunding burden. Indeed, both the Postal Service's proposed 80-percent funding level and the Commission's hypothesized 50- to 70-percent levels are far above "industry norms." Almost two-thirds of Fortune 1000 companies prefund 0 percent of their RHB liabilities, and the remaining third prefunded

[12] In its earlier comments, the Postal Service pointed out that, if it is unable to make normal cost and amortization payments into the RHB Fund, "the fund could run out of money in a little over a decade." *Id.* at 19. The Congressional Budget Office (CBO) recently underscored this point with its estimate that, under a current law baseline, the RHB Fund would exhaust Treasury balances by 2026 if 25 percent of fund assets were removed from the Treasury in 2017 for investment in non-Treasury funds. Cong. Budget Off., Cost Estimate: H.R. 5707, Postal Service Financial Improvement Act of 2016 (Oct. 20, 2016), at 2, *available at* http://go.usa.gov/xksPn. If those assets were kept in the RHB Fund (as is the expectation under current law), the CBO estimate suggests that exhaustion would likely occur in 2028. Of course, making smaller payments under a longer amortization schedule and reduced funding target would lengthen the amount of time before the PSRHBF would run out of money, but eventually it would still occur.

at a median level of only 23 to 37 percent between 2001 and 2010.[13] Thus, the overall average level of prefunding across all Fortune 1000 companies was only approximately 9 to 14 percent during that period. State governments and the Department of Defense prefund only about 30 percent of their liabilities.[14] Moreover, all of those employers have already reduced their liabilities through full Medicare integration; if normalized to the Postal Service's situation (which lacks full Medicare integration), the prefunding-level benchmarks would be even lower. Hence, "standard industry practice" would dictate funding levels well below what the Postal Service's proposal or the Commission's report contemplates.

However, simply lowering the prefunding level, without more, only kicks the can down the road without solving the underlying problem—the excessive, unaffordable costs of the Postal Service's RHB program—which cannot be ignored over the long term. That is why the Postal Service has proposed to tackle the costs of the RHB program, through Medicare integration. The Commission's approach, by contrast, elides the essential problem, which is ultimately puzzling because Medicare integration, supported by the mailing industry and labor, constitutes a straightforward and appropriate way of tackling the RHB liability itself, thereby putting the Postal Service's RHB program on a sound financial footing. Therefore, instead of implementing reforms that are limited solely to what the Commission is recommending, the President and Congress should instead implement the comprehensive combination of reforms that the Postal Service has proposed and industry and labor stakeholders have endorsed.

[13] USPS Comments at 22.

[14] *Id.*

II. Pension Reform

Another major contributor to the Postal Service's financial predicament are its artificially burdensome pension obligations. As the Postal Service explained in its earlier comments:

> The Postal Service is required to fund 100 percent of its total pension liabilities and has achieved 92.2 percent funding as of FY2015, far more than private-sector and state and local government employers and four times more than the rest of the federal government. Like the RHB Fund, assets are invested solely in low-yield Treasury securities, rather than higher-yielding diversified portfolios. Moreover, [the Office of Personnel Management (OPM)] calculates pension liabilities not on the basis of demographic and salary-growth assumptions relevant to postal employees, but on the basis of assumptions concerning the entire federal workforce. Finally, there is no provision to return overpayments in FERS to the Postal Service. Needless to say, no rational self-funded employer that still provides a defined-benefit pension plan would design such a funding scheme.[15]

The Postal Service has proposed three remedies that seek to mitigate the costs of its statutorily required participation in the Federal Employees Retirement System ("FERS") and the Civil Service Retirement System ("CSRS"):

1) Require OPM to calculate pension liabilities on the basis of postal-specific economic and demographic assumptions.

2) After recalculation of the liability, apply any current FERS surplus against outstanding debt, and any future surpluses against pension or RHB liabilities or debt.

3) Lengthen the amortization period for the supplemental CSRS liability to match the RHB amortization period. This measure alone would cut the annual CSRS payment almost in half.

[15] *Id.* at 23.

Instead of this comprehensive, common-sense, and consensus set of reforms, the Commission's report contemplates only the second measure: using FERS surpluses to offset other obligations.[16]

The asymmetry in FERS between the treatment of supplemental liabilities (which must be covered by the Postal Service through a series of amortization payments) and surpluses (which cannot be recouped by the Postal Service in any way) is undoubtedly important. By itself, however, this reform would no longer offer any real relief. Over the past few years, what was once a projected FERS surplus has turned into a supplemental liability to be amortized at an estimated $0.2 billion per year, as calculated by OPM using government-wide assumptions.[17]

The bigger issue with pensions is that the FERS liability and the greater CSRS liability are calculated unfairly on the basis of the federal workforce as a whole. No reasonable employer would calculate its pension liabilities by reference to other employers' workforce. It is therefore critical that any legislative reform require OPM to utilize postal-specific assumptions when calculating the Postal Service's pension liabilities, to ensure that the Postal Service is not obligated to pay more than is necessary.[18] In addition, the amortization period for CSRS should be lengthened to at least a period consistent with the RHB amortization schedule established in current law, in the interest of consistency among the Postal Service's post-retirement benefits

[16] Section 701 Report at 7.

[17] USPS Comments at 7, 24.

[18] Even if postal-specific assumptions were used to calculate the Postal Service's liabilities, the FERS surplus would now be modest. Therefore, a move to postal-specific assumptions would not lead to a large infusion of cash. Rather, the primary benefit of moving to postal-specific assumptions is to ensure that, moving forward, the Postal Service's pension liabilities are appropriately calculated, and payments to OPM are no larger than necessary.

obligations. Without these reforms – which the Commission's report neglects – the Postal Service will bear $3.2 billion more in expenses over the next five years than if Congress adopted the Postal Service's legislative proposal.

III. Product and Pricing Issues

The Postal Service is disappointed that the Commission declined the opportunity to urge the President and Congress to restore the recently expired exigent surcharge, at least pending the outcome of the ten-year review. As the Postal Service explained in its initial comments, Commissioners themselves have recognized that it would make sense for Congress, as a policy matter, to ameliorate the Postal Service's financial distress by allowing a longer exigent price increase.[19] The point of disagreement has always been over whether such a price increase is consistent with the specific terms of the current exigency provision, but Congress, unlike the Commission, is free to change the statute in the interest of providing much-needed financial relief.

Beyond this critical omission, the Postal Service agrees with many of the Commission's recommendations on products and pricing. The Postal Service agrees with the Commission's determination that the problems with the market-dominant price cap can and will be addressed in the upcoming ten-year review.[20] The Postal Service also appreciates that the Commission's recommendation that any new authority to offer nonpostal services be subject to reasonable regulation[21] aligns with the consensus proposal advanced by the Postal Service and numerous other labor and industry stakeholders. The President and Congress would also do well to consider the

[19] USPS Comments at 27-28.

[20] Section 701 Report at 2, 10.

[21] *Id.* at 26-27.

Commission's recommendations to allow the Postal Service greater leeway to experiment through market tests.[22]

However, the Postal Service believes that the Commission's recommendation on workshare discounts is counterproductive, for the reasons noted below. In addition, the recommendations on negotiated service agreements (NSAs) bear some clarification.

A. Workshare Discounts

The Commission's report identifies the current statute's prohibition on workshare discounts that exceed 100 percent of the Postal Service costs avoided through the worksharing activity (subject to certain exceptions).[23] The Commission goes on to recommend that Congress add a "soft floor": that is, a prohibition on workshare discounts less than 100 percent of avoided costs (subject to unspecified but "limited" exceptions).[24] In other words, the Postal Service would have to set (and periodically adjust) workshare discounts to pass through exactly 100 percent of avoided costs, with no room for business judgment, in almost all cases.

Despite the Commission's appeal to efficiency, the true effect of such a mechanistic requirement would be to dramatically reduce the Postal Service's pricing flexibility, without enhancing revenue or contribution. It is possible that raising discounts (in other words, lowering prices) further might lead some new actors to engage in worksharing, which would promote some efficiency in the market. However, any modest incremental gain would be overwhelmed by the enormous subsidy that the Postal Service would be forced to hand over to businesses that already find it

[22] *Id.* at 32-34.

[23] *Id.* at 9-11.

[24] *Id.* at 10-11.

worthwhile to workshare at current prices, even with less than 100 percent of avoided costs being passed on to them.

Such a recommendation is hard to square with the Commission's professed appreciation for the overwhelming importance of improving the Postal Service's financial condition – particularly given that the Commission's report devotes little space to recommendations that would actually make a meaningful contribution to that goal.[25] So long as the Postal Service's condition is so dire, then the time is simply not ripe to entertain (let alone focus disproportionately on) ways for Congress to hem in the Postal Service's ability to maintain revenue and contribution.

B. Negotiated Service Agreements

The Postal Service agrees with the Commission's assessment of the current process and legal standards for competitive Negotiated Service Agreements ("NSAs") and the treatment of non-public information: namely that the status quo is adequate and requires no statutory change.[26]

With respect to domestic market-dominant NSAs, the Commission proposes that Congress "clarify whether the more stringent standard set forth in 39 U.S.C. § 3622(c)(10) that the agreement 'improve the net financial position' of the Postal Service is still intended."[27] Instead, the Commission suggests that the standard could be harmonized with the attributable-cost-coverage standard for competitive NSAs, which the Commission views as less onerous and as "providing the Postal Service with increased opportunities to experiment with its pricing, with a goal towards designing

[25] *Id.* at 1.

[26] *Id.* at 17-18.

[27] *Id.* at 18.

domestic Market Dominant NSAs that ultimately result in an improved financial position."[28]

The Postal Service takes no position on this recommendation. However, it wishes to emphasize that any benefits of the Commission's recommendation only apply in the context of domestic market-dominant NSAs. For international market-dominant NSAs, the existing "improve net financial position" standard is clearly appropriate, and a "cover attributable costs" standard would actually be counterproductive, not liberating. International market-dominant NSAs consist of agreements with foreign posts to exchange mail at negotiated rates, rather than the default rates established in treaty instruments of the Universal Postal Union. Those default rates have historically failed to cover the Postal Service's costs of delivering inbound international mail. Therefore, the Postal Service has sought to improve its financial condition by negotiating higher rates for inbound international mail (in exchange for accepting higher rates for outbound international mail).[29] Given the lower default rates, however, the Postal Service is ill-positioned to achieve negotiated rates that fully achieve attributable-cost coverage. If the Postal Service were required to do so, the paradoxical result would be that foreign posts would prefer to stick with non-remunerative default rates rather than agreeing to the high price increases necessary for the Postal Service to cover attributable costs. Thus, a "cover attributable costs" standard for international market-dominant NSAs would actually worsen the Postal Service's net financial position.

[28] *Id.*

[29] Under longstanding practice since the PAEA, only the inbound half of this reciprocal rate relationship is subject to regulation as an NSA "product." The outbound rates represent costs to the Postal Service and are reflected in the financial analysis of outbound international products like First-Class Mail International.

IV. Service Issues

A. Contractor-Operated Retail Facilities

The Commission's report recommends "clarification on whether [Contract Postal Units] and nonpostal operation units also fall under the Commission's administrative review authority under [39 U.S.C. §] 404(d)."[30] There is a good reason why Post Office discontinuance laws and procedures have not been broadly expanded to contractor-operated facilities. As the Postal Service has repeatedly warned the Commission, doing so would interfere with the Postal Service's operational efficiency and business relationships by giving contractors undue leverage in negotiations. Congress has never intended the Commission to function as a board of contract appeals, overseeing the Postal Service's relationships with its suppliers. The Postal Service would only support "clarification" if it maintains these well-established boundaries.

B. Consultation Regarding Service Standard Changes

The Commission's report recommends that "Congress should clarify [39 U.S.C. § 3691] as to whether consultations with the Commission are required for proposals to change service standards," or only for proposals to establish new service standards. The Commission would also prefer clarification as to what degree of "consultation" is required.[31]

Whatever theoretical ambiguities might exist, actual practice should dispel any concern. Since the Postal Accountability and Enhancement Act (PAEA) introduced the relevant provision, the Postal Service has sought advisory opinions from the Commission under 39 U.S.C. § 3661 for all changes to service standards for its market-

[30] *Id.* at 21.

[31] *Id.* at 24-25.

dominant products, all of which affected service on a "nationwide or substantially nationwide" basis. Whatever "consultation" might mean, the process of a months-long back-and-forth between the Postal Service and Commission and the eventual issuance of an advisory opinion obviously fulfills that standard; if anything, it far exceeds it.

Thus, the ambiguities to which the Commission adverts only affect changes in service standards for market-dominant products that would have a purely local effect (for instance, a hypothetical change in the service standard for First-Class Mail between Hawaii and Guam). This scenario has not arisen in the decade since the PAEA. If it were to arise in the future, the Commission would be made aware of it and have an opportunity to present its views to the Postal Service. As such, it is difficult to see why this issue merits inclusion in the Commission's report.

C. Advisory Opinion Proceedings

The Commission asks Congress to require the Postal Service to provide a written response to Commission advisory opinions on nationwide service changes.[32] In essence, the Commission would like Congress to single out one preferred piece of the threefold reforms that the Senate passed in 2011 and that Senator Thomas Carper has included in more recent postal reform bills.[33] These provisions would (1) impose a statutory 90-day time limit on advisory opinion proceedings, (2) eliminate the antiquated requirement for a hearing on the record, and (3) require a Postal Service response to the Commission's advisory opinion. The Commission's exclusive focus on the third element would elevate the desire for additional regulation of the Postal Service over the

[32] *Id.* at 30.

[33] *See* S. 1789, 112th Cong. § 208 (passed Senate 2012); S. 2051, § 407 (introduced 2015).

equal, if not greater, need for reforms that would make the entire advisory opinion exercise more timely and relevant.

In an apparent attempt to obviate the need for a statutory time limit, the Commission touts its own undertaking to streamline advisory opinion proceedings.[34] The Commission's rules have yet to be tested in practice, but the Postal Service is hopeful that they will have the intended effect of allowing for more timely and relevant advisory opinions. However, what the Commission's report fails to acknowledge are the numerous loopholes that threaten to allow advisory opinion proceedings to extend well beyond the aspirational 90-day goal. That concern is particularly palpable for situations when the issue is the very sort of significant network changes that have drawn out advisory opinion proceedings in the past and, consequently, drawn frustration from the Postal Service and Members of Congress seeking more timely analysis. Thus, it may well be that the Commission's rule changes will not result in any real improvement in advisory opinions' timeliness. A statutory time limit is essential, and it would be in keeping with the firm statutory deadlines on most other Commission proceedings.[35]

Equally essential is the elimination of the requirement for formal hearings on the record. Although the Commission's report acknowledges the difficulty of streamlining proceedings under a formal-hearing requirement,[36] the Commission fails to take the logical next step of recommending that that requirement be abolished. This degree of formality is a relic from the pre-PAEA regulatory model, whereas the PAEA updated and

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[34] Section 701 Report at 29-30.

[35] *E.g.*, 39 U.S.C. § 404(d)(5) (120 days for Post Office closing appeals); *id.* § 3622(d)(1)(C) (45 days for market-dominant price adjustments); *id.* at (d)(1)(E) (90 days for exigent price adjustments); *id.* § 3632(b)(3) (15 days for competitive rates or classes not of general applicability); *id.* § 3641(c)(1) (30 days for market tests); *id.* § 3653 (90 days for annual compliance determination).

[36] Section 701 Report at 30.

streamlined every other form of postal regulatory proceeding.[37] If notice-and-comment procedures provide adequate due process on such complex matters as exigent rate increases and annual compliance determinations, which result in binding orders, then it is baffling why more burdensome and time-consuming procedures should be necessary for the Commission to issue a non-binding advisory opinion. Removing the requirement for a formal hearing on the record would update this outlier provision of postal law to allow for more timely and relevant advisory opinions while ensuring the same level of due process that has sufficed in all other postal regulatory settings.

V. Conclusion

The Postal Service's dire financial condition puts in peril its ability to provide universal service to the nation and meet its other legal obligations, absent legislative and regulatory change. Significant revisions to the PAEA are needed to enable the Postal Service to restore itself to financial solvency. Improving the Postal Service's financial stability in both the short-term and the long-term requires more comprehensive changes than are discussed in the Commission's report.

[37] Indeed, formal-hearing requirements appear to be antiquated in general. A search of post-PAEA Acts of Congress revealed not a single instance (other than in enforcement contexts) where Congress saw fit to introduce a requirement for an agency to hold hearings on the record.

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