

**POSTAL REGULATORY COMMISSION****39 CFR Parts 3010, 3020, 3050, and 3055**

[Docket No. RM2017-3; Order No. 4258]

**System for Regulating Market Dominant Rates and Classifications****AGENCY:** Postal Regulatory Commission.**ACTION:** Proposed rule.

**SUMMARY:** The Commission is proposing rules related to the current system of regulating rates and classes for market dominant products. Proposed rules are the result of a Commission statutory review wherein the Commission was required to review whether the system was achieving the objectives, taking into account the factors, established by Congress under the Postal Accountability and Enhancement Act of 2006. This notice informs the public of the proposed rules, invites public comment, and takes other administrative steps.

**DATES:** *Comments are due:* March 1, 2018; *Reply Comments are due:* March 30, 2018.

**FOR FURTHER INFORMATION CONTACT:** David A. Trissell, General Counsel, at 202-789-6820.

**SUPPLEMENTARY INFORMATION:****Table of Contents****I. Introduction and Procedural History****II. Statutory Authority****III. Proposed Regulatory Changes****IV. Description of Proposed Changes to Rules Appearing in the Code of Federal Regulations****V. Administrative Actions****VI. Ordering Paragraphs****I. Introduction and Procedural History**

Pursuant to 39 U.S.C. 3622(d)(3), 10 years after the enactment of the Postal Accountability and Enhancement Act (PAEA),<sup>1</sup> the Commission was required to initiate a review of the system for regulating rates and classes for market dominant products to determine if the ratemaking system has achieved the objectives of 39 U.S.C. 3622(b), taking into account the factors enumerated in 39 U.S.C. 3622(c).

On December 20, 2016, the Commission initiated its review by issuing an advance notice of proposed rulemaking (ANPR).<sup>2</sup> The ANPR

established a framework for the review, appointed an officer of the Commission to represent the interests of the general public, and provided an opportunity for public comment.

On December 1, 2017, the Commission issued its findings concerning the review.<sup>3</sup> The findings are based on the Commission's review of the system's performance during the 10 years following the passage of the PAEA with full consideration of comments received on topics relevant to the review. In short, based on its review of whether the existing ratemaking system has achieved the objectives of 39 U.S.C. 3622(b), taking into account the factors enumerated in 39 U.S.C. 3622(c), the Commission finds the system has not achieved the objectives of the PAEA. Order No. 4257 at 275.

Since the review concludes that the system for regulating rates and classes has not achieved the objectives, taking into account the factors, the Commission is initiating the instant rulemaking. The purpose of this rulemaking is to propose such modifications to existing regulations or adopt such an alternative system through new regulations that the Commission deems necessary to achieve the objectives of 39 U.S.C. 3622(b).

As explained more fully below, 39 U.S.C. 3622(d)(3) authorizes this rulemaking for the purpose of modifying existing regulations or adopting an alternative system as necessary to meet the objectives. The Commission also has standing authority to revise the existing system for regulating rates and classes as necessary. 39 U.S.C. 3622(a).

Additionally, the Commission has general authority to promulgate rules and regulations, establish procedures, and take any other action deemed necessary and proper to carry out its functions and obligations, as prescribed under title 39 of the United States Code. 39 U.S.C. 503.

This rulemaking proposes changes to title 39 of the Code of Federal Regulations. The rules in 39 CFR part 3010, subparts A, B, C, and E (existing §§ 3010.1 *et seq.*, 3010.10 *et seq.*, 3010.20 *et seq.*, and 3010.60 *et seq.*) are replaced in their entirety by new rules in new subparts A, B, C, D, E, F, G, H, and I (proposed §§ 3010.100 *et seq.*, 3010.120 *et seq.*, 3010.140 *et seq.*, 3010.160 *et seq.*, 3010.180 *et seq.*, 3010.200 *et seq.*, 3010.220 *et seq.*, 3010.240 *et seq.*, and 3010.260 *et seq.*).

December 20, 2016 (Order No. 3673); *see also* 81 FR 95071 (December 27, 2016) (to be codified at 39 CFR parts 3010 and 3020).

<sup>3</sup> Order on the Findings and Determination of the 39 U.S.C. 3622 Review, December 1, 2017 (Order No. 4257).

Rules specific to negotiated service agreements (NSAs) appearing in 39 CFR part 3010, subpart D (existing § 3010.40 *et seq.*) are moved to new 39 CFR part 3020, subpart G (proposed § 3020.120 *et seq.*). Minor changes are proposed in existing §§ 3050.20(c) and 3055.2(c). The proposed rules appear after the signature of this Order in Attachment A.

The next step in this rulemaking process is critical to the Commission's responsibility under the PAEA—seeking informed community participation and insight. The Commission has implemented a robust comment and reply period designed to elicit sound criticism of, concurrence with, or alternatives to the Commission's proposed approach.

**II. Statutory Authority****A. Introduction**

Section 3622(d)(3) of title 39 of the United States Code directs the Commission to conduct a review of the market dominant ratemaking system 10 years after the enactment of the PAEA in order to determine whether the system is achieving the objectives enumerated at 39 U.S.C. 3622(b), taking into account the factors enumerated at 39 U.S.C. 3622(c). This provision prescribes a two-step process. First, the Commission must determine whether the current ratemaking system is achieving the PAEA's objectives, taking into account its factors.

[The text of 39 U.S.C. 3622(d)(3) was removed to comply with the **Federal Register** Document Drafting Handbook, section 2.6. *See* 39 U.S.C. 3622(d)(3).]

The Commission completed the first step of this process on December 1, 2017, when it issued an order announcing its findings with regard to the current ratemaking system. *See* Order No. 4257. The Commission specifically determined that the ratemaking system has not achieved the objectives, taking into account the factors. *Id.* at 275.

The Commission now proceeds to the second step of the process established by section 3622(d)(3). This provision authorizes the Commission to promulgate rules either modifying the current ratemaking system or adopting an alternative ratemaking system, "as necessary to achieve the objectives."

[The text of 39 U.S.C. 3622(d)(3) was removed to comply with the **Federal Register** Document Drafting Handbook, section 2.6. *See* 39 U.S.C. 3622(d)(3).]

The Commission interprets this provision as providing broad authority to make changes to the market dominant ratemaking system. The authority to make changes to the system provided by

<sup>1</sup> Postal Accountability and Enhancement Act (PAEA), Public Law 109-435, 120 Stat. 3198 (2006).

<sup>2</sup> Advance Notice of Proposed Rulemaking on the Statutory Review of the System for Regulating Rates and Classes for Market Dominant Products,

section 3622(d)(3) expands upon the statutory authority provided by section 3622(a).

[The text of 39 U.S.C. 3622(a) was removed to comply with the **Federal Register** Document Drafting Handbook, section 2.6. See 39 U.S.C. 3622(a).]

Finally, the Commission has general authority, pursuant to section 503, to promulgate rules and regulations and establish procedures.

[The text of 39 U.S.C. 503 was removed to comply with the **Federal Register** Document Drafting Handbook, section 2.6. See 39 U.S.C. 503.]

#### B. Comments

The comments received in response to the ANPR that discuss the Commission's rulemaking authority primarily focus on two aspects of that authority pursuant to section 3622(d)(3): The authority to eliminate or modify the price cap and the authority to modify workshare discount provisions. The Appendix to this Order provides a list of commenters and citations to the comments filed in this docket in response to Order No. 3673.

#### 1. Authority To Eliminate or Modify the Price Cap

##### a. Plain Language

With regard to the price cap, multiple commenters take the position that the plain language of 39 U.S.C. 3622 constrains the Commission's ability to eliminate, modify, or replace the price cap. ANM *et al.* contend that the mandatory "shall" language used by Congress in establishing the consumer price index (CPI) price cap and its central role in the PAEA ratemaking scheme forecloses any claim that the statute makes the price cap merely optional.<sup>4</sup>

Commenters also advance a number of structural arguments for why section 3622 precludes any changes to the price cap. ANM *et al.*, MMA *et al.*, and GCA all assert that the scope of section 3622(d)(3) is limited by the title of section 3622(d)—"Requirements."<sup>5</sup>

ABA focuses on the use of the word "system" throughout section 3622, arguing that "the consistent use of the word 'system' throughout the section, rather than qualifiers such as 'first system' or 'initial system' or 'system preceding the 10 year review,' suggests Congress contemplated the same

requirements applying to any and all rate structures the Commission would create." ABA Comments at 8–10. GCA focuses on the use of the phrase "requirement," arguing that "[w]hen a particular phrase is used repeatedly in the same enactment, it is customary to give it the same meaning each time it appears . . . [which] suggests that . . . if a feature of the existing system is present because [section] 3622(d) makes it a 'requirement,' then it must remain in any modified or alternative system which emerges from the tenth-year review."<sup>6</sup>

Other commenters focus on the purported primacy of quantitative pricing standards over other provisions of the PAEA. ANM *et al.* and MMA *et al.* assert that three quantitative pricing standards rest at the top of the hierarchy of PAEA provisions—the CPI-U based price cap imposed by section 3622(d)(1)(A) and (d)(2); the workshare discount provisions imposed by section 3622(e); and the constraints on rate relationships between regular and preferred mail imposed by section 3626—and that the objectives and factors enumerated in section 3622(b) and (c) are subordinate to these quantitative pricing standards.<sup>7</sup>

MMA *et al.* posit that because Congress created the objectives and factors at the same time as the price cap, it must be concluded that only a system utilizing the price cap can achieve the objectives and factors. MMA *et al.* Comments at 15–16. Similarly, GCA asserts that both section 3622(a) and section 3622(d)(3) are supposed to effectuate the objectives and factors, so Congress must have concluded that the price cap was necessary to effectuate the objectives and factors. GCA Comments at 30–31. ANM *et al.* assert that under general canons of statutory construction, specific provisions, such as the price cap provision at section 3622(d)(1)(A), trump general provisions, such as section 3622(d)(3).<sup>8</sup>

Finally, these commenters highlight prior instances where the Commission is alleged to have ratified this view. ABA cites a prior order by the Commission where the Commission observed that "the role of the price cap is central to ratemaking, and the integrity of the price cap is indispensable if the incentive to reduce

costs is to remain effective."<sup>9</sup> ANM *et al.* also point to language from a prior Commission order purportedly recognizing that the PAEA's objectives and factors are subordinate to the statute's quantitative pricing standards.<sup>10</sup> Additionally, ANM *et al.* assert that the Commission is bound in the instant proceeding by prior holdings in its FY 2010 and FY 2011 Annual Compliance Determinations (ACDs) that the price cap takes precedence over the statutory factors.<sup>11</sup>

ABA, ANM *et al.*, and MMA *et al.* all take the position that the Commission's authority to review the ratemaking system and engage in rulemaking under section 3622(d)(3) is limited to the scope of the Commission's initial rulemaking authority under section 3622(a).<sup>12</sup> ANM *et al.* assert that section 3622(d)(3) mirrors section 3622(a), and as a result the Commission's authority to modify or replace regulations under section 3622(d)(3) is coextensive with the Commission's authority to establish those regulations in the first instance under section 3622(a). ANM *et al.* Comments at 10–11. Hence, according to ANM *et al.*, nothing in the language or structure of the PAEA suggests that the Commission's rulemaking authority under section 3622(d)(3) is broader than it was under section 3622(a). *Id.*

Based on this interpretation, MMA *et al.* assert that the Commission can modify regulations implementing the price cap but cannot change the fundamental requirements of the ratemaking system. MMA *et al.* Comments at 15. In MMA *et al.*'s view, "[a]s an administrative agency, the Commission already has inherent authority to revise regulations that it has previously promulgated . . . [and section 3622(d)(3)] merely directs the Commission to use its normal administrative powers." *Id.* at 14. GCA suggests that while the Commission cannot abolish the price cap, it can

<sup>9</sup> ABA Comments at 8 (citing Docket No. R2010-4, Order No. 547, Order Denying Request for Exigent Rate Adjustments, September 30, 2010, at 49–50).

<sup>10</sup> ANM *et al.* 2014 White Paper at 13 (citing Docket No. RM2009-3, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, September 14, 2010, at 36 (Order No. 536)); see also MMA *et al.* Comments at 15–16 (citing Docket No. ACR2010, Annual Compliance Determination, March 29, 2011, at 19 (FY 2010 ACD)).

<sup>11</sup> ANM *et al.* 2014 White Paper at 14–15 (quoting FY 2010 ACD at 18–19; Docket No. ACR2010R, Order No. 1427, Order on Remand, August 9, 2012; Docket No. ACR2011, Annual Compliance Determination, March 28, 2012, at 17 (FY 2011 ACD)). The specific factor at issue was Factor 2 (39 U.S.C. 3622(c)(2)), which requires coverage of attributable costs.

<sup>12</sup> ABA Comments at 9; ANM *et al.* 2014 White Paper at 9–11; MMA *et al.* Comments at 14.

<sup>4</sup> ANM *et al.* Comments at 9–10 n.2 (asserting that the Commission lacks authority to substantially modify the price cap) (citing ANM *et al.*, Limitations on the Commission's Authority Under Section 3622(d)(3), October 28, 2014, at 6 (ANM *et al.* 2014 White Paper)).

<sup>5</sup> ANM *et al.* 2014 White Paper at 4–7; MMA *et al.* Comments at 14–15; GCA Comments at 29–31.

<sup>6</sup> GCA Comments at 30 (citing *Ratzlaf v. United States*, 510 U.S. 135, 143 (1994)).

<sup>7</sup> ANM *et al.* 2014 White Paper at 12; MMA *et al.* Comments at 15–16.

<sup>8</sup> ANM *et al.* 2014 White Paper at 15 (citing *Navarro-Miranda v. Ashcroft*, 330 F.3d 672, 676 (5th Cir. 2003)).

“identify and specify features of the . . . price cap which do not adequately effectuate the objectives and factors, point out and analyze the particular shortcomings, identify the objective(s) or factor(s) they are hindering, and find ways to correct them in detail without hindering any other objective.” GCA Comments at 31–32.

Other commenters assert that the plain language of section 3622 permits the Commission to modify or replace the price cap.<sup>13</sup> The Postal Service takes the position that the “system” for purposes of section 3622 includes all provisions within section 3622(d), including the price cap provision. Postal Service Comments at 19. The Postal Service asserts that “[s]ection 3622(d) plainly states at the outset that its provisions are part of the ‘system for regulating rates and classes for market-dominant products.’” *Id.* Furthermore, the Postal Service asserts that “whatever the precise scope of ‘modification’ might be, the fact that the Commission is also authorized to adopt an ‘alternative system’ demonstrates that [s]ection 3622(d)(3) imposes no limitations on the Commission’s authority regarding the design of a replacement regulatory system, other than the requirement that any such replacement achieve the objectives.” *Id.* at 19–20.

#### b. Legislative History

Multiple commenters also base their arguments with regard to the price cap on the PAEA’s legislative history. ANM *et al.* and GCA note that an early version of the PAEA had referred to the price cap as an “allowable provision,” but that by the time the final bill was enacted it had become a “requirement.”<sup>14</sup> ANM *et al.* assert that nothing in the PAEA’s legislative history suggests that Congress intended for the Commission to have broader rulemaking authority under section 3622(d)(3) than it had under section 3622(a). ANM *et al.* Comments at 11–12. ANM *et al.* and MMA *et al.* contend that elimination or relaxation of the price cap would be contrary to the spirit of the PAEA.<sup>15</sup>

On the other hand, the Postal Service, NALC, and APWU all cite to a floor statement by Senator Susan Collins to the effect that the PAEA would provide 10 years of rate stability, after which the Commission would review the ratemaking system and, if necessary,

modify it or adopt an alternative system.<sup>16</sup> The Postal Service asserts that the House version of what became the PAEA would have permitted the Commission to choose a regulatory system, while the Senate version contained a permanent price cap; hence, the final version of the PAEA was a compromise that contained elements of both. Postal Service Comments at 20–21. The Postal Service maintains that it is clear that Congress intended for the Commission to review the ratemaking system in order to determine if it was actually achieving the objectives and factors specified by Congress and, if not, to design a system which would achieve the objectives. *Id.* at 22–23. The Postal Service maintains that the purpose of section 3622(d)(3) was to give the Commission authority to respond to changed circumstances subsequent to the PAEA’s enactment. *Id.* at 22–24. The Postal Service contends that it is clear from reviewing the legislative history that if Congress had desired to make the price cap irrevocable, it could have done so. *Id.* at 26–27.

#### c. Constitutional Concerns

Multiple commenters take the position that interpreting section 3622(d)(3) broadly would produce unconstitutional results. ANM *et al.* and MMA *et al.* assert that a broad interpretation of section 3622(d)(3) would violate the Presentment Clause of the Constitution, which prohibits a bill from becoming law without first passing both houses of Congress and then being “presented” to the President.<sup>17</sup> ANM *et al.* also assert that a broad interpretation of section 3622(d)(3) would violate the non-delegation doctrine, under which Congress may not delegate legislative power to an administrative agency where such delegation contains no standards to guide the agency’s discretion.<sup>18</sup> MMA *et al.* echo this argument, asserting that the PAEA’s objectives and factors do not provide an intelligible principle to guide the Commission’s discretion which would be sufficient to permit such a delegation. MMA *et al.* Comments at 15–16.

MMA *et al.* assert that a broad interpretation of section 3622(d)(3) could potentially violate constitutional

principles of separation of powers, based on the phrase “and as appropriate thereafter” in section 3622(d)(3). *Id.* at 16–17. MMA *et al.* maintain that “[i]f [the Commission] could change the fundamental nature of the system . . . anytime ‘appropriate thereafter,’ then it would have received an unprecedented grant to an Executive Branch agency of perpetual power to rewrite legislation.” *Id.* at 16.

Based on all of the foregoing, ANM *et al.* contend that a broad interpretation of section 3622(d)(3) would violate the canon of constitutional doubt, which prohibits agencies from construing statutes in such a way as to raise serious doubts about their constitutionality.<sup>19</sup> This is because, in ANM *et al.*’s view, “[t]here is a serious doubt that construing [s]ection 3622(d)(3) to authorize the Commission to rescind the CPI cap would pass muster under the Presentment Clause of the Constitution . . . or the constitutional limits on the delegation of legislative authority.” ANM *et al.* 2014 White Paper at 18.

The Postal Service, on the other hand, disagrees that a broad interpretation of Commission authority would present a concern with regard to constitutional separation of powers principles. Postal Service Comments at 25. The Postal Service deems section 3622(d)(3)’s delegation of authority to the Commission to be “unremarkable.” *Id.*

#### 2. Authority To Modify Workshare Discount Provisions

The second major topic addressed is the workshare discount provisions contained in 39 U.S.C. 3622(e). Most commenters addressing workshare discounts presume worksharing is within the scope of this proceeding and suggest worksharing related changes.<sup>20</sup> In contrast, a handful of commenters object to the review of the workshare discount provisions of section 3622(e).<sup>21</sup> The Postal Service contends that the “system” of ratemaking subject to review and possible rulemaking under section 3622(d)(3) does not include the workshare discount provisions. Postal Service Comments at 19, 28. The Postal Service bases this argument, first, on the PAEA’s plain language. The Postal

<sup>19</sup> ANM *et al.* 2014 White Paper at 17 (citing *United States v. Delaware & Hudson Co.*, 213 U.S. 366, 408 (1909); *Lowe v. SEC*, 472 U.S. 181, 227 (1985); *Edward J. DeBartolo Corp. v. Fla. Gulf Coast Bldg. & Constr. Trades Council*, 485 U.S. 568, 575 (1988)).

<sup>20</sup> See, e.g., ABA Comments at 11; ANM *et al.* Comments at 11–12, 82; Chairman Chaffetz and Chairman Meadows Comments at 2; MMA *et al.* Comments at 19, 71; Pitney Bowes Comments at 3–4; and PSA Comments at 6.

<sup>21</sup> See, e.g., APWU Comments at 5; Postal Service Comments at 28–30; and GCA Comments at 36–37.

<sup>13</sup> Postal Service Comments at 21–22; NALC Comments at 16; APWU Comments at 5–6.

<sup>14</sup> ANM *et al.* 2014 White Paper at 18 (citing *Clinton v. City of New York*, 524 U.S. 417 (1998)); MMA *et al.* Comments at 15.

<sup>15</sup> ANM *et al.* 2014 White Paper at 20 (citing *Mistretta v. United States*, 488 U.S. 361, 371–79 (1989); *Panama Ref. Co. v. Ryan*, 293 U.S. 388, 430 (1935); *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495, 529–31 (1935)).

<sup>13</sup> PR Comments at 29–30; NALC Comments at 16.

<sup>14</sup> ANM *et al.* 2014 White Paper at 16; GCA Comments at 30–31.

<sup>15</sup> ANM *et al.* 2014 White Paper at 5–7; MMA *et al.* Comments at 16.

Service asserts that “[s]ubsections (a) through (d) of [s]ection 3622 expressly set forth the parameters of the ‘system’ . . . [and] [a]t the end of these provisions comes [s]ection 3622(d)(3), with its provision for the Commission’s 10-year review of the ‘system’. . . .” Postal Service Comments at 28–29. However, it states that “[t]he workshare discount standards in subsection (e) follow[] the 10-year review provision . . . [and] subsection (e) does not specify that its standards are an aspect of the ‘system.’” *Id.* at 29. APWU similarly contends that the structure of the PAEA suggests Congress did not intend for workshare discount provisions to be subject to modification under section 3622(d)(3). APWU Comments at 5. GCA also takes the position that workshare provisions are not part of the “system” which section 3622(d)(3) authorizes the Commission to modify. GCA Comments at 37–38.

The Postal Service also asserts that the PAEA’s legislative history demonstrates that Congress intended the requirement that workshare discounts not exceed avoided costs to apply regardless of the regulatory system promulgated by the Commission under section 3622(a). Postal Service Comments at 30–31. GCA likewise asserts that when enacting the PAEA, Congress codified the Commission’s long-standing practice on workshare discounts into a set of statutory requirements, which GCA contends the Commission lacks authority to change. GCA Comments at 34.

Finally, the Postal Service and GCA assert that the Commission has previously affirmed the view that the workshare discount standards are separate and distinct from other provisions of section 3622, including the objectives and factors that underlie the review mandated by section 3622(d)(3).<sup>22</sup>

### C. Commission Analysis

The Commission’s determination that the system has not achieved the objectives, taking into account the factors, triggered the applicability of the second step of the system review contemplated by section 3622(d)(3). *See* Order No. 4257 at 275. This provision grants the Commission discretion regarding whether and how to promulgate regulations as necessary to achieve the PAEA’s objectives. 39 U.S.C. 3622(d)(3).

Section 3622(d)(3) provides the Commission with two discrete options.

The Commission “*may*, by regulation, make such modification *or* adopt such alternative system. . . .” 39 U.S.C. 3622(d)(3) (emphasis added). The use of “*may*,” rather than “*shall*,” demonstrates that Congress intended for the Commission to have discretion to decide whether to act at all.<sup>23</sup> Because “*or*” is disjunctive, the two options on either side of the “*or*” must have a different meaning from each other.<sup>24</sup> Therefore, the use of “*may*,” followed by two options connected by “*or*,” demonstrates that if the Commission does determine to act, then Congress granted the Commission the discretion to choose from two options with different meanings.

The first option is to “make such modification . . . as necessary to achieve the objectives.” 39 U.S.C. 3622(d)(3). This language connotes moderate change.<sup>25</sup> The second option grants authority to “adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.” 39 U.S.C. 3622(d)(3). This language contemplates replacement of the existing system.<sup>26</sup>

The scope of the term “alternative system” is given meaning by the statutory context in which the provision arises. For instance, section 3622(c)(4) limits the scope of “alternative means of sending and receiving letters and other mail matter at reasonable costs” to alternative means that are “available.” 39 U.S.C. 3622(c)(4). By contrast, the only limit section 3622(d)(3) imposes on the Commission’s ability to adopt an alternative system is that it must be “as necessary to achieve the objectives.” 39 U.S.C. 3622(d)(3). This comparison confirms that the usage of the term “alternative system” is intentionally broad. Congress knew how to impose express limits on the scope of “alternative system” but chose not to do so with respect to the Commission’s authority under section 3622(d)(3).

<sup>23</sup> *See Lopez v. Davis*, 531 U.S. 230, 239 (2001) (if certain statutory prerequisites are met, the Bureau of Prisons “*may*,” but also *may not*, grant early release.” (emphasis in original)).

<sup>24</sup> *Chao v. Day*, 436 F.3d 234, 236 (D.C. Cir. 2006) (terms connected using the disjunctive “*or*” must be given separate meanings).

<sup>25</sup> *See MCI Telecomm. Corp. v. Am. Tel. & Tel. Co.*, 512 U.S. 218, 228 (1994); *see also* Merriam-Webster Dictionary, available at <https://www.merriam-webster.com/dictionary/modification> (“modification” defined as “the making of a limited change in something”).

<sup>26</sup> *See* Merriam-Webster Dictionary, available at <https://www.merriam-webster.com/dictionary/adopt> (“adopt” defined as “to accept formally and put into effect”); <https://www.merriam-webster.com/dictionary/alternative> (“alternative” defined as “a proposition or situation offering a choice between two or more things only one of which may be chosen”).

The plain language of section 3622(d)(3) leaves it to the Commission’s discretion to determine what regulatory changes, if any, are logically required to achieve the PAEA’s objectives.<sup>27</sup> Subsection (b) of section 3622 provides that the system “shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others. . . .” 39 U.S.C. 3622(b). If Congress intended to further limit the scope of the section 3622 review or any related regulatory changes, it could have prescribed it. Instead, the PAEA set forth nine objectives to be balanced by the Commission.

Although some commenters focus on the title of section 3622(d)—“Requirements”—as precluding changes to the existing price cap, the plain meaning of the statute confirms that section 3622(d)(3) confers broad authority. The “Requirements” title alone is not dispositive. A statute’s title can aid in resolving ambiguity but has no power to enlarge the text or confer powers.<sup>28</sup>

The argument that the scope of subsection (a) limits the scope of subsection (d)(3) is contrary to the plain meaning and purpose of both subsections. First, the two subsections employ different language. The use of a parenthetical and the conjunction “and” in subsection (a) confirms the connection between the meanings of “establish” and “revise” as referring to the setup and periodic recalibration of the initial ratemaking system.<sup>29</sup> Subsection (a) requires the Commission to set up the initial regulatory system within a specific period. Subsection (a) also permits the Commission to improve or correct that system “from time to time thereafter” through normal rulemaking procedures. When doing so, the Commission must apply the objectives in conjunction with each other and take into account the factors. 39 U.S.C. 3622(b) and (c).

By contrast, subsection (d)(3) is not triggered until several separate and specific requirements are met. Subsection (d)(3) requires a review of the ratemaking system to take place 10

<sup>27</sup> *See* Merriam-Webster Dictionary, available at <https://www.merriam-webster.com/dictionary/necessary> (“necessary” defined as “logically unavoidable”).

<sup>28</sup> *Pa. Dept. of Corr. v. Yeskey*, 524 U.S. 206, 212 (1998).

<sup>29</sup> *See* Merriam-Webster Dictionary, available at <https://www.merriam-webster.com/dictionary/establish> (“establish” defined as “to institute (something, such as a law) permanently by enactment or agreement”); *id.*, available at <https://www.merriam-webster.com/dictionary/revise> (“revise” defined as “to look over again in order to correct or improve”).

<sup>22</sup> Postal Service Comments at 32 (citing Order No. 536 at 16–19, 34–37); *see also* GCA Comments at 36.

years after the PAEA's enactment, following notice and an opportunity for comment. Additionally, no regulatory changes may be made under subsection (d)(3) unless the Commission first determines that the system has not achieved the objectives, taking into account the factors. The scope of permissible action under subsection (d)(3), which is to "make such modification or adopt such alternative system," differs from the authority to "revise" the initial system.

The different language used demonstrates that Congress intended to create two separate but complementary processes: The Commission's general authority to set up and periodically recalibrate the initial ratemaking system under subsection (a); and the Commission's specific authority to review the initial system after 10 years and modify or replace any part of the system as necessary to achieve the objectives of the PAEA.

Moreover, the two subsections serve different purposes. Subsection (a) confers "authority generally" to the Commission regarding its duty to establish new regulations within a set timeframe and revise them as appropriate. Subsection (a) was necessary to address the pre-PAEA view that the Postal Rate Commission had "a very important, but expressly limited, role."<sup>30</sup> The PAEA transformed the Postal Rate Commission into the Postal Regulatory Commission, a separate independent agency with regulatory oversight of the Postal Service.<sup>31</sup> As discussed below, subsection (d)(3) was the result of a legislative compromise to achieve 10 years of rate stability, followed by a Commission-led review of the ratemaking system and, if warranted, modification or adoption of an alternative system to achieve the PAEA's objectives. Reading section 3622(d)(3) to confer authority to the Commission that is limited to the scope of section 3622(a) would be contrary to this purpose. And, any suggested

interpretation of the plain language must give way if it would conflict with Congress' manifest purposes.<sup>32</sup>

The reliance commenters place on Commission precedent is misplaced. None of the cited precedent involved an interpretation of the scope of 39 U.S.C. 3622(d)(3). Because subsection (d)(3) is not even triggered until *after* the 10-year anniversary of the enactment of the PAEA, the cited precedent merely served to acknowledge the bounds of Commission authority during the first 10 years under the PAEA. The cited statements were made in accordance with the Commission's authority to "establish" and "revise" the initial ratemaking system promulgated under subsection (a). However, subsection (d)(3) confers broader rulemaking authority than subsection (a). In accordance with its authority under section 3622(d)(3), and with the benefit of having conducted an extensive review following 10 years of experience in the operation of the initial ratemaking system, the Commission has now determined that the system has not achieved the PAEA's objectives, taking into account the statutory factors. Order No. 4257 at 275. Therefore, these prior statements made in a separate context do not in any way serve to limit the Commission's broader authority under section 3622(d)(3) to promulgate proposed rules.

With regard to the workshare discount provisions contained within section 3622(e), which a handful of commenters assert are not part of the ratemaking system, the Commission finds that the phrase "established under this section" in section 3622(d)(3) refers to section 3622 in its entirety, including the workshare discount provisions in section 3622(e). This conclusion derives from both the plain meaning of the term "section," as well as the fact that within section 3622(d)(3) there is a clear differentiation made between "sections" and "subsections."<sup>33</sup> Further, in its review of the system under section 3622(d)(3), the Commission is tasked with taking into account "the degree of preparation of mail for delivery into the

postal system performed by the mailer and its effect upon reducing costs to the Postal Service . . . ." 39 U.S.C. 3622(c)(5). Section 3622 defines workshare discounts as the discounts mailers receive for additional preparation of mailpieces, such as presorting, prebarcoding, handling, or transportation. See 39 U.S.C. 3622(e)(1). Therefore, workshare discount provisions are plainly part of the ratemaking system subject to review and possible rulemaking.

In sum, the plain meaning of the PAEA grants the Commission broad authority to engage in rulemaking in order to modify or replace the current ratemaking system. The scope of that authority is limited only by what is necessary to achieve the PAEA's objectives.

With regard to legislative history, the PAEA was designed to balance several objectives, including the Postal Service's financial needs and mailers' need for predictable and stable rates. To achieve 10 years of rate stability, the ratemaking system was intended to operate in accordance with specific statutory requirements and limitations. As previously described, after 10 years, the initial system would be subject to Commission review. If the Commission determined that the system did not achieve the PAEA's objectives taking into account its factors, then the Commission would have the authority to modify or replace the system as necessary to achieve the objectives. The legislative history confirms this structured approach. Specifically, the final version of the PAEA, H.R. 6407, represented a compromise between two bills—H.R. 22 and S. 662.

The first bill, H.R. 22, was introduced by Representative John McHugh on January 4, 2005, and reported back to the House with amendments on April 28, 2005. 151 Cong. Rec. H72 (daily ed. Jan. 4, 2005); 151 Cong. Rec. H2734 (daily ed. Apr. 28, 2005). On July 26, 2005, H.R. 22, as amended, was passed by the House of Representatives. 151 Cong. Rec. H6511, H6548–H6549 (daily ed. Jul. 26, 2005) (Roll Call No. 430). As discussed by GCA and ANM *et al.*,<sup>34</sup> under H.R. 22 as passed by the House of Representatives, proposed section 3622(d) was titled "Allowable Provisions." 151 Cong. Rec. H6523 (daily ed. Jul. 26, 2005). This bill provided that the ratemaking system could include one or more of several types of systems: Incentive regulation (*e.g.*, price caps, revenue targets); cost-of-service regulation; or any other form

<sup>30</sup> *Gov. of U.S. Postal Serv. v. Postal Rate Comm'n*, 654 F.2d 108, 112 (D.C. Cir. 1981). Under the Postal Reorganization Act, the Postal Rate Commission's responsibilities were limited to "review of rate, classification, and major service changes, unadorned by the overlay of broad FCC-esque responsibility for industry guidance and of wide discretion in choosing the appropriate manner and means of pursuing its statutory objective." *Mail Order Ass'n of Am. v. U.S. Postal Serv.*, 2 F.3d 408, 415 (D.C. Cir. 1993) (quoting *Gov. of U.S. Postal Serv.*, 654 F.2d at 117). "As a 'partner' of the Board [of Governors of the United States Postal Service] the Postal Rate Commission was assigned the duty and authority to make recommendations with respect to rates and classifications." *Gov. of U.S. Postal Serv.*, 654 F.2d at 114.

<sup>31</sup> *U.S. Postal Serv. v. Postal Regulatory Comm'n*, 717 F.3d 209, 210 (D.C. Cir. 2013).

<sup>32</sup> See *Sullivan v. Hudson*, 490 U.S. 877, 890 (1989) ("Congress cannot lightly be assumed to have intended" a result that would "frustrat[e] . . . the very purposes" of the statute). No sound approach to statutory interpretation would attribute to Congress an intent to "subvert the statutory plan." *Dep't of Revenue of Or. v. ACF Indus. Inc.*, 510 U.S. 332, 340 (1994).

<sup>33</sup> See 39 U.S.C. 3622(d)(3) ("[T]he Commission shall review the system for regulating rates and classes for market-dominant products established under *this section* to determine if the system is achieving the objectives in *subsection (b)*, taking into account the factors in *subsection (c)*." (emphasis added)).

<sup>34</sup> ANM *et al.* 2014 White Paper at 16; GCA Comments at 30–31; ANM *et al.* Comments at 21.

of regulation that the Commission considered appropriate to achieve the objectives, consistent with the factors. *Id.* Proposed section 3622(e) under this bill was titled “Limitation.” *Id.* This provision would have prohibited the Commission from permitting the average rate for any product to increase at an annual rate greater than the comparable increase in the CPI unless the Commission determined, after public notice and comment, that the increase was reasonable, equitable, and necessary. *Id.*

The second bill, S. 622, was introduced by Senator Collins on March 17, 2005, and reported back to the Senate with amendments on July 14, 2005. 151 Cong. Rec. S2994, S3012–S3031 (daily ed. Mar. 17, 2005); 151 Cong. Rec. S8301 (daily ed. Jul. 14, 2005). On February 9, 2006, the Senate considered those amendments and additional amendments to S. 662 by unanimous consent. 152 Cong. Rec. S898–S927 (daily ed. Feb. 9, 2006). Under this bill, proposed section 3622(d) was titled “Requirements,” and was subdivided into subsections titled “In general” and “Limitations.” *Id.* at S913–S914. The content of proposed section 3622(d)(1) and (2) under S. 662 employed similar language to that which was eventually used in the final version of the PAEA. *Compare id. with* 39 U.S.C. 3622(d)(1) and (2).

Also on February 9, 2006, through unanimous consent, the Senate passed H.R. 22,<sup>35</sup> by replacing the text of H.R. 22 with all the text of S. 662. 152 Cong. Rec. at S927–S942 (daily ed. Feb. 9, 2006). Therefore, as passed by the Senate, H.R. 22 contained the same title structure as S. 662, with proposed section 3622(d)—titled “Requirements”—being subdivided into two subsections titled “In General” and “Limitations.” *Id.* at S929. Then, the Senate sent H.R. 22, as amended and passed by the Senate, back to the House and requested a conference to resolve the differences between the two versions. *Id.* at S927, S942. For instance, as passed by the House on July 26, 2005, H.R. 22 provided for the ratemaking system to achieve seven objectives and for the Commission to take into account 11 factors. 151 Cong. Rec. H6523 (daily ed. Jul. 26, 2005). By contrast, as passed by the Senate on February 9, 2006, H.R. 22 provided for the ratemaking system to achieve 8 objectives and for the Commission to take into account 13

factors. 152 Cong. Rec. at S928–S929 (daily ed. Feb. 9, 2006).

None of the versions of the bills described above included the review provision that would eventually be codified at 39 U.S.C. 3622(d)(3). Nor was this provision referenced in hearings, committee reports, or the presidential signing statement. Instead, 39 U.S.C. 3622(d)(3) was included only in the final version of the PAEA introduced on December 7, 2006. H.R. 6407, 109th Cong., at 7 (2006). Pursuant to a compromise between the Senate and the House, H.R. 6407 blended together concepts appearing in the separate versions of the bills described above, including combining the objectives and factors.

There is only one statement in the Congressional Record about the review provision, and it was made upon receipt of the final version of the postal reform bill on December 8, 2006. Senator Collins, the Senate sponsor of postal reform, remarked:

The Postal Service will have much more flexibility, but the rates will be capped at the CPI. That is an important element of providing 10 years of predictable, affordable rates, which will help every customer of the Postal Service plan. After 10 years, the Postal Regulatory Commission will review the rate cap and, if necessary, and following a notice and comment period, the Commission will be authorized to modify or adopt an alternative system.

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

152 Cong. Rec. S11674, S11675 (daily ed. Dec. 8, 2006) (statement of Sen. Collins).

This statement confirms that section 3622(d)(3) was a part of a legislative compromise that required the price cap “Requirements,” as contained in the PAEA, to remain in place for 10 years, and then allowed the Commission the opportunity to review the effectiveness of this ratemaking system and potentially design a modified or alternative system.<sup>36</sup> This statement also

confirms that the congressional sponsors of the PAEA contemplated that the Commission would have broad discretion after the section 3622 review—including deciding whether to continue the price cap in its current form, modify it, or replace it. That Congress believed it might need to “reimpose the rate cap after it expires” clearly evidences its intent that the Commission had the authority, after its review, to eliminate the price cap through the potential modification or adoption of an alternative system. The statement also confirms that Congress did not consider the current price cap to be a permanent or immutable requirement of the system. Senator Collins further stated:

This *compromise* is not perfect and, indeed, earlier tonight, there were issues raised by the appropriators—legitimate issues—that threatened at one point to derail the bill again. It has been a delicate *compromise* to satisfy all of the competing concerns. Everyone has had to *compromise*, but I think we have come up with a good bill. This *compromise* will help ensure a strong financial future for the U.S. Postal Service and the many sectors of our economy that rely on its services, and it reaffirms our commitment to the principle of universal service that I believe is absolutely vital to this institution.

*Id.* (emphasis added). Senator Thomas Carper also confirmed that the final bill was “a difficult compromise.” 152 Cong. Rec. S11675 (daily ed. Dec. 8, 2006) (statement of Sen. Carper).

Congress passed the PAEA, amending title 39, to ensure the financial viability of the Postal Service.<sup>37</sup> Senator Collins stated that “[w]ith this landmark reform legislation, we will put the Postal Service on a firm financial footing.” 152 Cong. Rec. S11674 (daily ed. Dec. 8, 2006) (statement of Sen. Collins). The legislative history confirms that Congress intended to empower the Commission to modify or replace the system following the section 3622 review as necessary to achieve the objectives.

Finally, with regard to the constitutional infirmities alleged by some commenters, the scope of the Commission’s authority under section 3622(d)(3) does not raise separation of powers issues because section 3622(d)(3) meaningfully constrains the Commission’s authority.

Under the nondelegation doctrine, Congress cannot delegate legislative

contained the “requirement” language with regard to the price cap. As a result, the statement in the Congressional Record is particularly probative as to the existence of a compromise.

<sup>37</sup> See *Newspaper Ass’n of Am. v. Postal Regulatory Comm’n*, 734 F.3d 1208, 1217 (D.C. Cir. 2013) (citing S. Rep. No. 108–318, at 2–4 (2004)).

<sup>35</sup> H.R. 22 had been pending in the Senate since July 27, 2005. 151 Cong. Rec. S9155, S9156 (daily ed. Jul. 27, 2005).

<sup>36</sup> It is worth noting that Senator Collins introduced the initial bill in the Senate which

power to the Executive Branch.<sup>38</sup> However, Congress does not violate the nondelegation doctrine merely because it legislates in broad terms and leaves a certain degree of discretion to an Executive Branch actor, so long as Congress sets forth “an intelligible principle” to which the actor must conform.<sup>39</sup> The Supreme Court has routinely upheld delegations to the Executive Branch “under standards phrased in sweeping terms.” See *Loving*, 517 U.S. at 771. Congress may permissibly delegate authority to the Executive Branch to regulate in a manner that is necessary to adhere to policy objectives in a statute.<sup>40</sup> In this instance, the statute gave clear direction to the Commission about how to exercise its legal authority to make modifications or adopt an alternative system. Any modifications or the adoption of an alternative system must be necessary for the system to achieve the objectives in 39 U.S.C. 3622(b), and it is with those objectives in mind that the Commission proposes the regulations below.

With regard to the Presentment Clause, the comparison made by some commenters to the Line Item Veto Act which was struck down in *Clinton v. City of New York* is inapt. First, the President’s exercise of cancellation authority under the Line Item Veto Act, 5 days after legislation’s enactment, was “necessarily [ ] based on the same conditions that Congress evaluated when it passed those statutes.” *Clinton*, 524 U.S. at 443. By contrast, Congress’ delegation to the Commission under section 3622(d)(3) is meaningfully constrained by several separate conditions that must occur after the enactment of the PAEA: The passage of 10 years; a comprehensive review of the ratemaking system by the Commission; notice to the public and an opportunity for comment; and a determination by the Commission that the system is not achieving the PAEA’s objectives, taking into account the statutory factors.

Second, whereas the impermissible Line Item Veto Act required the

President to make certain determinations before cancelling a provision, those determinations did not qualify his discretion as to whether to cancel or not. *Id.* at 443–44. By contrast, the Commission’s discretion under section 3622(d)(3) to either modify the ratemaking system, adopt an alternative system, or do neither is contingent on a determination that the system did not achieve the PAEA’s objectives, taking into account the statutory factors. If the Commission determined that the system had achieved the objectives, taking into account the factors, the Commission’s authority under section 3622(d)(3) to either modify the system or adopt an alternative system would not have been triggered.

Third, the impermissible Line Item Veto Act allowed the President to override the policy objectives contained in a cancelled statute, which were developed by Congress, with his own policy objectives, which were developed unilaterally. *Id.* at 444. By contrast, section 3622(d)(3)’s delegation of rulemaking authority to the Commission is limited because it is required to effectuate the nine objectives embodied in the PAEA, which were developed by Congress.

Therefore, the Commission’s authority to modify or adopt an alternative system under section 3622(d)(3) remains within the permissible bounds of the separation of powers between the Legislative Branch and the Executive Branch.

In conclusion, the Commission has broad authority to either modify or replace the existing market dominant ratemaking system. This authority extends to modification of regulations currently in place and the statutory rate setting requirements of section 3622 (including those applicable to workshare discounts in 39 U.S.C. 3622(e)). The constraint on the Commission’s authority is that the system as implemented must be designed to achieve the objectives of section 3622(b).

### III. Proposed Regulatory Changes

#### A. Introduction

In Order No. 4257, the Commission concluded that the system for regulating rates and classes did not achieve the objectives, taking into account the factors. Therefore, the Commission is proposing new regulations that it deems necessary to achieve the objectives of 39 U.S.C. 3622(b). The reasons that certain objectives were not achieved, taking into account the factors, and the proposed solutions to address these issues fall within the following broad areas.

The medium-term financial stability of the Postal Service is addressed in section C—Supplemental Rate Authority. The changes presented in this section provide the Postal Service with an additional 2 percentage points of rate authority per calendar year. This authority is available only for the first 5 full calendar years following the effective date of these regulations.

The long-term financial stability of the Postal Service is addressed in section D—Performance-Based Rate Authority. The changes presented in this section make up to an additional 1 percentage point of rate authority available per calendar year. Of this rate authority, 0.75 percentage points is allocated based on meeting operational efficiency-based rate authority requirements, and 0.25 percentage points is allocated based on meeting service quality-based rate authority requirements.

Issues related to non-compensatory classes and products are addressed in section E—Non-Compensatory Classes and Products. The changes presented in this section impose rate design requirements on non-compensatory products. The changes also provide the Postal Service with an additional 2 percentage points of rate authority per calendar year for non-compensatory classes of mail.

Issues related to inefficient rate design concerning workshare discounts are addressed in section F—Workshare Discounts. The changes presented in this section employ rate design concepts based on efficient component pricing (ECP). The proposed regulations establish bands that set the percentages of avoided costs that may be reflected in the discounts. The proposed regulations include a 3-year grace period.

Miscellaneous issues related to the rate adjustment process are addressed in section G—Enhancements to the Ratemaking Process. The changes presented in this section increase visibility into future planned rate adjustments by proposing changes to the Schedule for Regular and Predictable Rate Adjustments requirements.

Changes are also proposed for the rate adjustment process, including a proposal to extend the notification period for planned rate adjustments from 45 to 90 days.

Prior to addressing these broad areas and the related proposed solutions, the Commission first provides background related to the Postal Service’s financial stability in section B below. This background material provides context and supports the Commission’s proposed solutions described in more detail in sections C and D.

<sup>38</sup> See, e.g., *Loving v. United States*, 517 U.S. 748, 758 (1996).

<sup>39</sup> *Id.* at 771–72 (citing *J.W. Hampton, Jr. & Co. v. United States*, 276 U.S. 394, 409 (1928); *Touby v. United States*, 500 U.S. 160, 165 (1991)).

<sup>40</sup> See, e.g., *Touby v. United States*, 500 U.S. at 163, 165 (statute authorizing Attorney General to schedule controlled substance on temporary basis as “necessary to avoid an imminent hazard to the public safety” did not violate nondelegation doctrine because it contained an intelligible principle); *National Broadcasting Co. v. United States*, 319 U.S. 190, 217, 225–26 (1943) (upholding delegation to the Federal Communications Commission to regulate radio broadcasting according to “public interest, convenience, or necessity”).

## B. The Path to Financial Stability

### 1. Background

The existing ratemaking system did not achieve the PAEA's objectives during the 10 years following the PAEA's enactment. *See generally* Order No. 4257. The Postal Service is in poor financial health. *Id.* at 274. The market dominant ratemaking system established under 39 U.S.C. 3622 did not assure "adequate revenues, including retained earnings, to maintain financial stability," as required by Objective 5. *Id.* at 178 (quoting 39 U.S.C. 3622(b)(5)). In Order No. 4257, the Commission discussed financial stability using a three-tiered analysis: short-term, medium-term, and long-term. *Id.* at 151–78. Because the three tiers build upon each other, this analysis found that all three tiers must be achieved in order to support a finding that the system maintained financial stability. *Id.* at 159. As set forth in Order No. 4257, although the short-term financial measure was generally achieved, medium-term and long-term financial stability measures were not achieved. *Id.* at 274.

Moreover, although costs were reduced and operational efficiency was increased during the PAEA era, these cost reductions and operational efficiency increases were not maximized, as required by Objective 1. *Id.* at 222, 248; 39 U.S.C. 3622(b)(1). The Commission found that the cost reductions and operational efficiency gains experienced under the existing ratemaking system have been insufficient to contribute to the financial stability of the Postal Service. Order No. 4257 at 222, 248.

Therefore, the Commission considers regulatory proposals aimed to put the Postal Service on the path to financial stability.

### 2. Comments

Most of the comments received with regard to the Postal Service's financial stability discuss the Postal Service's finances within the context of whether the Commission should keep, modify, or eliminate the current consumer price index for all urban consumers (CPI-U) price cap.

#### a. Comments in Support of Retaining the Price Cap

Most of the commenters in favor of keeping the CPI-U price cap generally contend that the Postal Service's current revenue is adequate to provide necessary services. ANM *et al.*, for example, assert that the Postal Service's revenue and earnings are improving, that mail volume has stabilized, and

that operating income has been positive for several years and is projected to remain so. ANM *et al.* Comments at 3–4, 23–25, 32–33. MMA *et al.*, DMA *et al.*, and LSC contend that the Postal Service's revenue is adequate to meet controllable and operating costs.<sup>41</sup>

ANM *et al.* and MMA *et al.* both note that competitive products are now generating a large share of the Postal Service's revenue, and that expected growth in competitive package services is increasing.<sup>42</sup> ANM *et al.* assert that the Postal Service's liquidity is healthy. ANM *et al.* Comments at 4, 34–35. MMA *et al.* contend that the Postal Service faces no serious risk of insolvency. MMA *et al.* Comments at 31–32.

MMA *et al.* assert that cash flow is the most appropriate measure of the Postal Service's financial stability, and that by this metric, the Postal Service is "quite stable." *Id.* at 37. Furthermore, MMA *et al.* maintain that the Postal Service's finances are well-positioned in the long run, when all of its assets are fairly valued.<sup>43</sup>

ANM *et al.* and MMA *et al.* both assert that the Postal Service's finances are better than they appear, because the Postal Service significantly undervalues its real estate holdings.<sup>44</sup> ANM *et al.*, MMA *et al.*, and DMA *et al.* all maintain that the Postal Service's pension and benefit funds are well-funded.<sup>45</sup> MMA *et al.*, in particular, dispute many of the metrics used to assess the Postal Service's financial stability. MMA *et al.* Comments at 31–32. They contend that the Postal Service's finances are not comparable to those of a private firm, and that the financial ratios used to measure private firms are not generally applicable to the Postal Service. *Id.* at 32, 41.

Although many of these commenters acknowledge that the Postal Service's net earnings remain negative, they generally attribute this to the PAEA's requirement to prefund the Postal Service Retiree Health Benefits Fund (PSRHBF) and assert that this requirement is not part of the PAEA's ratemaking system.<sup>46</sup> Noting that Congress mandated the PSRHBF

<sup>41</sup> DMA *et al.* Comments at 3; MMA *et al.* Comments at 31; LSC Comments at 3.

<sup>42</sup> ANM *et al.* Comments at 28; MMA *et al.* Comments at 36–37.

<sup>43</sup> *Id.* MMA *et al.* also assert that even if financial stability is measured by controllable income, the Postal Service is doing well. *Id.* at 40.

<sup>44</sup> ANM *et al.* Comments at 5–6, 44; MMA *et al.* Comments at 43.

<sup>45</sup> ANM *et al.* Comments at 4–5, 40–41; MMA *et al.* Comments at 44; DMA *et al.* Comments at 3.

<sup>46</sup> ANM *et al.* Comments at 4, 38; DMA *et al.* Comments at 3; MMA *et al.* Comments at 40–41, 47–48; Netflix Comments at 18; NNA Comments at 31; LSC Comments at 3; ACMA Comments at 5.

prefunding requirement, many of these commenters assert that the problem should be addressed through a legislative fix—not through a price increase.<sup>47</sup>

ANM *et al.* and MMA *et al.* raise concerns regarding whether any additional revenue would be used appropriately by the Postal Service. ANM *et al.* assert that any additional revenue would be "squandered through laxer control of costs." ANM *et al.* Comments at 9. MMA *et al.* contend that the precise nature of the Postal Service's "needs" in terms of capital is an issue that requires critical assessment by the Commission. MMA *et al.* Comments at 38–39.

Several commenters state that raising the price cap would undermine rate predictability and stability. ANM *et al.* assert that the price cap provides "the only effective protection . . . to mailers and consumers . . . against abuse of the Postal Service's market power." ANM *et al.* Comments at 8. They maintain that relaxing the price cap would lead to a loss of credibility for the Commission and hamper the ability of Postal Service management to bargain effectively with labor and other interest groups that might seek to raise the Postal Service's costs. *Id.* at 8–9. DMA *et al.* maintain that raising the price cap would be a burden to mailers. DMA *et al.* Comments at 3.

Other commenters, including ANM *et al.*, DMA *et al.*, and GCA, maintain the raising the price cap would undermine operational efficiency.<sup>48</sup> GCA specifically states that any upward adjustment in the price cap would reduce incentives for efficiency and cost reduction. GCA Comments at 21. NNA cautions that lifting the price cap to improve the Postal Service's financial condition could dissuade Congress from providing legislative relief, tempt future legislators to add costs to the system, or make privatization of the Postal Service more attractive. NNA Comments at 32–33.

#### b. Comments in Support of Modifying the Price Cap

Another group of commenters suggests keeping a price cap system but modifying its form. For instance, the Public Representative contends that the Postal Service's revenue under the price cap must be increased. PR Comments at 33. He proposes modifying the price cap formula to account for changes in demand (*i.e.*, for declining mail

<sup>47</sup> DMA *et al.* Comments at 3; LSC Comments at 3; NNA Comments at 4–5.

<sup>48</sup> ANM *et al.* Comments at 9; DMA *et al.* Comments at 3; GCA Comments at 20–21.

volumes) and to reflect the PSRHBF payment obligation. *Id.* at 33, 35–47. MH and NAAD, on the other hand, advocate that the Commission cease using CPI-U as a price index and return to a more cost-based approach to ratemaking. MH and NAAD Comments at 10.

### c. Comments in Support of Eliminating the Price Cap

The third group of commenters consists primarily of the Postal Service and the postal unions, who advocate that the Commission should eliminate the price cap altogether. These commenters generally take the position that revenue under the existing ratemaking system is insufficient to enable the Postal Service to maintain financial stability.<sup>49</sup> Some of these commenters assert that current revenue levels are not sufficient to cover costs or allow for investments in infrastructure.<sup>50</sup>

The Postal Service asserts that it has experienced a net loss every year since the PAEA was enacted, primarily due to declining mail volume. Postal Service Comments at 84–86. APWU asserts that when instituting the CPI-U price cap Congress did not foresee the changes and market forces over the past decade, including mail volume declines, an increase in the number of mail delivery points, changes in the mail mix, and an economic recession. APWU Comments at 29. NALC maintains that by depriving the Postal Service of revenue and causing it to reduce the quality and availability of its services, the price cap risks driving away even more customers. NALC Comments at 8.

The Postal Service asserts that it has dangerously low liquidity and lacks the ability to meet all of its financial obligations. Postal Service Comments at 87. It represents that it only has enough cash reserves to sustain it for approximately 29 days. Postal Service Comments at 87. NALC notes that with the Postal Service's borrowing authority exhausted and with no access to capital markets, the only source of liquidity available to the Postal Service has been its meager cash reserves. NALC Comments at 7. It asserts that this state of constrained liquidity renders the Postal Service vulnerable to an economic downturn or crisis. *Id.*

The Postal Service states that constrained liquidity has prevented it from investing adequately in capital expenditures. Postal Service Comments

at 88. APWU, NALC, and NPHMU echo this assertion.<sup>51</sup> The Postal Service and NALC contend that the Postal Service's level of capital expenditures is far lower than that of its competitors.<sup>52</sup> NALC asserts that insufficient capital investments could undercut the Postal Service's long-term performance. NALC Comments at 12.

With regard to operational efficiency, the Postal Service maintains that deferral of capital expenditures has become a major drag on the Postal Service's efficiency improvement efforts. Postal Service Comments at 88–90. The Postal Service asserts that despite having made significant efficiency gains and cost cuts, the available remaining efficiency gains and/or cost cuts come nowhere close to enabling the Postal Service to maintain financial stability under the existing price cap. *Id.* at 83–84. NALC concurs with this conclusion, maintaining that the Postal Service has made significant strides in containing and reducing costs but is running out of feasible cost-cutting opportunities. NALC Comments at 6–9.

In addition to eliminating the price cap, APWU and NALC both suggest permitting a one-time true-up rate proceeding to reset the rate base for all classes.<sup>53</sup>

### 3. Commission Analysis

As the Commission concluded in Order No. 4257, the Postal Service is not financially stable because the current ratemaking system has not assured “adequate revenues, including retained earnings, to maintain financial stability,” as required by Objective 5. Order No. 4257 at 178 (quoting 39 U.S.C. 3622(b)(5)). Therefore, the Commission determines that it would be inappropriate to retain the existing ratemaking system unchanged. Doing so would not only be contrary to Objective 5, it would negatively impact the mailing industry as a whole. According to the 2015 Envelope Manufacturing Association's U.S. Mailing Industry Jobs and Revenue Study (EMA Study), in FY 2014, the latest year data are available, the nation's mailing industry employed 7.5 million workers and generated \$1.4 trillion in revenues. February 24, 2017 EMA Comments at 2. The EMA study states:

<sup>49</sup> APWU Comments at 23–24; NALC Comments at 9; NPHMU Comments at 3; *see also* MH and NAAD Comments at 7–8.

<sup>52</sup> Postal Service Comments at 88–89; NALC Comments at 10.

<sup>53</sup> APWU Comments at 30; NALC Comments at 17.

[A]lmost 85 percent of mailing industry jobs depend[] upon the delivery sector, of which the USPS is the center.

However, if one analyzes further between the public and private sector components of the delivery network (*i.e.* separating the USPS from its private sector competitors), the dependence of the US economy on the USPS becomes even clearer. Some 6.9 million private sector jobs depend on the 617,000 jobs of the USPS. This distribution of jobs impact clearly shows (as would a similar comparison of revenues) that the Postal Service's importance to the economy is substantially greater than one might assume if the Postal Service were examined in isolation.

*Id.* at 6.

At the other extreme, however, the Commission determines that it would be inappropriate to design a system that lacks a mechanism to limit the magnitude of price adjustments. Such a mechanism is necessary to create predictability and stability, as required by Objective 2. Order No. 4257 at 103; 39 U.S.C. 3622(b)(2).

The Commission finds, as discussed further below, that additional pricing authority is necessary to achieve the objectives of the PAEA. The Commission seeks to complement, rather than replace, the CPI-U price cap by providing discrete, clearly-defined amounts of additional rate authority. This additional rate adjustment authority is designed to put the Postal Service on the path toward generating positive net income and retained earnings. Accordingly, the Commission aims to design a ratemaking system that will put the Postal Service on the path to financial stability required by Objective 5 in a way that is consistent with the other objectives, such as Objectives 1 and 3, of the PAEA. Below the Commission describes its methodology to determine the amount and mechanism to provide that additional rate adjustment authority.

#### a. The Commission's Methodology

In order to estimate the appropriate amount of revenue to put the Postal Service on the path to financial stability, the Commission relies upon its three-tiered analysis detailed in Order No. 4257 as its starting point.

The Postal Service has been able to operate continuously without service interruption, consistent with the Commission's analysis demonstrating that the Postal Service has met the threshold of short-term financial stability. Order No. 4257 at 165. Beyond the short-term, however, the Postal Service's financial health is in jeopardy. *See generally id.* at 165–78. The medium-term financial stability analysis details that the Postal Service

<sup>49</sup> *See, e.g.*, Postal Service Comments at 82–83; APWU Comments at 29; NALC Comments at 4–6; NPMHU Comments at 3.

<sup>50</sup> NALC Comments at 4–6, 7; APWU Comments at 23–24.

experienced a net loss in every year during the PAEA era because total revenue generated was inadequate to cover total costs. *Id.* at 168. The long-term financial stability analysis shows that the Postal Service did not attain retained earnings during the PAEA era. *Id.* at 171. Additionally, during the PAEA era the Postal Service exhausted its borrowing authority and reduced its capital investments. *See id.* at 169–77.

Consistent with its financial stability analysis in Order No. 4257, the Commission derives reference points for how much additional revenue would be needed to put the Postal Service on the path to medium-term financial stability and for how much additional revenue would be needed to put the Postal Service on the path to long-term financial stability. In line with this two-pronged methodology, there are two components of additional rate authority: The first to address medium-term financial stability and the second to address long-term financial stability.

Although the financial stability discussion in this Order generally parallels Order No. 4257's division into the medium-term and long-term tiers, the medium-term and long-term financial stability concepts are interrelated. As detailed in section III.D.1, *infra*, the path to financial stability is cyclical. Adequate revenues build up net income (which demonstrates medium-term financial stability) and over time should lead to retained earnings (which demonstrate long-term financial stability). Retained earnings may be used to fund capital investment, which should lead to operational efficiency gains and help maintain high quality service standards. Operational efficiency gains and maintenance of high quality service standards should in turn lead to increased revenues and reduced costs, which should build up net income. Because the Postal Service's financial health is poor, it is necessary to try to make progress on multiple aspects of this cycle simultaneously.

Although the cycle above is centered around medium- and long-term financial stability (Objective 5), the cycle also affects several other objectives. In particular, the cycle also includes the goals underlying Objective 1 (maximize incentives to reduce costs and increase operational efficiency) and Objective 3 (maintain high quality service standards). In Order No. 4257, the Commission found that the system did not achieve the goals of the PAEA related to each of these objectives. *See* Order No. 4257 at 274–75. The Commission's proposed solution is structured to not only put the Postal

Service on the path to medium- and long-term financial stability, but also to address Objective 1's requirement that the system maximize incentives to increase operational efficiency and Objective 3's requirement that the high quality service standards are maintained.

Several commenters express concerns regarding the appropriate use of additional revenue by the Postal Service and the effects of any revenue increases on the Postal Service's incentives to cut costs and increase operational efficiency.<sup>54</sup> In order to ensure appropriate incentives, it is necessary to make the long-term additional rate authority contingent on the Postal Service meeting or exceeding an operational efficiency-based standard and adhering to service standard quality criteria.

The Commission expects that its proposal will incentivize the Postal Service to take necessary steps to reduce costs. As discussed in more detail in the remainder of this section, the Postal Service will need to realize cost reductions in order for the system to achieve financial stability. The Commission also expects its proposed solution to support continued cost reduction. As demonstrated by the cycle discussed above and in more detail in section III.D.1, *infra*, improvements in medium- and long-term financial stability and increased operational efficiency should lead to cost reductions when the cycle is functioning normally.

The Commission intends to review the proposed regulatory changes to the market dominant ratemaking system after the supplemental rate authority expires as explained in more detail below. This time period is consistent with the recommendations for another review in the near-term made by the Public Representative (suggesting to review in 4 years)<sup>55</sup> and the Postal Service (suggesting to review in 5 years).<sup>56</sup> It is critical under a price cap regime to be able to revisit a plan's performance quickly enough to prevent either persistent windfalls to the firm that harm consumers or persistent revenue shortfalls that damage the producer. *See* Kwoka Declaration at 11–12. At the same time, however, reviewing the system too frequently can undermine the incentives towards efficiency that the price cap was intended to foster. *See id.* at 8. The Commission determines that reviewing the system after the supplemental rate

authority expires is reasonable and appropriate. The Commission discusses the expiration of the supplemental rate authority in more detail in section III.C.3, *infra*.

#### b. The Commission's Proposed Approach

Based on the methodology described above, the Commission proposes a two-pronged solution designed to place the Postal Service on the path to financial stability by providing rate adjustment authority in addition to the CPI-U rate authority. The Commission proposes to make available both: (1) Supplemental rate authority to put the Postal Service on the path to medium-term financial stability and (2) performance-based rate authority (contingent on the Postal Service meeting or exceeding an operational efficiency-based standard and adhering to service standard quality criteria) to put the Postal Service on the path to long-term financial stability. The remainder of this section summarizes the purpose, amount, and mechanization of each type of rate authority. The Commission provides more detailed explanations of the supplemental rate authority and performance-based rate authority, *infra*, in sections III.C and III.D, respectively.

First, the proposed supplemental rate authority aims to put the Postal Service on the path to medium-term financial stability by providing the Postal Service the opportunity to generate additional revenue to cover its obligations. In determining the amount of supplemental rate authority, the Commission uses the \$2.7 billion FY 2017 net loss as its reference point.<sup>57</sup> Providing a discrete amount of supplemental rate authority on a steady and regular annual basis for 5 years should put the Postal Service on the path to medium-term financial stability while also taking into account pricing predictability and stability. Therefore, the Commission provides for 2 percentage points of rate authority per class of mail per calendar year for each of the first 5 full calendar years following the effective date of these proposed rules. This proposed supplemental rate authority is necessary to achieve Objective 5. The detailed justifications relating to the purpose, amount, and mechanism to allocate the proposed supplemental rate authority are addressed in section III.C, *infra*.

Second, the proposed performance-based rate authority aims to put the Postal Service on the path to long-term

<sup>54</sup> *See, e.g., ANM et al. Comments at 9; DMA et al. Comments at 3; GCA Comments at 20–21.*

<sup>55</sup> PR Comments at 60–61.

<sup>56</sup> Postal Service Comments at 219 n.430.

<sup>57</sup> United States Postal Service, 2017 Report on Form 10-K, November 14, 2017, at 16 (Postal Service FY 2017 Form 10-K).

financial stability by providing the Postal Service the opportunity to generate retained earnings. These earnings would fund adequate levels of capital investment. In determining the amount of performance-based rate authority, the Commission uses several reference points related to capital investment, capital assets, and borrowing authority. Making the availability of this performance-based rate authority contingent on the Postal Service meeting or exceeding an operational efficiency-based standard and adhering to service standard quality criteria should put the Postal Service on the path to long-term financial stability while also providing for accountability. Therefore, the Commission provides for up to 1 percentage point of rate authority per class of mail per calendar year, contingent on the Postal Service meeting or exceeding an operational efficiency-based standard and adhering to service standard quality criteria. This proposed performance-based rate authority is necessary to achieve Objectives 1, 3, and 5. The detailed justifications relating to the purpose, amount, and mechanism to allocate the proposed performance-based rate authority are addressed in section III.D, *infra*.

### C. Supplemental Rate Authority

#### 1. Background

In the three-tiered financial stability analysis used in Order No. 4257, the Commission determined that although short-term stability was achieved under the PAEA, medium- and long-term stability were not. This section discusses the medium-term tier of the financial stability test. To be deemed financially stable in the medium-term, the Postal Service's total revenue should cover total cost (both attributable and institutional). Order No. 4257 at 165. The Commission measured this by analyzing net income, which consists of (total revenue – [attributable costs + institutional costs]). *Id.* The Commission found that the Postal Service experienced a net loss in every year of the PAEA era, as total revenue generated was inadequate to cover total costs. *Id.* at 168. As a result, the Commission determined that the Postal Service did not achieve medium-term financial stability. *Id.* This was compounded because the existing ratemaking system did not achieve cost reductions and operational efficiency gains sufficient to contribute to the financial stability of the Postal Service. *See id.* at 274.

Therefore, the Commission aims to design a ratemaking system that will put

the Postal Service on the path to generating positive net income. The Commission uses Order No. 4257's medium-term stability framework for its analysis, but utilizes the FY 2017 net loss as a starting point for its calculation to put the Postal Service on the path towards medium-term financial stability. In the remainder of this section, the Commission discusses how it estimates the amount of the proposed supplemental rate authority necessary to address this net loss. The Commission then discusses how it proposes to allocate this proposed supplemental rate authority in a manner that balances the PAEA's objectives.

#### 2. Amount of Supplemental Rate Authority

To estimate the amount of additional revenue that would be needed in order to put the Postal Service on the path to medium-term financial stability, the Commission uses as its starting point the FY 2017 net loss.

During the first 10 years under the PAEA, the Postal Service's net loss ranged from \$2.8 billion to \$15.9 billion. Order No. 4257 at 168, Table II–10. The net losses experienced over this period show that the rate adjustment authority under the existing market dominant ratemaking system was insufficient. The Commission determines that an adjustment to the system is necessary to provide the Postal Service with tools to address its ongoing net income shortfall.

Based on the FY 2017 net loss of \$2.7 billion, the Postal Service would need additional revenue of \$2.7 billion to achieve medium-term stability (*i.e.*, to have total revenue equal to all attributable and institutional costs).<sup>58</sup> This represents 5.7 percent of FY 2017 market dominant revenue. While the Commission relies on the FY 2017 net loss as a reference point, it also looks to additional considerations in determining the amount of proposed supplemental rate authority. The Postal Service's future financial position will be affected by a multitude of influences such as changes in inflation, the cost of inputs, changes in operational efficiency, secular volume trends, and mailers' responses to price changes. As a result, it is not possible to precisely calculate the exact amount of additional pricing authority that will achieve

<sup>58</sup> For purposes of determining the amount of supplemental rate authority, competitive products are assumed to maintain the current level of contribution to institutional costs. In the 10 years following the enactment of the PAEA, revenue generated from competitive products has covered those products' attributable costs and has exceeded those products' required contribution to institutional costs.

medium-term stability in future years. Such precision is not necessary to effectuate the Commission's proposal because the proposed supplemental rate authority is not designed to provide sufficient revenue to cover costs in the same way as the revenue requirement of the Postal Reorganization Act's break-even regime. Instead, the proposed supplemental rate authority is designed to provide the opportunity to generate additional revenue that is sufficient, when combined with cost reductions and operational efficiency gains, to improve the financial stability of the Postal Service.

#### 3. Phase-in Mechanism

##### a. Proposed Commission Solution

Taking this \$2.7-billion revenue increase developed using the FY 2017 net loss as its reference point, the Commission has considered how to authorize the proposed supplemental rate authority in a manner that will put the Postal Service on the path to generating sufficient revenue to meet its medium-term obligations balancing all of the PAEA's objectives. The Commission has given weight to the commenters' concerns regarding the timing and magnitude of rate increases. Based on these concerns and the analysis in Order No. 4257, the Commission proposes to design the ratemaking system to allow for this proposed supplemental rate authority on an annual basis over a finite period.

Given the magnitude of the FY 2017 loss, the Commission finds that the most appropriate means of putting the Postal Service on a path to medium-term financial stability is to provide 2 percentage points of supplemental rate authority each year for a 5-year period, after which it ends. As discussed in section III.B.3, *supra*, the Commission determines that 5 years is a reasonable and appropriate time period to allow the Postal Service the opportunity to achieve medium-term financial stability, after which time the Commission will review the Postal Service's financial performance.

Specifically, the Commission proposes to make available to the Postal Service 2 percentage points of supplemental rate authority per class of mail per calendar year for each of the first 5 full calendar years following the effective date of these proposed rules. This proposal is structured to encourage regular and stable timing and magnitude of rate increases—that is the same amount of supplemental rate authority, provided on an annual basis at the same time each year, over a finite period of years. This proposed magnitude and 5-

year phasing schedule will allow mailers to plan their operations and budgets over this period. Applying this proposed supplemental rate authority in addition to the CPI-U price cap for 5 years produces estimated revenues with a net present value equal to that of a one-time rate increase of 5.7 percent above CPI-U followed by 4 years of inflation-only increases. These estimates of future revenues are developed by applying the future rate increases to current mail volumes. Market dominant product volumes have been declining overall and shifting toward lower-priced products and rates. Given these recent volume trends and the effects of price elasticity,<sup>59</sup> the assumption of constant mail volumes results in revenue estimates the Commission reasonably anticipates will be higher than the revenues that the proposed rate adjustment authority would actually generate. Accordingly, the Commission intends for the Postal Service to achieve cost reductions and operational efficiency gains sufficient to close the gap between total revenue and total costs.

<sup>59</sup> See Order No. 4257 at 127–30.

This proposed approach is consistent with the Commission's analyses and the resulting conclusions reached in Order No. 4257. See *generally id.* at 142–46, 247–49, 274–75. At the same time, the proposal is necessary to achieve Objective 5, as the supplemental rate authority will put the Postal Service on the path to medium-term financial stability.

b. Commission Analysis of the Alternatives

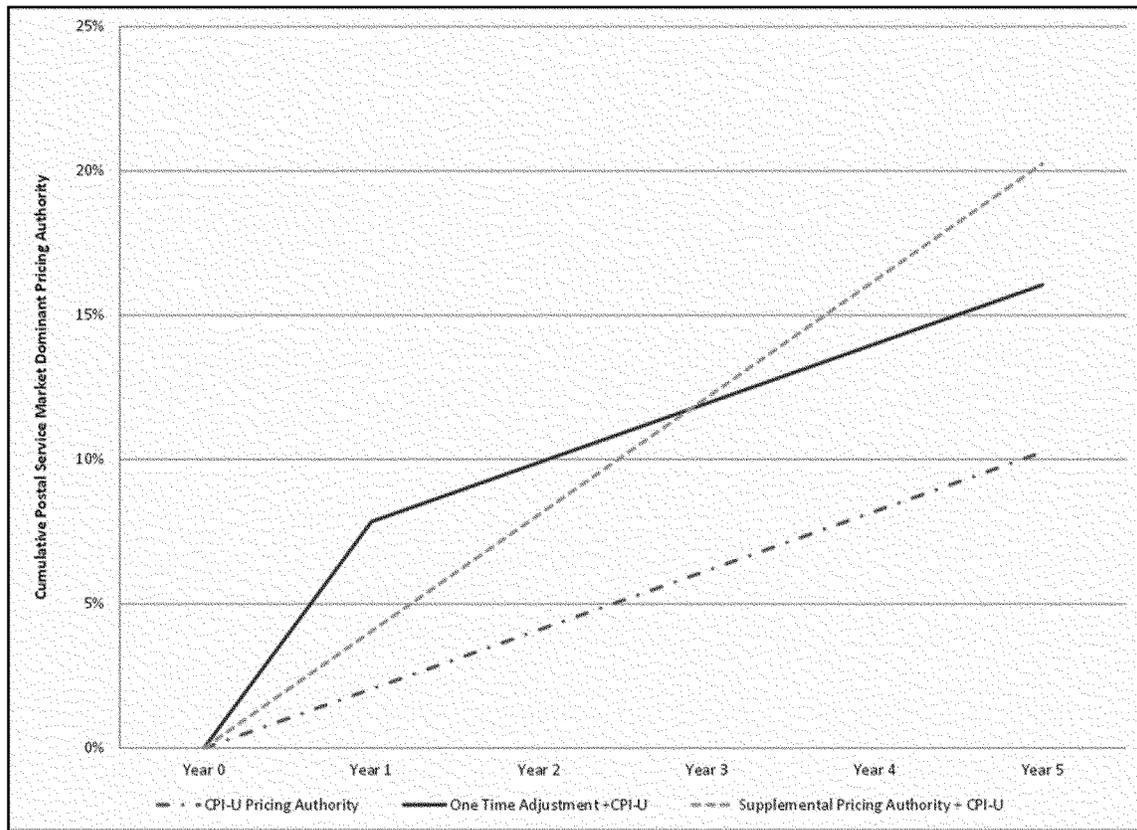
The Commission evaluated an alternative approach that would grant the Postal Service supplemental rate authority for use on a one-time basis. Specifically, this one-time rate adjustment would provide for 5.7 percentage points of rate authority for use during the first year following the effective date of these proposed rules.<sup>60</sup> Ultimately, the Commission determines that phasing in 2 percentage points of supplemental rate authority over 5 years better balances the PAEA's objectives.

<sup>60</sup> Under this option, the proposed performance-based rate authority, intended to put the Postal Service on the path to long-term financial stability, would not be available until the second year following the effective date of these proposed rules.

Both the Commission's proposal and the one-time rate adjustment option would put the Postal Service on the path to medium-term financial stability. In light of commenter views, the difficulty in forecasting the potential effects of a one-off rate adjustment, and the complications involved in correcting those potential effects, the Commission determines that spreading increases out over a longer period of time is more prudent. Spreading the increases allows the Commission, Postal Service, and stakeholders to monitor the evolving financial health, efficiency gains, cost reductions, and other goals of the ratemaking system over a period of years. Therefore, the Commission proposes to allow 2 percentage points of supplemental rate authority per year over 5 years. This determination is illustrated in Figure III–1, which illustrates that over a 5-year period, the rate increases under the Commission's proposal would be more smooth and steady than the alternative approach of providing 5.7 percentage points of rate authority in year 1.

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**Figure III-1**  
**Cumulative Postal Service Market Dominant Rate Adjustment Authority, Projected Years 1-5**



Source: Library Reference PRC-LR-RM2017-3/2.

In Figure III-1, CPI-U is estimated to be 2.05 percent each year for the next 5 years.<sup>61</sup> One-time supplemental authority of 5.7 percent, combined with a CPI-U authority pricing increase of 2.05 percent would lead to pricing authority of 7.75 percent for each class of mail. Such an increase would be well outside the industry's experience under the PAEA system of ratemaking. See Order No. 4257 at 106, Table II-3. The Commission notes that predicting the impacts of such a change would therefore be difficult, and the Commission, the Postal Service, and mailers would have limited opportunity to make adjustments for those impacts. On the other hand, moderated increases spread across a longer period should allow the Commission, the Postal Service, and mailers to monitor the

evolving financial health, efficiency gains, cost reductions, and other goals of the ratemaking system over a period of years. As a result, the Commission proposes a series of five CPI-U price adjustments with the additional supplemental authority and finds such approach is most consistent with the metrics developed and employed by the Commission in Order No. 4257.

#### c. Proposed Regulatory Changes

The Commission has considered the comments and the foregoing analysis in developing proposed subpart D to 39 CFR part 3010. The Commission proposes to allocate 2 percentage points of supplemental rate authority per class of mail per calendar year for each of the first 5 full calendar years following the effective date of these proposed rules.

#### d. Conclusion

This proposed supplemental rate authority will address the Postal Service's ongoing financial instability by providing the opportunity for the Postal Service to generate adequate

revenue and put the Postal Service on the path to financial stability which is necessary to achieve Objective 5. See 39 U.S.C. 3622(b)(5).

#### D. Performance-Based Rate Authority

##### 1. Background

As discussed in Order No. 4257, the existing ratemaking system did not achieve the objectives during the first 10 years following the PAEA's enactment. The Commission identifies three interrelated deficiencies of the existing ratemaking system, which the Commission proposes to address through the performance-based rate authority.

The PAEA intended the market dominant ratemaking system to enable the Postal Service to achieve financial stability. Order No. 4257 at 146. To maintain financial stability, the ratemaking system must enable the Postal Service to "assure adequate revenues, including retained earnings," as required by Objective 5. *Id.* at 147 (quoting 39 U.S.C. 3622(b)(5)). Moreover, as detailed in Order No.

<sup>61</sup>This is consistent with the medium-term forecast by the Bureau of Labor Statistics. Bureau of Labor Statistics Employment and Economic Projections for 2016 to 2026 (as of October 2017), Excel file "historicmacro.xls," tab I, row 40, available at [https://www.bls.gov/emp/ep\\_data\\_aggregate\\_economy.htm](https://www.bls.gov/emp/ep_data_aggregate_economy.htm).

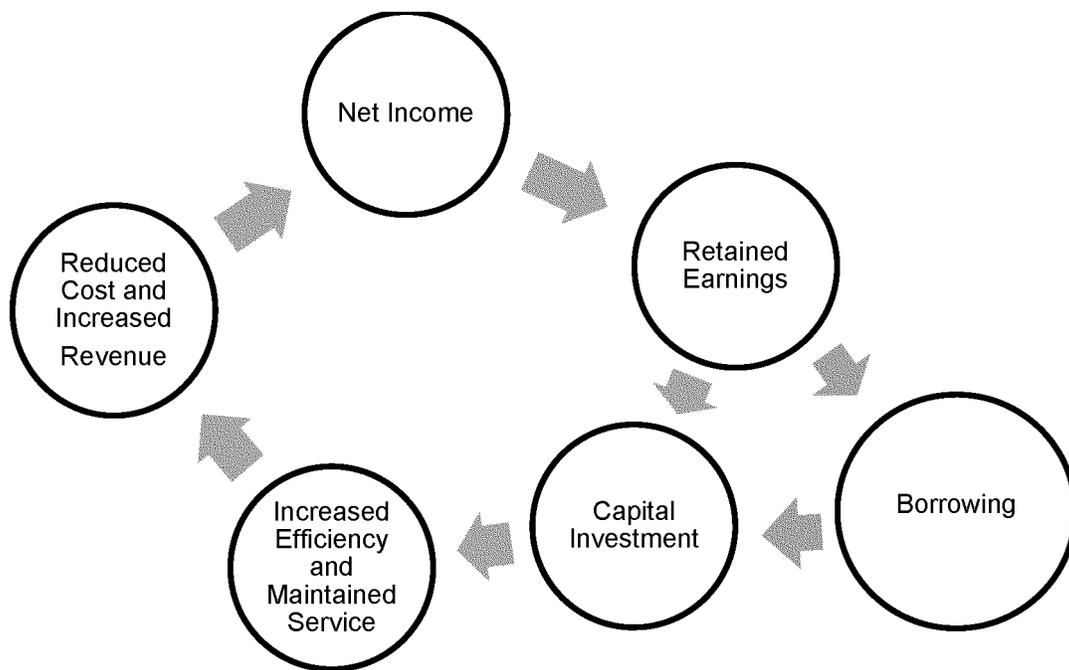
4257, the PAEA intended that the Postal Service's financial health would be maintained in conjunction with other objectives of the PAEA. *See id.* at 274. The ratemaking system must "maximize incentives to reduce costs and increase efficiency," as required by Objective 1. *Id.* at 178 (quoting 39 U.S.C. 3622(b)(1)). Further, the PAEA intended that the ratemaking system would encourage the maintenance of high quality service standards, as required by Objective 3.

*Id.* at 261–62 (citing 39 U.S.C. 3622(b)(3)).

Ideally, these three objectives would function in a harmonious cycle. The cycle begins with the path to financial stability. A financially healthy Postal Service generates adequate revenues to ensure net income, which provide retained earnings. Retained earnings enable the Postal Service to make the kinds of capital investments needed to improve operational efficiency. Capital investments that improve efficiency will also likely lead to cost reductions and

help maintain high quality service standards. Maintenance of high quality service standards promotes demand for postal products, which leads to increased revenue. Increased revenue and decreased costs lead to sustained net incomes, which results in retained earnings. A related but separate component to this cycle is borrowing. Retained earnings can be used to pay down debt and borrowing can be used to finance capital investments. Figure III–2 illustrates this cycle.

**Figure III-2  
Financial Health Cycle**

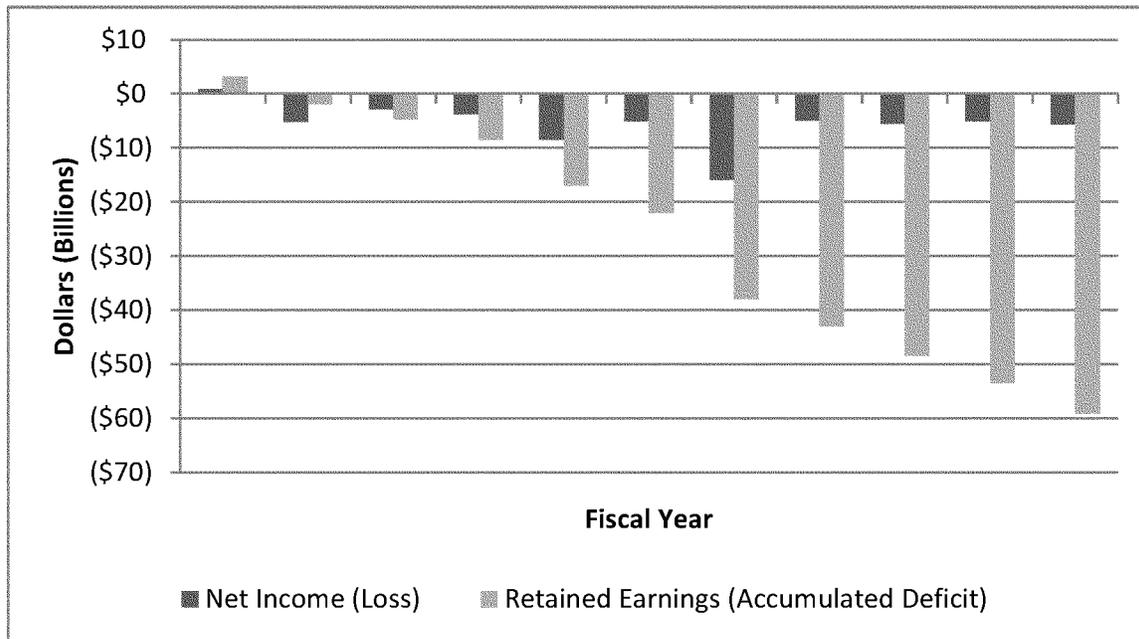


However, this cycle has broken down under the existing ratemaking system because consecutive net losses have

resulted in an accumulated deficit rather than retained earnings. Starting from the baseline FY 2006, Figure III–

3 illustrates the Postal Service's recurring net losses and accumulated deficit during the PAEA era.

**Figure III-3**  
**Net Income and Retained Earnings (Accumulated Deficit), FY 2006 –**  
**FY 2016**



Source: Library Reference PRC-LR-RM2017-3/2.

As shown in Figure III–3, the recurring net losses resulted in accumulated deficit in every year since the PAEA was enacted in FY 2007. Between FY 2008 and FY 2012, the accumulated deficit increased from \$4.7 billion to \$38 billion. After FY 2012, the accumulated deficit continued to grow, but at a slower rate. This was due, in part, to the exigent surcharge in place from January 2014 to April 2016.<sup>62</sup> The accumulated deficit of \$59.1 billion in FY 2016 includes \$54.8 billion in expenses related to prefunding the RHBF.<sup>63</sup>

The Postal Service has no shareholders and may not invest in stocks, bonds, or other financial instruments. Therefore, without retained earnings, its only means of financing capital investments is through revenue or borrowing. As accumulated deficit increased in the early years under the PAEA, the Postal Service began relying heavily on borrowing. It reached its \$15 billion borrowing authority limit in FY 2012—5 years after the PAEA was enacted. *See* Order No. 4257 at 164, Table II–8. After that, the Postal Service began offsetting its lack of

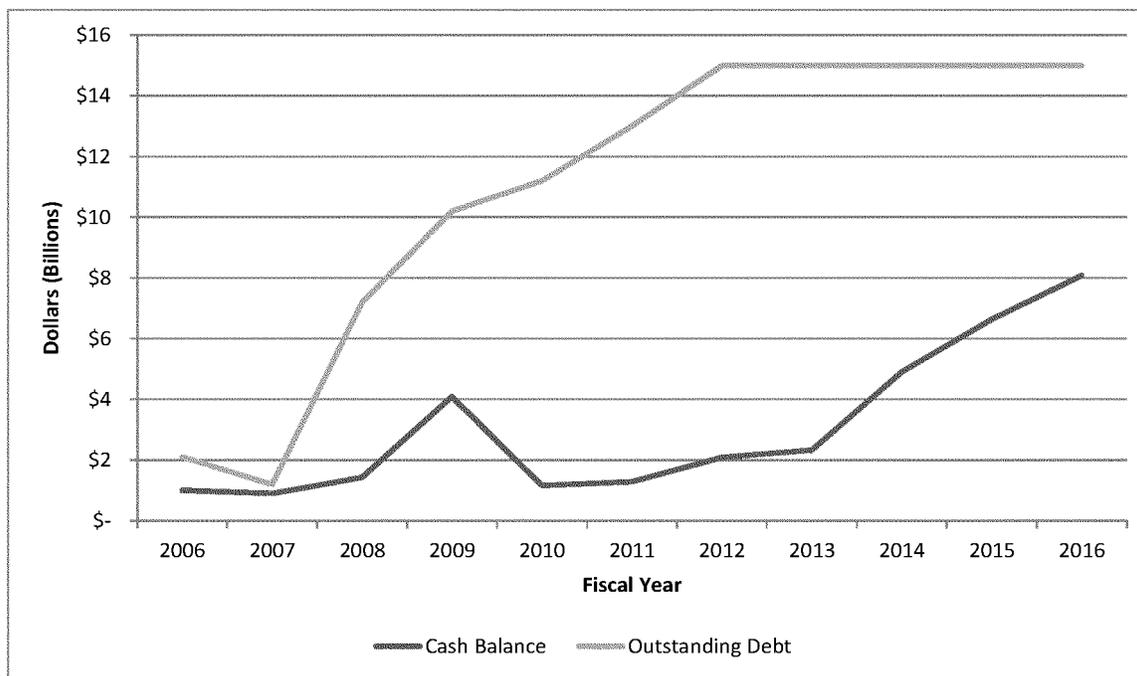
borrowing authority by increasing cash-on-hand. *See id.* at 163–64. Although the Postal Service has been unable to generate net income since the PAEA was enacted, it has been able to generate operating profits. Thus, while the Postal Service has not paid all of its obligations, as noted in Order No. 4257, it has been able to increase its cash reserves. *See id.* at 164, Table II–8. Figure III–4 shows the Postal Service’s outstanding debt and cash on hand for FY 2006 through FY 2016.

<sup>62</sup> *See* Docket No. R2013–11, Order No. 1926, Order Granting Exigent Price Increase, December 24, 2013; 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.

<sup>63</sup> United States Postal Service, 2016 Report on Form 10–K, November 15, 2016, at 58 (Postal Service FY 2016 Form 10–K).

**Figure III-4**  
**Postal Service End of Year Outstanding Debt and Cash Balance**  
**FY 2006 – FY 2016**



Source: Library Reference PRC-LR-RM2017-3/2.

The accumulated deficit and lack of borrowing authority has severely restricted the Postal Service's ability to make capital improvements.<sup>64</sup> The Postal Service selects its capital improvements based on need and budget.<sup>65</sup> Capital commitments are made for the projects selected.<sup>66</sup> The Postal Service makes commitments for capital investments based, in part, on the availability of cash flow from its operations.<sup>67</sup> The funds used to pay for

these commitments are called capital outlays.<sup>68</sup> Because needs and budgets vary by year, the amount of capital commitments and outlays fluctuate annually.<sup>69</sup>

As its accumulated deficit increased, the Postal Service began to decrease its capital commitments and subsequent outlays. Figure III-5 illustrates the change in capital commitments and outlays throughout the PAEA era.<sup>70</sup> Capital outlays were severely curtailed

in FY 2012, FY 2013, and FY 2014.<sup>71</sup> This reflected the Postal Service's lack of capital commitments in the preceding years and was due in part to the Postal Service reaching its borrowing authority limit in FY 2012. In FY 2015 and FY 2016, capital outlays began to increase as the Postal Service made capital commitments based on additional revenue generated by the exigent rate increase.<sup>72</sup>

<sup>64</sup> Postal Service FY 2016 Form 10-K at 10, 32; see also 2015 Report on Form 10-K United States Postal Service, November 13, 2015, at 9, 46 (Postal Service FY 2015 Form 10-K); 2014 Report on Form 10-K United States Postal Service, December 5, 2014, at 9 (Postal Service FY 2014 Form 10-K).

<sup>65</sup> See Postal Service FY 2015 Form 10-K at 31 ("We continued to employ a discretionary capital expenditure plan for priority projects that are essential to conserve cash."); *id.* ("Priority has been given to projects: 1. Needed for safety and/or health or legal requirements; 2. Required to provide service to our customers; and 3. Initiatives with a high return on investment and a short payback period."); *id.* ("To save cash, we have also deferred facilities maintenance, which has no impact on health and safety issues."); see also Postal Service FY 2014 Form 10-K at 32.

<sup>66</sup> See Postal Service FY 2015 Form 10-K at 32 n.4 ("Capital commitments pertain to purchases of equipment, building improvements, and vehicles for legally binding obligations.")

<sup>67</sup> See *id.* at 31 ("The source of funds needed to fulfill these commitments was generated from our operating activities.")

<sup>68</sup> See United States Postal Service, 2008 Report on Form 10-K, September 26, 2008, at 24 (Postal Service FY 2008 Form 10-K) ("Our capital cash outlays consist of the funds invested for new facilities, new automation equipment, and new services.")

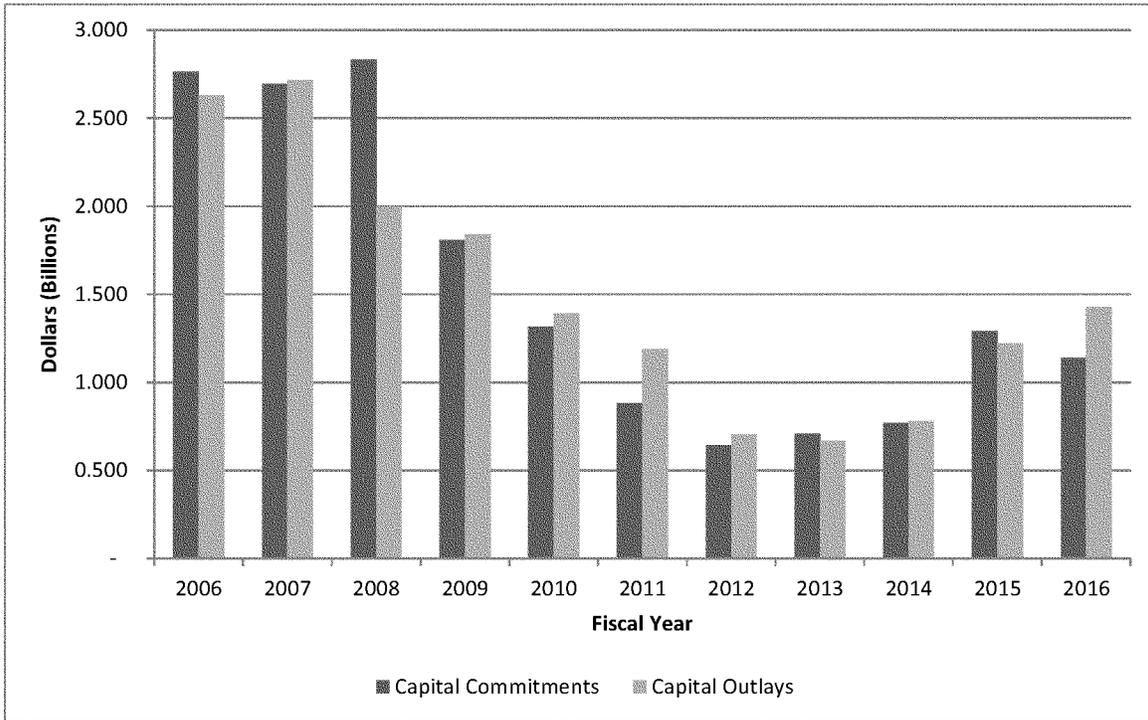
<sup>69</sup> See Postal Service FY 2014 Form 10-K at 9 ("If our operations do not generate the liquidity we require, we may be forced to reduce, delay or cancel investments in technology, facilities and/or transportation equipment, as we have done in the recent past.")

<sup>70</sup> As seen in Figure III-5, the decrease in capital outlays lagged the decrease in capital commitments, as the Postal Service continued to fund capital commitments made in prior years.

<sup>71</sup> U.S. Postal Service Five-Year Strategic Plan, Fiscal Years 2017 to 2021, September 30, 2016, at 23 (FY 2017–2021 Strategic Plan).

<sup>72</sup> The Postal Service stated that "[i]n 2016, [it] invested \$1.4 billion in the purchase of property and equipment, an increase of \$206 million over 2015, as [it] used additional cash on hand to fund some of [its] much-needed investments in building improvements, vehicles, equipment and other capital projects. In 2015, [it] invested \$1.2 billion in the purchase of property and equipment, an increase of \$441 million over 2014." Postal Service FY 2016 Form 10-K at 32. It also stated that "[a]vailable liquidity (cash and short-term investments, plus available borrowing capacity) has increased by approximately \$6 billion from the reported 2012 low. This improvement would not have occurred had the Postal Service not defaulted on the annual PSRHF pre-funding payments in 2012 and subsequent years. Aside from the defaults, the improvement is largely attributable to the temporary exigent surcharge . . . which generated approximately \$4.6 billion in incremental revenue from January 2014 through April 10, 2016, as well as to aggressively managing capital expenditures and operating expenses under management's control." *Id.* at 47.

**Figure III-5  
Capital Commitments and Outlays, FY 2006 – FY 2016**



Source: Library Reference PRC-LR-RM2017-3/2.

However, even with the increase in capital commitments and outlays in FY 2015 and FY 2016, the value of the

Postal Service’s net asset holdings decreased substantially during the PAEA era.<sup>73</sup> As shown in Table III-1

property and equipment declined by \$7.8 billion, or 33.8 percent between FY 2006 and FY 2016.

<sup>73</sup> Net asset holdings are property and equipment recorded at cost, including interest on borrowings

used to pay for the construction of major capital

additions, less accumulated depreciation. FY 2016 USPS Form 10K at 44.

**Table III-1  
Net Asset Holdings and Capital Purchase Trends, FY 2006 – FY 2016**

<b>Fiscal Year</b>	<b>Property and Equipment, net</b>	<b>Capital Commitments</b>	<b>Capital Cash Outlays</b>
2006	\$23,095	\$2,760	\$2,630
2007	\$23,596	\$2,694	\$2,715
2008	\$23,193	\$2,830	\$1,995
2009	\$22,680	\$1,809	\$1,839
2010	\$21,595	\$1,315	\$1,393
2011	\$20,337	\$881	\$1,190
2012	\$18,863	\$644	\$705
2013	\$17,512	\$708	\$667
2014	\$16,338	\$770	\$781
2015	\$15,686	\$1,288	\$1,222
2016	\$15,296	\$1,139	\$1,428
Change FY 2006 to FY 2016	(\$7,799)	(\$1,621)	(\$1,202)
Percent change FY 2006 to FY 2016	-33.8%	-58.7%	-45.7%

**Source:** Library Reference PRC-LR-RM2017-3/2.

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The Postal Service's sharp decline in capital investments contributed to the system not achieving Objective 1 ("maximize incentives to reduce costs and increase efficiency"), Objective 3 ("maintain high quality service standards established under section 3691"), and Objective 5 ("assure adequate revenues, including retained earnings, to maintain financial stability"). 39 U.S.C. 3622(b)(1), (3), and (5). The lack of financial stability, insufficient levels of efficiency gains and cost reductions, and inability to adequately encourage the maintenance of service standard quality were interrelated causes and effects of the deficiencies experienced under the existing ratemaking system.

To address these interrelated deficiencies, the ratemaking system must provide the Postal Service the opportunity to generate additional revenue coupled with incentives to increase operational efficiency and maintain high quality service standards. Therefore, the Commission determines that it is necessary to provide additional rate authority to put the Postal Service on the path to long-term financial stability, contingent on the Postal Service meeting particular performance-based thresholds.

**2. Amount of Performance-Based Rate Authority**

After balancing the objectives of the ratemaking system, the Commission determines that the best course of action is not to provide the Postal Service a specific level of retained earnings or a set amount of funding for capital investment but rather to put the Postal Service on a path to long-term financial stability while providing meaningful incentives for the Postal Service to increase operational efficiency and maintain high quality service standards. Given the importance of capital investment to the cycle shown in Figure III-2, *supra*, the Commission finds that capital investment data from the PAEA era are appropriate reference points. As a result of its analysis below, the Commission determines that the appropriate amount of performance-based rate authority is 1 percentage point per annum.

This amount was determined by analyzing net asset holdings, capital outlays, and borrowing authority. The \$7.8 billion needed to replace the net asset holdings that declined in the PAEA era represents approximately 16 percent of FY 2017 market dominant revenue. Capital outlays were approximately \$1.2 billion less in FY 2016 than in FY 2006, the last fiscal year before PAEA was enacted. The

reduction in the annual capital outlays that occurred during the PAEA era represents approximately 2.5 percent of FY 2017 market dominant revenue. The \$15 billion in borrowing authority that the Postal Service exhausted during the PAEA era represents approximately 31 percent of FY 2017 market dominant revenue. Taking into account these reference points, the impact of the proposed supplemental rate authority, and the rate increases experienced during the PAEA era, the Commission applies its expert judgment in postal matters to determine that 1 percentage point per annum is the appropriate amount of performance-based rate authority.

All other things being equal, the 1 percentage point of proposed performance-based rate authority would allow the Postal Service to return to pre-PAEA levels of capital outlays in just over 2 years. In approximately 5 years, the proposed performance-based rate authority would produce enough cumulative additional revenue to allow the Postal Service to replace the \$7.8 billion decrease in net capital assets that occurred in the PAEA era. It would take approximately 9 years of accumulated additional revenue at a 1-percent rate of increase in prices to also pay off the \$15 billion in borrowing authority the Postal Service exhausted during the PAEA.

These calculations assume that all of the future rate increases are applied to FY 2017 volumes. As noted in section III.C.2, *supra*, market dominant product volumes have been declining overall, as well as shifting toward lower-priced products and rates. Given these trends, and the mailers predicted responses to price increases, the Commission anticipates that the amount of additional revenue generated by this proposed performance-based rate authority will be less than these calculations suggest. As noted above, the Postal Service will need to improve operational efficiency to achieve financial stability. Given the uncertainty as to the exact amount of revenues the performance-based rate authority will produce and how much improvement in efficiency the Postal Service will achieve under this approach, the Commission will review the Postal Service's long-term financial stability after the supplemental rate authority expires and consider whether adjustments to the performance-based rate authority should be made. See section III.B.3, *supra*.

Because of the interdependence of long-term financial stability, operational efficiency, and service quality, the Commission addresses these jointly by linking the availability of this additional rate authority to efficiency and service standard metrics. To facilitate this combined approach, the additional rate authority is structured as an annual amount that is conditioned on the achievement of efficiency gains and the maintenance of service standards. The full amount of the proposed performance-based rate authority will not be available if the Postal Service does not meet or exceed an operational efficiency-based standard and adhere to service standard quality criteria. The magnitude, timing, and conditional design of this mechanism balances the need to ensure the long-term financial stability of the Postal Service (Objective 5), maximize incentives to reduce costs and increase efficiency (Objective 1), and maintain high quality service standards (Objective 3) with the other statutory objectives of the PAEA consistent with the analysis in Order No. 4257.

### 3. Performance Incentive Mechanism

The Commission has carefully considered how to allocate this

additional rate authority in a manner that will address the interrelated systemic deficiencies. The Commission finds that although additional revenue is needed, additional revenue, alone, is insufficient to address the need to also increase operational efficiency and maintain high quality service standards. As discussed in Order No. 4257, all of these are necessary in order for the system to achieve the objectives of 39 U.S.C. 3622(b). Therefore, the Commission proposes to address these interrelated issues through the creation of a Performance Incentive Mechanism (PIM). Generally, a PIM takes the form of either a bonus (*e.g.*, additional rate authority) or a penalty (*e.g.*, reduction in rate authority) tied to performance criteria. The use of PIMs may be particularly appropriate where the regulated entity, such as the Postal Service, is subject to cost-cutting pressures.<sup>74</sup>

#### a. Proposed Commission Solution

Consistent with the analysis in Order No. 4257, the solution proposed by the Commission is necessary to achieve several of the PAEA's objectives. In fashioning the incentive mechanism, the Commission has specifically focused on Objective 1 (maximizing incentives to reduce costs and increase efficiency), Objective 3 (maintaining high quality service standards), and Objective 5 (assuring adequate revenues, including retained earnings, to maintain financial stability), and the Commission's related analysis in Order No. 4257. See 39 U.S.C. 3622(b)(1), (3), and (5).

The Commission proposes to make this performance-based rate authority conditional on the Postal Service meeting or exceeding an operational efficiency-based standard and adhering to service standard quality criteria. Using a performance-based approach should encourage the Postal Service to maintain service standard quality and maximize incentives to increase efficiency—thereby addressing areas where the existing ratemaking system was deficient in the 10 years following the enactment of the PAEA. In line with the general premise that improved operational efficiency should help to improve service, the Commission determines that it is appropriate to attach more weight to the operational efficiency aspect of the incentive mechanism. Therefore, the Commission

divides this 1 percentage point of performance-based rate authority between an operational efficiency-based standard (0.75 percentage points), and service quality-related criteria (0.25 percentage points).

#### b. Proposed Regulatory Changes

The Commission has considered the comments and the foregoing analysis in developing proposed subpart E to 39 CFR part 3010, which sets forth the criteria for the availability of performance-based rate authority. The Commission proposes to allocate up to 1 percentage point of rate authority based on the Postal Service meeting or exceeding an operational efficiency-based standard and adhering to service standard quality criteria.

#### c. Conclusion

This proposed performance-based rate authority will address three interrelated deficiencies in the existing ratemaking system: Generating sufficient revenue to assure long-term financial stability, maximizing incentives to reduce costs and increase efficiency, and maintaining high quality service standards. This proposed performance-based rate authority is necessary to achieve Objectives 1, 3, and 5. In sections III.D.4 and III.D.5, *infra*, the Commission details the specifics of the operational efficiency and service aspects of the incentive mechanism.

## 4. Operational Efficiency

### a. Introduction

The existing market dominant ratemaking system did not maximize incentives to increase operational efficiency in accordance with Objective 1. Order No. 4257 at 222; 39 U.S.C. 3622(b)(1). Consistent with Order No. 4257, the Commission uses total factor productivity (TFP) as its determinative metric for operational efficiency because it is the best available measure of efficiency. Order No. 4257 at 206.

Because TFP contains all of the components needed to determine the efficiency of a multi-product firm and comprehensively accounts for both the inputs and outputs of the Postal Service, TFP reflects the efficiency changes that occur in a given year. *Id.* To arrive at the final TFP figure, the model divides the workload index by the input index as follows:

<sup>74</sup> See Mark Newton Lowry & Tim Woolf, *Performance-Based Regulation in High Distributed Energy Resources Future*, Lawrence Berkley

National Laboratory, Report No. 3, January 2, 2016; see also Melisa Whited, Tim Woolf, & Alice Napoleon, *Utility Performance Incentive*

*Mechanisms: A Handbook for Regulators*, Western Interstate Energy Board, March 9, 2015.

$$TFP = \frac{\text{Workload}}{\text{Input}} := \frac{f(\text{Output, Network})}{f(\text{Labor, Capital, Materials})}$$

The Postal Service calculates TFP annually and files that figure and the supporting data with the Commission.<sup>75</sup> The Postal Service detailed the current TFP methodology in Docket No. N2010–1.<sup>76</sup> The Commission considers this methodology an accepted analytical principle. Order No. 4257 at 207. As such, any future changes to this methodology are subject to Commission review and approval through the rulemaking process appearing in existing § 3050.11. *Id.*

TFP generally increased during the PAEA era. *Id.* at 208. However, the system was: (1) Unable to achieve operational efficiency gains sufficient to contribute to the financial stability of the Postal Service; and (2) unable to achieve increases in efficiency at a greater rate than in the relevant comparable time period (the 10 years prior to implementation of the PAEA). *Id.* at 222–26. Therefore, the Commission proposes modifications to the ratemaking system to incentivize the Postal Service to address these deficiencies.

#### b. Comments

The Postal Service and the Public Representative include detailed evaluations of operational efficiency in their comments.

The Postal Service retained Christensen Associates (Christensen) to provide an evaluation of TFP as a measure of operational efficiency. Postal Service Comments at 57 (citing Postal Service Comments, Appendix D). The TFP methodology as used by the Postal Service was initially developed by Christensen in 1983. Postal Service Comments, Appendix D at 2. In an appendix attached to the Postal Service's comments, Christensen explains the calculation of TFP, compares TFP to other potential ways of measuring efficiency gains, and discusses how TFP results should be assessed. *See id.* Appendix D. Christensen concludes that TFP is a more comprehensive measure of operational efficiency than the other measures considered by the Commission, but Christensen cautions that the TFP measurement is subject to

substantial year-to-year variation. *Id.* at 4–5. Christensen recommends analyzing TFP trends over multi-year periods when evaluating TFP improvements. *Id.* at 6. The Postal Service echoes Christensen's concern that if TFP is to be used an evaluation tool, it is important to look at TFP trends over several years, rather than at annual TFP results in isolation. Postal Service Comments at 57, 197.

The Postal Service suggests that the price cap is no longer necessary to incentivize the Postal Service to aggressively focus on increasing operational efficiency and reducing costs. *Id.* at 190. The Postal Service maintains that the efficiency gains that have occurred during the PAEA era were driven more by the Postal Service's strategy to respond to volume declines presented by the "new normal" marketplace than by the discipline imposed by the price cap. *Id.* Therefore, the Postal Service states that even without a price cap, it has strong incentives to reduce costs and increase efficiency in order to restrain price increases and thereby minimize further volume decline. *Id.*

Moreover, the Postal Service asserts that a lack of financial stability, which it attributes to the price cap, inhibits its ability to ensure the efficiency of its operations by limiting its ability to make capital investments. *Id.* at 193. Further, the Postal Service acknowledges that "after 17 years of substantial efficiency gains and cost reductions, it must be recognized that the ability to achieve *additional* reduction in those costs that are within the Postal Service's control will be more difficult moving forward." *Id.* at 194 (emphasis in original). In support of this premise, Christensen observes "in order to continually increase TFP, the Postal Service must continue to find new ways to reduce costs." *Id.* Appendix D at 6.

The Public Representative suggests that there is a high level of uncertainty associated with measuring the efficiency of the Postal Service. PR Comments at 28. In her declaration in support of the Public Representative, Dr. Lyudmila Y. Bzhilyanskaya acknowledges that TFP has been widely used to assess productive efficiency in service industries but comments that she has reservations regarding the utilization of TFP as an exhaustive measure of efficiency. Bzhilyanskaya Decl. at 8. She states that technological progress and other aspects of efficiency (such as scale

efficiency, allocative efficiency, and/or dynamic efficiency), may not be fully reflected in the TFP metric but are still important for the Postal Service. *Id.* She also states that annual TFP indexes focus more on short-term productivity and do not always consider long-term productivity, which is better reflected by cumulative TFP indexes and/or TFP trends. *Id.* at 9. Moreover, she expresses concern that TFP is not capable of capturing changes in product and/or service quality. *Id.* at 12. She suggests improvements to the transparency of information related to the TFP indexes, exploration of alternative indexing procedures, and adjustments when new products are introduced or a product is transferred from the market dominant to the competitive products list. *Id.* at 5–7, 10–11.

Other commenters discuss operational efficiency more generally. ANM *et al.* assert that the Postal Service's productivity has been stagnant. ANM *et al.* Comments at 6. They maintain that the Postal Service "needs to revive its cost saving efforts and make serious progress in network rationalization and delivery mode conversion." ANM *et al.* Comments at 6–7, 51–53.

NNA recommends encouraging specific practices to increase operational efficiency for newspapers such as more efficient container preparation and increased use of Intelligent Mail barcodes. NNA Comments at 3–4.

APWU maintains that the Postal Service has largely realized all of the efficiencies that it can, forcing it to turn to service cuts and forestall capital investments for efficiency improvements and new product development. APWU Comments at 10. It asserts that the TFP gains occurring after 2007 came at the expense of service. *Id.* at 26.

#### c. Proposed Commission Solution

Based on the comments and the Commission's analysis in Order No. 4257, the Commission proposes to use a performance-based mechanism to encourage the Postal Service to maximize the incentives to increase operational efficiency by allocating 0.75 percentage points of performance-based rate authority based on the Postal Service meeting or exceeding an operational efficiency-based standard. The Commission refers to this proposed rate authority as the operational efficiency-based rate authority.

<sup>75</sup> See, e.g., USPS Annual Tables, FY 2016 TFP (Total Factor Productivity), March 1, 2017.

<sup>76</sup> See Docket No. N2010–1, Responses of the United States Postal Service to MPA Interrogatories MPA/USPS–T2–2–7.a.–c., 8–12, Redirected from Witness Corbett, June 23, 2010, file "MPA.T2.3.b.TFP.Formulas.pdf."

Consistent with its analysis in Order No. 4257, the Commission proposes to measure operational efficiency for purposes of this incentive mechanism using TFP. Conditioning rate authority on increases in TFP incentivizes the Postal Service to maximize output while minimizing costs, leading to improvements in operational efficiency. Using a performance-based approach to incentivize continued TFP growth will help incentivize the Postal Service to overcome the challenges to finding new ways to increase efficiency referenced by the Postal Service and Christensen.

The Commission proposes to evaluate as part of its ACD whether average TFP growth for the most recent 5-year period has met or exceeded 0.606 percent. The standard of 0.606 percent reflects the average growth for TFP over the most recent 5 fiscal years of the PAEA era, *i.e.*, for the 5-year period from FY 2011 to FY 2016.<sup>77</sup> If the Commission finds that such is the case, then the 0.75 percentage points of operational efficiency-based rate authority shall be allocated to each class of mail for the next calendar year. If the Commission finds that average TFP growth for the most recent 5-year period has not met or exceeded 0.606 percent, then the 0.75 percentage points of operational efficiency-based rate authority shall not be made available to the Postal Service. This proposed procedure will give the Postal Service and ratepayers adequate advance notice of whether the 0.75 percentage points of operational efficiency-based rate authority will be available to the Postal Service to use for the next calendar year.

The Commission anticipates that the Postal Service's operational efficiency for the next 5 years will continue to increase at least at the same rate that it has over the most recent 5 years of the PAEA era. The Commission may reevaluate this standard after the expiration of the proposed supplemental rate authority.

Use of a rolling 5-year average for TFP growth should allow enough time for the effects of any long-term investments to appear in the TFP calculation. This also minimizes the possibility raised by both the Postal Service and Christensen of an isolated annual result being unrepresentative. Moreover, this approach is consistent with the Commission's maximization analysis in Order No. 4257, which compared the pace of efficiency gains by comparing the 10 years of experience in the PAEA era and the 10 years immediately preceding implementation of the PAEA.

*See* Order No. 4257 at 248. This approach, therefore, should incentivize the Postal Service to achieve efficiency gains sufficient to contribute to the financial stability of the Postal Service.

Existing § 3050.60(e) requires the Postal Service to provide the input data and calculations used to produce the annual TFP estimates by March 1 of each year. This rule facilitates the Commission's ability to evaluate proposed methodological changes under existing § 3050.11 and the public's ability to access and understand such changes. Additionally, to increase the transparency of TFP, the Commission intends to use existing § 3050.2, which requires documentation of periodic reports (*e.g.*, calculations and links within and between spreadsheets) to ensure that TFP is measured and calculated in a transparent manner. Order No. 4257 at 207.

#### d. Commission Analysis of Alternatives

Although the Public Representative and the Postal Service noted the limitations of TFP as a measurement of operational efficiency, no commenter proposed an alternative measurement. Christensen evaluated other measurements proposed by the Commission in Order No. 3673, such as real unit operating costs, simpler productivity measures, and total workhours. Postal Service Comments, Appendix D at 4. Christensen concluded that these measures do not fully capture the complexity of Postal Service efficiency in comparison to TFP. *Id.* The Commission agrees with these conclusions. Moreover, Order No. 4257 discusses several other ways to measure efficiency and concludes that TFP is the best metric available to assess the Postal Service's efficiency. *See* Order No. 4257 at 206.

The Postal Service comments that the price cap affects its ability to raise capital to make necessary improvements. Postal Service Comments at 130. However, removing the price cap entirely might further weaken the Postal Service's existing incentives to maximize operational efficiency. Conditioning the availability of the operational efficiency-based rate authority on measurable TFP growth should ensure that improving the Postal Service's financial stability does not occur at the expense of continuing to increase operational efficiency. Therefore, the proposed solution is necessary to achieve efficiency gains sufficient to contribute to the financial stability of the Postal Service.

#### e. Proposed Regulatory Changes

The Commission has considered the comments and the foregoing analysis in developing proposed subpart E to 39 CFR part 3010, which sets forth the criteria for the availability of performance-based rate authority. Proposed § 3010.180 describes the applicability of both the operational efficiency-based rate authority and the service quality-based rate authority. Proposed § 3010.181 outlines the procedure for allocation of the operational efficiency-based rate authority.

#### f. Conclusion

The Commission proposes to allocate 0.75 percentage points of rate authority based on the Postal Service meeting or exceeding an operational efficiency-based standard. This proposed operational efficiency-based rate authority will address that the existing ratemaking system did not maximize the incentives to increase efficiency, as required by Objective 1. Therefore, this proposed operational efficiency-based rate authority is necessary to achieve Objective 1. The proposal balances the need to provide the Postal Service with the opportunity to generate additional revenue necessary to attain long-term financial stability and the danger that increased revenue might weaken the Postal Service's incentives to operate more efficiently.

### 5. Service

#### a. Introduction

The existing ratemaking system limits rate increases, and by extension, revenue (assuming volume for market dominant products does not significantly increase). Therefore, as discussed above, cost reduction and operational efficiency improvements are critical to putting the Postal Service on the path to financial stability and retained earnings. However, without adequate incentives requiring service to be maintained, reducing service may be a means of reducing costs. Therefore, the PAEA intended that the system should be designed to encourage the maintenance of high quality service standards (established under 39 U.S.C. 3691) and to hold the Postal Service accountable for consistently achieving those standards, as required by Objective 3. Order No. 4257 at 250 (citing 39 U.S.C. 3622(b)(3)).

The PAEA required the Postal Service to establish, in consultation with the Commission, an initial set of service standards for market dominant products to take effect within 1 year of the PAEA's enactment. *Id.* at 42 (citing 39

<sup>77</sup> The 5-year average is 0.605656, which the Commission rounds to 0.606.

U.S.C. 3691(a)). The Postal Service may adjust service standards from time to time, subject to the requirement that it seek an advisory opinion from the Commission before doing so on a substantially nationwide basis. *Id.* at 251 n.366 (citing 39 U.S.C. 3661(b); 39 U.S.C. 3691(a)). Service standards are determined by two components: A “delivery day range,” which comprises the range of days within which all mail eligible for the service standard can be expected to be delivered (*e.g.*, between 1 and 5 days for First-Class Mail); and “business rules,” which determine eligibility for each specific service standard (*e.g.*, 1-Day (referred to as “overnight”); 2-Day; and 3–5-Day for First-Class Mail). *Id.* at 250.

The initial service standards were reduced during the PAEA era through two major sets of revisions made by the Postal Service. *Id.* at 266. The first set of revisions began in FY 2012 when the Postal Service implemented its “Mail Processing Network Rationalization” initiative (Network Rationalization).<sup>78</sup> Network Rationalization substantially affected the level of service for multiple mail classes multiple market-dominant mail classes, including First-Class Mail, Standard Mail, Periodicals, and Package Services. Order No. 4257 at 266. Most significantly, Network Rationalization eliminated overnight service for all First-Class Mail pieces sent by retail customers (First-Class Mail Single-Piece Letters/Postcards). Network Rationalization Revisions at 31, 194. The second set of revisions began in FY 2014 when the Postal Service implemented its “Standard Mail Load Leveling” initiative (Load Leveling), which added 1 day to the applicable delivery day range for certain Standard Mail pieces.<sup>79</sup>

The Postal Service asserted that both sets of revisions to the service standards were undertaken to improve operational efficiency. Network Rationalization Revisions at 31,191; Load Leveling Revisions at 12,390. Both sets of revisions increased the expected days-to-delivery for the affected mailpieces. Order No. 4257 at 268–69.

The Commission issued an advisory opinion applicable to Network Rationalization concluding that it was possible for the Postal Service to undertake significant network rationalization and to realize substantial cost savings while preserving most of

the initial service levels.<sup>80</sup> The Commission issued an advisory opinion applicable to Load Leveling recommending that the Postal Service perform additional analysis of “operational changes that could potentially result in unintended consequences,” such as diminished service performance, before proceeding with a nationwide rollout.<sup>81</sup> Despite these advisory opinions issued by the Commission, the Postal Service proceeded with both sets of revisions. Order No. 4257 at 266.

The decline of service standards during the PAEA era demonstrates that the existing ratemaking system did not effectively encourage the Postal Service to maintain service quality. *See id.* at 269. This creates a danger that the Postal Service could reduce service standards below the high quality level required by Objective 3. *Id.* Therefore, the Commission considers what, if any, action is appropriate with respect to service.

#### b. Comments

Many commenters express dissatisfaction with their current service. *See, e.g.*, NNA Comments at 3. The comments also contain a range of proposed solutions related to service, which the Commission summarizes below. Because the majority of comments concerning service are incorporated within proposals to eliminate, modify, or retain the existing price cap, the Commission subdivides its summary of the comments into three corresponding subsets. Proposals related to service that are suggested independent of a proposal to eliminate, modify, or retain the price cap are summarized in a fourth subset below.

##### (1) Comments in Support of Eliminating the Price Cap To Improve Service

The Postal Service and the unions suggest that eliminating the price cap will allow the Postal Service to collect more revenue and thereby improve service.

The Postal Service contends that having sufficient resources to ensure financial integrity is a prerequisite to maintaining high quality service. Postal Service Comments at 44–45. The Postal Service asserts that the lack of financial liquidity has caused it to defer capital investments needed to sustain service. *Id.* at 89. The Postal Service cautions

that continued deferral of capital investment would be inconsistent with “providing appropriate levels of service in an efficient manner.” *Id.* Therefore, the Postal Service recommends that the Commission, in conjunction with eliminating the price cap, monitor service performance. *Id.* at 218–19, 221–22. The Postal Service opposes the application of a quality of service factor (Q-Factor) to the price cap as needlessly complex and counter-productive to remediate service issues. *Id.* at 222 at n.435.

Similarly, NALC favors eliminating the price cap based on its contention that adequate revenues are necessary to fulfill the Postal Service’s fundamental mission to provide prompt and reliable postal services nationwide. NALC Comments at 1.

APWU asserts that the price cap pressures the Postal Service to reduce costs at the expense of service. APWU Comments at 26. Stating that “Congress did not anticipate a decrease in mail volume, an increase i[n] delivery points, a recession, and [a] change in [the] mail mix,” APWU recommends that the Commission move away from the price cap system to a more flexible system that will allow the Postal Service to better “respond to varied and unexpected changes.” *Id.* at 29. Eighteen officers of local chapters of the APWU also recommend eliminating the price cap and assert that the financial harms flowing from the price cap have reduced the quality of service standards and service performance.<sup>82</sup>

##### (2) Comments in Support of Incentivizing Service Improvements Under a Modified Price Cap

Other commenters suggest improving service under a modified price cap. Although the Public Representative asserts that the Commission could modify the price cap to include a Q-Factor to link service and rates directly, he cautions that imposing a Q-Factor would be premature, especially if the Commission significantly changes other aspects of the system that may positively affect service. PR Comments at 59. Therefore, he recommends that in the short-term, the Commission continue to monitor service performance. *Id.* at 60. He suggests that the Commission focus this proceeding

<sup>78</sup> See Revised Service Standards for Market-Dominant Mail Products, 77 FR 31190 (May 25, 2012) (Network Rationalization Revisions).

<sup>79</sup> See Service Standards for Destination Sectional Center Facility Rate Standard Mail, 79 FR 12390, 12393 (March 5, 2014) (Load Leveling Revisions).

<sup>80</sup> Docket No. N2012–1, Advisory Opinion on Mail Processing Network Rationalization Service Changes, September 28, 2012, at 45 (Network Rationalization Advisory Opinion).

<sup>81</sup> Docket No. N2014–1, Advisory Opinion on Service Changes Associated With Standard Mail Load Leveling, March 26, 2014, at 49–50.

<sup>82</sup> Thomas Comments at 1; Whalen Comments at 1; Oldt Comments at 1; VanScyoc Comments at 1; Corley Comments at 1; Rathore Comments at 1; Fallacara Comments at 1; Cliche Comments at 1; Landry Comments at 1; Fawcett Comments at 1; Bieberitz Comments at 1; Collins Comments at 1; Sarcone Comments at 1; Preminger Comments at 1; Bates Comments at 1–2; Casselli Comments at 1; Athanaskos at 1; Pagaduan Comments at 1.

on adjusting the price cap to relieve the financial pressure on the Postal Service. *Id.* If those changes to the system improve the Postal Service's financial stability and service performance still fails to improve, then he suggests considering a penalty-style Q-Factor that would adjust the price cap downward. *Id.*

MH and NAAD suggest that the Commission consider potential service consequences when evaluating proposed rate changes. MH and NAAD Comments at 11. They also advise that the Commission ensure that cost-control (or revenue-limitation) does not lead to unavoidable Postal Service management decisions that decrease achievement of service objectives. *Id.*

UPS, which proposes to retain the price cap, suggests that any proposals to relax the price cap should be counterbalanced by raising and enforcing service standards. UPS Comments at 6.

#### (3) Comments in Support of Retaining the Price Cap To Maintain Service

Several commenters contend that eliminating or relaxing the price cap may negatively affect service because the price cap has incentivized the Postal Service to make needed service-related changes in order to improve operational efficiency. For instance, Minnesota Power asserts that “[t]he CPI cap is a necessary tool to encourage the Postal Service to improve service and further reduce costs.” Minnesota Power Comments at 2. AF&PA agrees that “[r]emoving or raising the CPI price cap would remove these important incentives, resulting in a less efficient Postal Service with lower quality service. . . .” AF&PA Comments at 6. MMA *et al.* question whether increased revenues would improve service by suggesting that there is inadequate evidence to determine whether rate increases positively affect service. MMA *et al.* Comments at 25–26. Similarly, SIIA asserts that there is no reason to expect that increased rates would improve service. SIIA Comments at 8. GCA asserts that service problems have been attributable to decisions to realign the Postal Service's networks rather than the price cap. GCA Comments, Appendix B at 1.

#### (4) Other Proposals Related to Service Performance

Multiple commenters focus on improving service performance. Several commenters discuss the importance of consistent and reliable on-time service

performance.<sup>83</sup> Some commenters discuss the need to improve service performance measurement and monitoring.<sup>84</sup> Connecting service performance with operational efficiency, some commenters suggest operational improvements that the Postal Service could consider to improve efficient service performance.<sup>85</sup>

#### c. Proposed Commission Solution

Based on the comments and the Commission's analysis in Order No. 4257, the Commission proposes to use a performance-based mechanism to encourage the Postal Service to maintain service standard quality by allocating 0.25 percentage points of the performance-based rate authority based on the Postal Service adhering to service standard quality criteria. The Commission refers to this proposed rate authority as the service quality-based rate authority.

The Commission proposes that the service quality-based rate authority be allocated for a class of mail if all of the Postal Service's service standards (including applicable business rules) for that class for the applicable year met or exceeded the service standards in place during the prior fiscal year on a nationwide or substantially nationwide basis. To facilitate this review, the Commission proposes to require the Postal Service to provide in its Annual Compliance Report (ACR) a description of and reason for any changes to service standards, or to certify that no changes to service standards have been made, since the last ACR. Under the proposed rules, the Commission would issue a preliminary determination, specific to each class of mail, at the time of the ACD.

Under the proposed rules, any interested person will have 30 days to challenge this preliminary determination. The subject matter of the challenge is limited to changes in the service standards, including the business rules, that occur on a national or substantially nationwide basis. If no timely challenge is filed, the preliminary determination shall become final. If a timely challenge is filed, then the Commission will rule on any challenge within 60 days after the filing of the challenge. Any service quality-based rate authority allocated under this

process would be available to the Postal Service for the upcoming calendar year. This proposed procedure will give the Postal Service and ratepayers adequate advance notice of whether, for each class, the 0.25 percentage points of service quality-based rate authority will be available to the Postal Service to use for the next calendar year.

This service quality-based rate authority is linked to the service standards and the business rules rather than actual service performance such as on-time delivery performance. Service performance issues are most appropriately dealt with in the ACD. Order No. 4257 at 273.

#### d. Commission Analysis of Alternatives

Ultimately, the Commission strives to balance competing policy concerns in a manner that will encourage the Postal Service “[t]o maintain high quality service standards established under section 3691,” as required by Objective 3. 39 U.S.C. 3622(b)(3). On the one hand, the Commission has considered comments contending that the operation of the price cap over the past 10 years has placed extreme financial pressure on the Postal Service to cut costs, resulting in the failure to maintain service standards. The Commission also has given weight to other comments cautioning that relaxing or eliminating the price cap may weaken incentives to provide efficient and reliable service. Moreover, the Commission has considered the commenters' concerns regarding the Postal Service's use of its revenues and resources with respect to service. Therefore, the Commission proposes rules to strike a balance between relieving the financial pressure to allow the Postal Service the opportunity to improve service and incentivizing the Postal Service to maintain high quality service standards for its market dominant products.

The Commission agrees with the comments proposing to continue the existing approach to address service performance issues. The Commission also agrees with the Public Representative that introduction of a Q-Factor is premature given the other changes being proposed that may affect service. Overall, the Commission encourages the Postal Service to continue its efforts to improve service performance. The Commission recommends that the Postal Service consider the operational and monitoring improvements suggested by the commenters in this proceeding and continue its work with stakeholders on these issues outside of this proceeding.

<sup>83</sup> AF&PA Comments at 9; ANM *et al.* Comments at 53 n. 34; SIIA Comments at 7.

<sup>84</sup> NNA Comments at 19; GCA Comments, Appendix B at 6.

<sup>85</sup> Furka Comments at 7–9 (suggesting zoning changes); Yao Comments at 2, 4 (addressing staffing and capacity concerns); NNA Comments at 3 (recommending “continuous improvement in operations” to improve service).

### e. Proposed Regulatory Changes

The Commission has considered the comments and the foregoing analysis in developing proposed subpart E to 39 CFR part 3010, which sets forth the criteria for the availability of performance-based rate authority. Proposed § 3010.180 describes the applicability of both the operational efficiency-based rate authority and the service quality-based rate authority. Proposed § 3010.182 outlines the procedure for allocation of the service quality-based rate authority. Changes are proposed to existing § 3055.2 to require that the Postal Service provide in its ACR a description of and reason for any changes to service standards, or to certify that no changes to service standards have been made, since the last ACR.

### f. Conclusion

The Commission proposes to allocate 0.25 percentage points of rate authority based on the Postal Service's adhering to service standard quality criteria. This will encourage the Postal Service to maintain high quality service standards, as necessary to achieve Objective 3. This approach balances the need to assure Postal Service's long-term financial stability and encourage the Postal Service to maintain high quality service standards.

### E. Non-Compensatory Classes and Products

#### 1. Introduction

As explained in Order No. 4257, non-compensatory products threaten the financial integrity of the Postal Service because the revenue from these products does not cover their attributable cost. Order No. 4257 at 234–35. During the PAEA era, multiple market dominant products did not recover their attributable costs. Moreover, the Periodicals class has not covered its attributable costs since the enactment of the PAEA. In this section, the Commission discusses these issues and proposes a solution to put the Postal Service on the path to having fully compensatory products and classes.

#### 2. Non-Compensatory Products

##### a. Introduction

Non-compensatory products are those products for which attributable costs exceed revenue. In the FY 2016 ACD, the Commission identified 10 non-compensatory products: (1) In-County Periodicals; (2) Outside County Periodicals; (3) USPS Marketing Mail Flats (formerly called Standard Mail Flats); (4) USPS Marketing Mail Parcels

(formerly called Standard Mail Parcels); (5) Stamp Fulfillment Services; (6) Money Orders; (7) Collect on Delivery; (8) Stamped Envelopes; (9) Inbound Letter Post;<sup>86</sup> and (10) Media Mail/Library Mail. See FY 2016 ACD at 42–71. Table III–2 below shows the percentage of total attributable costs recovered by each of these products respectively (*i.e.*, their “cost coverage”).

TABLE III–2—NON-COMPENSATORY PRODUCTS IN FY 2016

Classes: Products	FY 2016 cost coverage (%)
Periodicals: In-County .....	70.0
Periodicals: Outside County	73.5
USPS Marketing Mail: Flats	79.4
USPS Marketing Mail: Parcels .....	64.6
Special Services: Stamp Fulfillment Services .....	87.3
Special Services: Money Orders .....	91.1
Special Services: Collect on Delivery .....	41.1
Special Services: Stamped Envelopes .....	92.3
First-Class Mail: Inbound Letter Post .....	66.4
Package Services: Media Mail/Library Mail .....	75.2

SOURCE: FY 2016 ACD at 42–71; Docket No. ACR2016, Library Reference PRC–LR–ACR2016/5, March 28, 2017.

With the exception of the two Periodicals products—In-County Periodicals and Outside County Periodicals, which will be addressed subsequently in this Order—all of these non-compensatory products are included within classes of mail for which the overall class revenue exceeds overall class attributable cost. Products such as USPS Marketing Mail Flats, Stamp Fulfillment Services,<sup>87</sup> and Media Mail/Library Mail have historically failed to cover their attributable costs. See *id.* at 48, 60, 70. Other products, such as Money Orders have only recently become non-compensatory. See *id.* at 60–62.

In Order No. 4257, the Commission found that non-compensatory products are not reasonably or efficiently priced and may threaten the financial integrity

<sup>86</sup> The Commission also found that other market dominant International Mail products did not cover costs in FY 2016: Three agreements within the Inbound Market Dominant Multi-Service Agreements with Foreign Postal Operators product and Inbound Registered Mail (within the International Ancillary Services product). See FY 2016 ACD at 63.

<sup>87</sup> The Stamp Fulfillment Services product provides for the fulfillment of stamp orders placed by mail, phone, fax, or online to the Stamp Fulfillment Services Center in Kansas City, Missouri. See FY 2016 ACD at 59.

of the Postal Service because revenue from these products fails to cover costs. See Order No. 4257 at 235, 139–42. Accordingly, the Commission proposes modifications to the system of ratemaking that will require price increases to improve the cost coverage for non-compensatory products.

##### b. Comments

The primary commenter with regard to non-compensatory products was the Postal Service. The Postal Service comments that the price cap inhibits its ability to make rational and efficient pricing decisions. Postal Service Comments at 131. The Postal Service uses the USPS Marketing Mail Flats product as an example. Cost coverage for this product has declined since passage of the PAEA. *Id.* at 134. The Postal Service asserts that while it has the ability to rebalance rates among products within the USPS Marketing Mail class in order to improve USPS Marketing Mail Flats' cost coverage, and it has done so to some extent, volumes for this product are in “autonomous decline” relative to other products in the USPS Marketing Mail class. *Id.* As a result, the Postal Service maintains that if it were to maximize price increases for USPS Marketing Mail Flats, any temporary increase in unit contribution might be offset if volume declines as a result of the price increases led to decreased overall contribution. *Id.* at 134–35. Meanwhile, according to the Postal Service, it would have foregone the opportunity to increase contribution from USPS Marketing Mail products with stable or increasing volumes. *Id.* at 135. The Postal Service takes the position that in a time of limited class-level price increase authority, it would be imprudent for it to pursue such a strategy. *Id.* The Postal Service urges the Commission to remove the price cap from the ratemaking system altogether, stating that the price cap has failed to meet most of the PAEA's objectives. *Id.* at 138.

##### c. Proposed Commission Solution

The Commission proposes to define “non-compensatory products” as products for which attributable cost exceeds revenue, as determined by the most recent ACD. As a starting point, the Commission proposes to prohibit the reduction of rates for non-compensatory products.

Also, for non-compensatory products in classes for which attributable costs for the entire class do not exceed revenue for the class, the Commission proposes to require minimum product-level price increases. Under the

Commission's proposal, whenever the Postal Service files a request for the Commission to review a notice of rate adjustment applicable to any class of mail, it will be required to propose to increase the rate for any non-compensatory product within that class by a minimum of 2 percentage points above the percentage increase for the class. This proposed rate increase does not create additional rate authority for the entire class. The proposed rate increase must comply with the other rate setting criteria appearing in the proposed rules accompanying this Order: CPI (proposed subpart C), supplemental (proposed subpart D), performance-based (proposed subpart E), and banked rate authority (proposed subpart G). After addressing any non-compensatory product(s), the Postal Service will retain pricing flexibility with regard to use of the remaining authority under the price cap for that class.

#### d. Commission Analysis of Alternatives

The Commission recognizes that the proposed solution places some limitation on the Postal Service's pricing flexibility. Consistent with the analysis in Order No. 4257, the solution

proposed by the Commission allows for continued achievement of Objective 4 (allowing the Postal Service pricing flexibility) while making changes necessary to achieve Objective 1 (maximize incentives to increase pricing efficiency) and Objective 8 (establishing and maintaining reasonable rates). See 39 U.S.C. 3622(b)(1), (4), and (8).

The Commission's proposal does not mandate immediate full cost coverage for non-compensatory products, but it does seek to narrow the coverage gap and move non-compensatory products toward full cost coverage over time. Given the substantial increase needed for some non-compensatory products to cover their attributable costs, a 2-percentage point rate increase represents an appropriate mechanism for improving cost coverage while simultaneously maintaining stability and predictability in rates, as required by Objective 2. See 39 U.S.C. 3622(b)(2). Both the Postal Service and the mailing community will have notice, through the ACD, of the products that are non-compensatory and thus subject to an additional 2-percentage point rate increase.

The purpose of the pricing requirements for non-compensatory

products is for the cost coverage of these products to move toward, and eventually above, 100 percent. The Commission performed a scenario-based analysis to determine the appropriate level of additional price increases for non-compensatory products. In Table III-3, the most recent CPI-U projections were combined with unit attributable cost growth rates from the most recent 8 years to estimate changes in cost coverage assuming that prices are increased by 1 percent, 2 percent, or 3 percent above the average rate increase for the class.<sup>88</sup> The CPI-U change is projected to be 2.05 percent for the next 5 years, while the change in the unit attributable cost of USPS Marketing Mail Flats was 2.6 percent per year for the last 8 years. Table III-3 assumes that the next 5 years will experience the same unit attributable cost change and that CPI-U will conform to projections. Each year, in addition to the CPI-U rate authority, the 2 percent of supplemental authority and either 1 percent, 2 percent, or 3 percent of additional rate authority is applied to estimate the increase in revenue. The following table details the resulting estimated cost coverages for USPS Marketing Mail Flats.

**Table III-3  
USPS Marketing Mail Flats Cost Coverage Scenarios**

Year	1.0%		2.0%		3.0%	
	Coverage	Increase	Coverage	Increase	Coverage	Increase
Year 0	77.3%	0.0%	77.3%	0.0%	77.3%	0.0%
Year 1	79.1%	5.05%	79.9%	6.05%	80.6%	7.05%
Year 2	81.0%	5.05%	82.6%	6.05%	84.1%	7.05%
Year 3	82.9%	5.05%	85.3%	6.05%	87.8%	7.05%
Year 4	84.9%	5.05%	88.2%	6.05%	91.6%	7.05%
Year 5	86.9%	5.05%	91.2%	6.05%	95.5%	7.05%
Total		27.93%		34.14%		40.58%

In the scenarios detailed in Table III-3, USPS Marketing Mail Flats would experience 5-year cumulative price increases of between 27.93 and 40.58 percent.<sup>89</sup> Even in the scenario where prices are increased 7.05 percent per

year the estimated cost coverage remains below 100 percent 5 years after implementation. As explained above, the prior table contains the assumption, based on historical data, that unit attributable costs will continue to

increase at a higher rate than the CPI-U. The Commission changes this assumption in its calculation in Table III-4 below.

<sup>88</sup> The unit attributable costs by product are only available for the most recent 8 years due to the product list change associated with the PAEA and concurrent changes to cost reporting. The Postal

Service did not report the unit attributable costs for each and every PAEA product until FY 2008. See Docket No. ACR2008 Library Reference USPS-LR-FY08-1.

<sup>89</sup> The 5-year cumulative increases are greater than the sum of the annual increases due to the effects of compounding.

**Table III-4  
USPS Marketing Mail Flats Full Cost Coverage Scenario**

Year	1.0%		2.0%		3.0%	
	Coverage	Increase	Coverage	Increase	Coverage	Increase
Year 0	78.5%	0.0%	78.5%	0.0%	78.5%	0.0%
Year 1	81.6%	5.05%	82.4%	6.05%	83.2%	7.05%
Year 2	84.9%	5.05%	86.5%	6.05%	88.2%	7.05%
Year 3	88.3%	5.05%	90.9%	6.05%	93.5%	7.05%
Year 4	91.9%	5.05%	95.4%	6.05%	99.1%	7.05%
Year 5	95.5%	5.05%	100.2%	6.05%	105.0%	7.05%
<b>Total</b>		<b>27.93%</b>		<b>34.14%</b>		<b>40.58%</b>

In Table III-4, unit attributable costs are assumed to increase at 1.0 percent per year, or 1.6 percent below the historical average. If the Postal Service increases prices at 2 percent above the class average and reduces the growth in unit attributable cost, the cost coverage exceeds 100 percent after 5 years.

The Commission determines that requiring the Postal Service to increase the rate for any non-compensatory product by a minimum of 2 percentage points above the percentage increase for the class is appropriate because it balances the need for mailers to pay reasonable rates with the need for the Postal Service to achieve cost reductions.

#### e. Proposed Regulatory Changes

Proposed subpart F is added to 39 CFR part 3010 to address the issue of non-compensatory products and classes. Proposed § 3010.200 defines non-compensatory products as those for which the attributable costs for the product exceeded the product's revenue as determined by the most recent ACD.

Proposed § 3010.201 sets forth the rate setting criteria for non-compensatory products in classes for which overall class revenue exceeds overall class attributable cost.

Existing § 3010.20(e) is replaced by proposed §§ 3010.127(b) and 3010.129(g), which prohibit the reduction of rates of non-compensatory products.

#### f. Conclusion

The proposed rate setting criteria applicable to non-compensatory products is necessary to achieve Objectives 1 and 8. Products that do not generate revenues that cover their attributable costs contribute to the system's inability to achieve reasonable and efficient prices. Gradual above-average increases to the prices of non-

compensatory products will bring those products to full cost coverage over time and thereby achieve reasonable and efficient rates as envisioned by the PAEA. This proposed approach will also allow for continued pricing flexibility and consistent with the Commission's evaluation of the ratemaking system in Order No. 4257.

### 3. Non-Compensatory Classes

#### a. Introduction

The Periodicals class has not covered its attributable costs since the enactment of the PAEA. FY 2016 ACD at 42. This is because the Periodicals class consists of only two products—In-County Periodicals and Outside County Periodicals—and each of those products is non-compensatory. *Id.* at 45. Over the course of the PAEA era, cost coverage for the Periodicals class has generally declined—from 83.0 percent in FY 2007 to 73.7 percent in FY 2016. *Id.* at 42. The insufficient cost coverage for the Periodicals class has resulted in a negative contribution of more than \$5 billion since FY 2007. *Id.* at 44. Also, the Package Services class contribution was negative from FY 2009 through FY 2012. Order No. 4257 at 232–33. As a class, Package Services did not cover its attributable costs for 4 years during the PAEA era. *Id.* Non-compensatory products are not reasonably or efficiently priced and may threaten the financial integrity of the Postal Service because revenue from these products fails to cover costs. *See id.* 234–35, 139–142. Non-compensatory classes are non-compensatory because they are dominated by non-compensatory products.

Non-compensatory classes create unique problems in a ratemaking system that is limited to inflation-based increases applied at the class level. 39 U.S.C. 3622(d)(3)(A). Unless the Postal Service is able to constrain class costs

to below the level of inflation, the coverage for the class cannot improve.

If a non-compensatory product forms part of a class that is compensatory on the whole, then the rates for the non-compensatory product can be increased by a greater percentage than the compensatory products in that class while keeping the overall class increase within the price cap.

But if, as with Periodicals, the entire class is non-compensatory, there is no opportunity to rebalance rates among products, because increasing the rates for one product generally requires offsetting decreases to the rates for other products, and there are no products with positive cost coverage against which such offsets can be made.<sup>90</sup> In Order No. 4257, the Commission stated that non-compensatory mail classes threaten the financial integrity of the Postal Service. Order No. 4257 at 274. Accordingly, the Commission proposes modifications to the system of ratemaking that will grant additional rate authority to non-compensatory classes of mail in order to achieve the same goal articulated for non-compensatory products, *i.e.*, to improve the cost coverage for such classes and to put the Postal Service on the path to having fully compensatory classes.

#### b. Comments

Several commenters proposed solutions for non-compensatory mail classes.

The Postal Service asserts that the cost-coverage problems with regard to the Periodicals class are the result of a

<sup>90</sup> As the Public Representative recognizes, the only exception to this general rule occurs when changes in the CPI-U index result in an increase in the cap for the class. PR Comments at 23. However, for the Periodicals class, in particular, these relatively small increases in the cap do not provide enough headroom for price increases that could provide meaningful improvement to the overall cost coverage for the class. *Id.*

complex set of factors, including the fact that the Periodicals class was already non-compensatory at the advent of the PAEA era when the price cap was imposed, mail volumes and density with regard to Periodicals is declining, and changes in mailer behavior have lowered unit revenue (such as reducing the weight and advertising content of mailings). Postal Service Comments at 132. The Postal Service asserts that the price cap has failed to supply pricing tools necessary for the Postal Service to face these challenges. *Id.* at 136. Because the price cap is imposed at the class level, the Postal Service maintains that it does not allow for the correction of an entire class which is non-compensatory, such as Periodicals. *Id.* Therefore, the Postal Service urges the Commission to remove the price cap system altogether. *Id.* at 138.

The Public Representative recommends that the Commission “[a]djust the price cap for Periodicals to give the Postal Service the opportunity to attempt improvements in cost coverages.” PR Comments at 33. The Public Representative states that raising the price cap for Periodicals would provide the Postal Service “the pricing flexibility that Objective 4 [of the PAEA] was intended to achieve,” without relieving the Postal Service of its “obligation . . . to reduce costs or to increase efficiency.” *Id.* at 56–57 (citing 39 U.S.C. 3622(b)(4)).

NNA states that in lieu of “punitive” price increases for the non-compensatory Periodicals class, both the In-County and Outside County Periodicals mail products could be made more efficient. NNA Comments at 24–25. NNA proposes specific revision to the worksharing price structure. *Id.* NNA opines that better data with regard to Periodicals are necessary before making any sweeping rate changes. *Id.* at 29. NNA does not recommend any changes to the price cap for non-compensatory mail classes such as Periodicals.

PSA maintains that the Periodicals class is being subsidized by other mail classes, resulting in rates which are not just and reasonable. PSA Comments at 4–5.

SIIA maintains that “any efforts to enhance pricing flexibility should take into consideration the impact this has on mailers, particularly if the flexibility is not strategically applied to accommodate the goals of rate predictability and long-term, sustainable cost-coverage objectives . . . .” SIIA Comments at 8.

ANM *et al.* state that “[c]reating a blanket exception to the CPI cap for classes of mail or products merely

because they reportedly fail to cover attributable costs would be undesirable and unfair . . . .” ANM *et al.* Comments at 75. ANM *et al.* maintain that “the inability of certain products to recover their attributable costs is not evidence that the current system is failing to properly apportion costs . . . [because] the ‘underwater’ condition of the [Periodicals] class is a function of excessive costs, not overly-constrained prices . . . .” *Id.* at 76. According to ANM *et al.*, “[n]o system of ratemaking can entirely protect against poor business decisions . . . .” *Id.* Moreover, ANM *et al.* urge the Commission to “recognize that the ‘underwater’ products and other products with higher coverage ratios are often complementary goods.” *Id.* at 77. By way of example, ANM *et al.* state that “subscriptions to periodicals mailed at Periodicals Mail rates generate large volumes of allied mailings (*e.g.*, acknowledgments, renewal notices, invoices, and solicitations) that have much higher reported coverage ratios . . . [and which] offset[] most of the reported shortfall from Periodicals Mail.” *Id.*

#### c. Proposed Commission Solution

Because improved cost coverage for products within non-compensatory classes cannot be attained by rebalancing rates among products within such classes, the Commission proposes a solution that expands pricing authority for non-compensatory classes in order to allow for additional product-level rate increases within such classes. If the attributable cost for an entire class exceeds revenue for that class, the Commission proposes to provide 2 percentage points of additional rate authority for the class. Under the Commission’s proposal, as part of the first generally applicable rate adjustment in a calendar year, the Postal Service, when seeking to raise rates for a non-compensatory class, must use all available rate authority for non-compensatory classes. This includes all CPI (proposed subpart C of 39 CFR part 3010), supplemental (proposed subpart D of 39 CFR part 3010), performance-based (proposed subpart E of 39 CFR part 3010), and banked rate authority up to the 2-percent maximum (proposed subpart G of 39 CFR part 3010), *plus* the additional 2 percentage points provided for non-compensatory classes (proposed subpart F of 39 CFR part 3010). This proposal applies only if the Postal Service chooses to adjust rates for the non-compensatory class.

If there are any products within a non-compensatory class for which product-level revenue exceeds the product-level attributable cost, then

prices for such products may only be increased up to the amount of the class average. Moreover, the Commission proposes to prohibit the reduction of rates for non-compensatory products.

#### d. Commission Analysis of Alternatives

Although the existing ratemaking system limits the Postal Service’s pricing flexibility and ability to make efficient pricing decisions with respect to non-compensatory classes, removal of the price cap is not an appropriate solution. To create pricing predictability and stability, the ratemaking system must contain a mechanism that limits the magnitude of price adjustments. See Order No. 4257 at 103. Nevertheless, the Commission finds that to make no change to the price cap structure for the non-compensatory classes would continue the trend of negative class contribution and continue to hinder the achievement of Objective 1 (maximize incentives to increase pricing efficiency), Objective 5 (assure adequate revenues, including retained earnings, to maintain financial stability), and Objective 8 (establishing and maintaining reasonable rates). See 39 U.S.C. 3622(b)(1), (5), and (8).

The Commission’s proposed solution does not mandate immediate full cost coverage for non-compensatory classes, but it does seek to narrow the coverage gap and move prices towards full cost coverage over time. Further, given the substantial increase needed for the Periodicals class to cover its attributable cost, the proposed 2-percentage point increase represents an appropriate mechanism for improving cost coverage while simultaneously maintaining stability and predictability in rates, as required by Objective 2. See 39 U.S.C. 3622(b)(2). Both the Postal Service and the mailing community will know, through the ACD, which classes are non-compensatory and thus subject to a 2-percentage point rate increase in class-level rate authority.

The Commission determines that a requirement that the Postal Service increase the rates for any non-compensatory class by an additional 2 percentage points is appropriate because it balances the need for mailers to pay a more reasonable rate with the need for the Postal Service to achieve cost reductions and improvements in operational efficiency.

#### e. Proposed Regulatory Changes

Proposed subpart F is added to 39 CFR part 3010 to address the issue of non-compensatory products and classes. Proposed § 3010.200 defines non-compensatory classes of mail as those for which attributable costs for the class

exceed revenue derived from the class as determined by the most recent ACD.

Proposed § 3010.202(a) provides for 2 percentage points of additional rate authority for a non-compensatory class. Proposed § 3010.202(b) sets forth the rate setting criteria that applies if the Postal Service chooses to adjust rates for a non-compensatory class.

Proposed § 3010.202(c) describes the requirements applicable to the availability, calculation, and use of the 2 percentage points of additional rate authority for a non-compensatory class.

Existing § 3010.20(e) is replaced by proposed §§ 3010.127(b) and 3010.129(g), which prohibit the reduction of rates of non-compensatory products.

#### f. Conclusion

The proposed increase in class-level rate authority applicable to non-compensatory classes is necessary to achieve Objectives 1 and 8. Non-compensatory classes are dominated by non-compensatory products. For these classes to generate revenues that cover their attributable costs, the products within them must have prices that are reasonable and efficient prices. However, non-compensatory classes could not be addressed with the same solution as for non-compensatory products in compensatory classes because the price cap is applied at the class level. An increase in the class-level rate authority for non-compensatory classes will gradually move the prices of non-compensatory products within non-compensatory classes to the cost coverage over time, thereby achieving reasonable and efficient rates as envisioned by the PAEA. This proposed approach is necessary to achieve Objectives 1 and 8 and is consistent with the Commission's analysis of the other objectives in Order No. 4257.

### F. Workshare Discounts

#### 1. Introduction

The PAEA aimed to allow the Postal Service pricing flexibility while increasing pricing efficiency. *See* Order No. 4257 at 48, 144–45. Pricing efficiency is required by Objective 1's directive to "maximize incentives to reduce costs and increase efficiency." *Id.* at 130 (quoting 39 U.S.C. 3622(b)(1)). The ratemaking system achieves pricing efficiency when prices adhere as closely as practicable to ECP. *Id.* at 136. Under ECP, price differences should equal as closely as practicable cost differences. *See id.* at 130–31. Although the Postal Service had the ability to adhere to ECP, even under a price cap, the

Commission's analysis demonstrates that during the PAEA era, the Postal Service chose not to price according to ECP. *Id.* at 139. Specifically, the Postal Service failed to set most workshare discounts in accordance with ECP during the 10 years following enactment of the PAEA. *Id.* at 136–38. In the remainder of this section, the Commission summarizes the existing requirements relating to workshare discounts and discusses how the existing ratemaking system did not produce workshare discounts that adhere to ECP.

Workshare discounts are rate discounts that the Postal Service provides to mailers for presorting, prebarcoding, handling, or transporting mail. 39 U.S.C. 3622(e)(1). Workshare discounts reduce prices for mailpieces that are prepared or inducted in a manner that allows the Postal Service to avoid certain activities that it would have otherwise performed. The Commission must "ensure that [workshare] discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity" (avoided cost) unless certain exceptions are met. 39 U.S.C. 3622(e)(2).

The Commission reviews workshare discounts for compliance with section 3622(e) both before and after their implementation. The Commission's pre-implementation review of proposed workshare discounts occurs during rate adjustment proceedings. Existing § 3010.12(b)(6) requires the Postal Service to justify that a statutory exception applies to any proposed workshare discount that exceeds its avoided costs. Under this existing rule, the Postal Service must also identify and explain discounts that are set substantially below avoided costs, and explain any relationship between discounts that are above and those that are below avoided costs.

The Commission completes its post-implementation review for compliance with 39 U.S.C. 3622(e) in the ACD at the end of each fiscal year. Existing § 3050.20(c) requires the Postal Service's ACR to address discounts greater than avoided costs. Existing § 3050.24 requires the Postal Service to file documentation that supports its avoided cost estimates.

In both pre- and post-implementation reviews, the Commission ascertains compliance with 39 U.S.C. 3622(e) by evaluating the workshare discount's passthrough.<sup>91</sup> When a workshare

<sup>91</sup> Passthroughs represent the relationship between the amount of the workshare discount and the avoided cost as a percentage. A workshare discount's passthrough percentage is determined by

discount equals avoided cost, the passthrough equals 100 percent. If a workshare discount is less than the avoided cost, then the passthrough is below 100 percent. Conversely, if a workshare discount is greater than the avoided cost, then the passthrough is above 100 percent.

To adhere to ECP, workshare discounts should be set equal, on a per-unit basis, to the costs avoided by the Postal Service when the mailer performs the workshare activity. Order No. 4257 at 131. Using ECP to set workshare discounts would produce passthroughs equal to 100 percent. *Id.* However, most workshare discounts during the PAEA era have been set substantially above or substantially below 100 percent. *Id.* at 136–38. The Postal Service's failure to set workshare discounts in accordance with ECP demonstrates that the existing ratemaking system has not increased pricing efficiency, as intended by the PAEA. *Id.* at 145.

Workshare discounts set substantially above or substantially below avoided costs are problematic because they send inefficient price signals to mailers and therefore reduce productive efficiency in the postal sector.<sup>92</sup> Specifically, inefficient pricing signals disrupt two sets of incentives—the incentives to the Postal Service to right-size its network and the incentives to mailers to enter volume that best conforms to that network. *See id.* at 216–19. This disruption may take volume away from the least-cost producer, which may result in less efficient volume and decreased revenue for the Postal Service.<sup>93</sup>

dividing the workshare discount by costs avoided and expressing the result as a percentage. For example, if the Postal Service offers a discount of \$0.05 for mailers to presort mailpieces and this presorting permits the Postal Service to avoid \$0.04 in cost, then the worksharing passthrough is 125 percent ( $0.05/0.04 = 1.25 = 125$  percent).

<sup>92</sup> *See, e.g.,* FY 2016 ACD at 1 ("Workshare discounts that exceed avoided costs adversely affect Postal Service finances because they incentivize mailers to perform worksharing that the Postal Service could have done on a less costly basis."); Docket No. ACR2009, Annual Compliance Determination, March 29, 2010, at 76 (observing that "the combination of low and differential passthroughs [for Periodicals] may send conflicting price signals to mailers and prevent them from entering mail in a way that reduces the end-to-end cost"); Docket No. R2012–3, Order No. 987, Order on Price Adjustments for Market Dominant Products and Related Mail Classification Changes, November 22, 2011, at 12–13 (expressing concern that setting passthroughs inefficiently, by pricing to excess capacity, may ultimately send inefficient price signals and harm efficient Postal Service operations).

<sup>93</sup> "[A]n integrated mail service will be produced most efficiently if its various components are provided by the least-cost producer." Order No. 4257 at 131 n.231 (quoting Docket No. RM2010–13, Order No. 1320, Order Resolving Technical Issues

## 2. Comments

Several commenters recommend that the Commission require all workshare discount passthroughs to be set at or near 100 percent. Other commenters recommend retaining the existing requirements or suggest changes to accepted analytical principles.

### a. Comments in Support of Setting all Workshare Discount Passthroughs Closer to 100 Percent

Several commenters recommend that the Commission require the Postal Service to set workshare discounts at or near 100 percent of avoided costs.

Pitney Bowes comments extensively on this issue and favors the Commission establishing a soft floor for workshare discounts to provide additional incentives for the Postal Service to reduce costs and increase efficiency. Pitney Bowes Comments at 3. Specifically, Pitney Bowes recommends that the soft floor require the Postal Service to set workshare discounts at, or as close as possible to, avoided costs subject to clearly defined and limited exceptions. *Id.* It asserts that a soft floor would promote productive efficiency by incentivizing the least cost provider to perform the work. *Id.* at 19. It contends that a soft floor would ensure that mailers and mail service providers were fully compensated for the work they perform and send more efficient pricing signals that will help grow mail and reduce costs. *Id.* at 13–14. It maintains that establishing a soft floor for workshare discounts would help achieve several objectives and factors appearing in 39 U.S.C. 3622(b) and (c) without unduly conflicting with or affecting others. *Id.* at 16–22. It notes that the Commission made a similar recommendation in its most recent Section 701 Report. *Id.* at 4, 10, 20. In support of Pitney Bowes' proposal, Professor John C. Panzar recommends that the Commission require the Postal Service to adhere to ECP by setting workshare discounts equal to, or as close as practicable to, 100 percent of avoided costs. Panzar Statement at 14. He asserts that doing so would promote efficiency and just and reasonable rates without unduly limiting the Postal Service's pricing flexibility. *Id.* at 1, 2, 14.

Other commenters also support the Commission tightening requirements for the Postal Service to set workshare discounts at or near 100 percent of avoided costs. PSA also favors establishing a soft floor. PSA Comments at 5. MMA *et al.* suggest that the

Commission modify existing § 3010.2(b)(6) to require the Postal Service to pass through 100 percent of costs avoided unless a sound justification exists for not doing so. MMA *et al.* Comments at 70–72. They contend that this rule change would be consistent with ECP and would maximize efficiency and reduce costs. *Id.* at 71–72. Similarly, ABA asserts that setting workshare discounts at 100 percent of avoided costs promotes efficiency and a more just and reasonable rate schedule without unduly constraining the Postal Service's pricing flexibility. ABA Comments at 11.

Chairman of the House Oversight and Government Reform Committee Jason Chaffetz and Chairman of the Government Operations Subcommittee Mark Meadows comment that both the Postal Service and the mailing industry would benefit by having workshare discounts set equal to avoided costs. Chairman Chaffetz and Chairman Meadows Comments at 2. They assert that setting discounts below avoided costs “discourages the mailing industry from performing work more cost-effectively than the Postal Service.” *Id.* LSC also recommends moving many existing workshare discounts as close to 100 percent passthrough as is feasible to incentivize mailer participation and reduce the Postal Service's costs. LSC Comments at 1. ANM *et al.* recommend setting workshare discounts at 100 percent of avoided costs to encourage more co-mailing and co-binding, which would help enable Periodicals and flat-shaped USPS Marketing Mail to cover their attributable costs. ANM *et al.* Comments at 11–12, 56, 82.

### b. Comments in Support of Retaining the Existing Rules

Other commenters recommend against changing workshare discount requirements in this proceeding. The Postal Service asserts that there is inadequate economic justification to base workshare discounts solely on ECP cost avoidances. Postal Service Comments at 232. It contends that “[w]hile ECP may advance the achievement of Objective 1 in some respects (as well as take into account Factor 5),” requiring all workshare discounts to fully conform to ECP would not appropriately balance the objectives because it would “largely vitiate the Postal Service's pricing flexibility.” *Id.* at 230, 232. Similarly, GCA states that “those objectives and factors [in section 3622(b) and (c)] would be best served by preserving the Commission's treatment of worksharing.” GCA Comments at 50.

### c. Comments Suggesting Changes to Accepted Analytical Principles Related to Workshare Discounts

Some commenters suggest changes to accepted analytical principles relating to workshare discounts. MMA *et al.* recommend applying workshare discounts only within a product—specifically to sever the link between First-Class Mail Single-Piece Letters/Postcards and workshare discounts for First-Class Mail Presorted Letters/Postcards. MMA *et al.* Comments at 66–70. GCA recommends that the Commission consider using a 3-year moving average of cost avoidances to smooth out cost fluctuations. GCA Comments at 15. Expressing concern with the accuracy of the accepted postal cost accounting system, ACMA recommends considering the volatility of passthroughs when determining how close to 100 percent a workshare discount is set. ACMA Comments at 2–3.

### 3. Proposed Commission Solution

The Commission proposes rules to phase out two practices that harm pricing efficiency: Workshare discounts set substantially below avoided costs and workshare discounts set substantially above avoided costs.

Therefore, the proposed rules establish bands—ranges with upper and lower limits—for workshare discount passthroughs. A passthrough must fall within the applicable band to be compliant. All passthroughs that fall outside of the applicable band would be noncompliant, subject to a 3-year grace period commencing from the effective date of these rules or when a new workshare discount is established.

The proposed rules promote ECP and help the ratemaking system to maximize incentives to increase efficiency by incentivizing the Postal Service to set workshare discount passthroughs closer to 100 percent in accordance with Objective 1. *See* 39 U.S.C. 3622(b)(1). Also, consistent with Objective 4 (to allow pricing flexibility), the bands allow the Postal Service discretion to set passthroughs within the applicable band. *See* 39 U.S.C. 3622(b)(4). The bands also accommodate the concerns related to excessive workshare discounts referenced in the PAEA. *See* 39 U.S.C. 3622(e)(2). As described below, the proposed upper and lower limits applicable to each band provide a sufficient range for compliant passthroughs to encompass most fluctuations in cost avoidance and mitigate rate shock.

The Commission proposes two bands—one for Periodicals and one for

all other classes. For Periodicals, passthroughs must range between 75 percent and 125 percent. For all other classes, passthroughs must range between 85 percent and 115 percent. The wider band for Periodicals takes into account the wider variance observed in passthroughs for Periodicals and “the educational, cultural, scientific, or informational value” of those mailpieces. See 39 U.S.C. 3622(c)(11) and (e)(2)(C).

The proposed ranges for each band are supported by an empirical analysis. Comparing the passthroughs in the first proceeding (Docket No. R2008–1) and in the most recent proceeding (Docket No. R2017–1) to adjust rates for all classes in the PAEA era demonstrates how passthroughs have become increasingly inconsistent with ECP over the PAEA era, especially for Periodicals.

With respect to passthroughs for Periodicals, in Docket No. R2008–1, 14 of 27 conformed to the proposed Periodicals band, ranging from 75 to 125 percent. Eleven of 27 Periodicals passthroughs set in that proceeding fell below the proposed band, and 2 of 27 were above the proposed band. By contrast, in Docket No. R2017–1, most passthroughs for Periodicals did not conform to the proposed band. In Docket No. R2017–1, 7 of 28 of the passthroughs for Periodicals conformed to the proposed band. Fourteen of 28 of the Periodicals passthroughs set in Docket No. R2017–1 fell below the proposed band and 7 of 28 were above the proposed band.

With respect to passthroughs for all other classes with workshare discounts—First-Class Mail, USPS Marketing Mail, and Package Services—in Docket No. R2008–1, 46 of 69 passthroughs conformed to the proposed band, ranging from 85 to 115 percent. The passthroughs outside of the proposed band were nearly evenly distributed. Eleven of 69 of the passthroughs fell below the proposed band, and 12 of 69 were above the proposed band. By contrast, in Docket No. R2017–1, most passthroughs for First-Class Mail, USPS Marketing Mail, and Package Services did not conform to the proposed band. In Docket No. R2017–1, 20 of 75 these passthroughs conformed to the proposed band. Thirty-seven of 75 of the passthroughs fell below the proposed band, and 18 of 75 were above the proposed band.

Comparing the passthroughs set in these two proceedings also demonstrates that more passthroughs have moved below 100 percent. The median passthrough for Periodicals declined from 89 percent in Docket No. R2008–1 to 75 percent in Docket No.

R2017–1. The median passthrough for all other classes declined from 97 percent in Docket No. R2008–1 to 85 percent in Docket No. R2017–1.

Because most workshare discount passthroughs fell within the proposed bands during the first rate proceeding under the PAEA, phasing out passthroughs that fall outside the range for each proposed band over a limited period of time appears to be a reasonable and achievable method to promote ECP. Moreover, based on an analysis of the percentage change in cost avoidances between ACDs, the Commission found that a majority of these changes fell within the proposed bands. This confirms that the ranges for the proposed bands are sufficient to encompass most fluctuations in cost avoidance. Therefore, the Commission proposes the bands with ranges of plus or minus 25 percent for Periodicals and plus or minus 15 percent for all other classes, subject to a 3-year grace period.

The 3-year grace period is consistent with the PAEA’s direction to phase out excessive workshare discounts over a limited period of time. See 39 U.S.C. 3622(e)(2). Based on an analysis of current workshare discounts and projections of potential outcomes, the Commission determines that 3 years is an appropriate amount of time for the Postal Service to phase out workshare discounts set substantially above or substantially below avoided costs without creating rate shock.

For all existing passthroughs, the Postal Service will have 3 years after the proposed rules go into effect to adjust the passthroughs to comply with the applicable band. If the Postal Service establishes a new workshare discount after the proposed rules become effective that does not comply with the applicable band, the Postal Service will have 3 years after establishing the new workshare discount to adjust the passthrough to comply with the applicable band.<sup>94</sup> A grace period for workshare discounts established after the proposed rules go into effect is necessary because new workshare discounts would be based on estimated avoided cost data that will become more reliable in later years.

For both current and new workshare discounts, the proposed rules require the Postal Service to submit a plan to bring passthroughs into compliance with the applicable band in each rate adjustment filed during the grace period. After the grace period expires, any workshare discounts outside the

applicable band would be noncompliant.

#### 4. Commission Analysis of Alternatives

Based on a determination that the existing ratemaking system did not achieve pricing efficiency, the Commission declines to retain the existing rules relating to workshare discounts.

The Commission also declines to require that all passthroughs be set at exactly 100 percent. Although such a rule would be consistent with ECP, the proposed rules incorporate the concerns of commenters regarding fluctuations in cost avoidance and continue to allow the Postal Service some pricing flexibility with regard to workshare discounts by establishing bands of compliant passthroughs. Establishing bands (plus or minus 25 percent for Periodicals and plus or minus 15 percent for all other classes) incorporates the suggestions of commenters to incentivize the Postal Service to set workshare discounts closer to 100 percent of avoided costs. The lower limits applicable to the proposed bands (75 percent for Periodicals and 85 percent for all other classes) incorporate the suggestions that passthroughs adhere to a “soft floor.”

The suggested changes to accepted analytical principles related to workshare discounts fall outside of the scope of this proceeding. This proceeding focuses on proposing rules as necessary for the ratemaking system to achieve the objectives in 39 U.S.C. 3622(b). The standard for changing accepted analytical principles differs. Accepted analytical principles may be changed to improve the quality, accuracy, or completeness of the Postal Service data or analysis underlying the ACR. 39 CFR 3050.11(a). Any interested person may petition the Commission to initiate a proceeding to consider changing accepted analytical principles. *Id.* The proponent of the change must identify the accepted analytical principal for review, explain any perceived deficiencies, and suggest remedies. 39 CFR 3050.11(b).

The Commission declines to adopt GCA’s suggestion to use a 3-year moving average of cost avoidances to smooth out cost fluctuations. This approach would place too much emphasis on avoiding rate shock while failing to produce workshare discounts that are calculated based on current prices and costs. Instead, the Commission’s approach proposed in this proceeding—bands for passthrough compliance after a 3-year grace period—will encompass most cost avoidance fluctuations and

<sup>94</sup> The Postal Service must also continue to submit a detailed report to the Commission as required by 39 U.S.C. 3622(e)(4).

encourage the improvement of costing data.

5. Proposed Regulatory Changes

The Commission has considered the comments and the foregoing analysis in developing proposed subpart I to 39 CFR part 3010. Proposed § 3010.260 explains the applicability of proposed subpart I. Proposed § 3010.261 sets forth the upper and lower limits for passthroughs applicable to each class. Proposed § 3010.262 provides for a 3-year grace period to bring noncompliant passthroughs (existing and new) into compliance with the applicable band. Proposed § 3010.262 also requires the Postal Service to submit a plan to bring the noncompliant passthroughs into compliance with the applicable band. To conform with this proposed change, the Commission proposes to delete existing § 3010.12(b)(6). To reflect the deletion of § 3010.12(b)(6), the Commission also proposes a conforming deletion in § 3050.20(c).

Proposed § 3010.123(f) retains existing § 3010.12(b)(5)'s requirements for the schedule of workshare discounts. Proposed § 3010.123(g) retains existing § 3010.12(c)'s requirements pertaining to the contents of a Postal Service's request to review a notice of rate adjustment that establishes a new workshare discount.

6. Conclusion

The proposal to require that workshare discount passthroughs conform to the applicable bands, subject to a 3-year grace period, is necessary to achieve Objective 1. Workshare discounts set substantially above or below avoided costs send inefficient

pricing signals and are inconsistent with ECP. Such discounts contribute to the system having not achieved efficient prices, which may have contributed to the Postal Service's poor financial health by disrupting incentives for the Postal Service to right size its network and for mailers to enter volume that best conforms to the network. Proposed subpart I requires the Postal Service to gradually phase out these problematic practices and set more efficient prices. This proposed approach will also allow for continued pricing flexibility for the Postal Service.

G. Procedural Improvements

1. Introduction

The Commission proposes two procedural changes to improve the ratemaking process relating to planned rate adjustments of general applicability. These proposed changes are within the scope of the Commission's general authority to revise its regulations. 39 U.S.C. 3622(a); 39 U.S.C. 503. These proposed procedural changes are consistent with the Commission's review in Order No. 4257 and take into account the comments received in this proceeding. Therefore, the Commission sees no detriment to proposing these procedural changes in this docket. First, the Commission proposes to improve the requirements relating to the schedule for regular and predictable rate adjustments. Second, the Commission proposes to lengthen the notice period for rate adjustments and make conforming adjustments to the timing of comments and the Commission's decision.

2. Schedule for Regular and Predictable Rate Adjustments

a. Introduction

In Order No. 4257, the Commission determined that the ratemaking system must have a mechanism that limits the magnitude of price adjustments and is sufficiently transparent to allow for mailers to understand how the limitation mechanism works. Order No. 4257 at 103. Existing § 3010.9(e) requires the schedule for regular and predictable rate adjustments to be updated "[w]henver the Postal Service deems it appropriate." 39 CFR 3010.9(e). Over the past 10 years, the Postal Service has, for the most part, filed its notices of rate adjustments on predictable and consistent schedules. Order No. 4257 at 61, 143. Where it has deviated from those schedules, such deviations have been based on external factors from which a mailer or postal customer could reasonably forecast the potential effect on the timing of price adjustments. *Id.* In this section, the Commission considers potential procedural improvements.

b. Comments

In conjunction with its recommendation to eliminate the price cap, the Postal Service suggests that the Commission require the Postal Service to give mailers guidance regarding the timing and magnitude of rate increases at the class and product level, before filing a specific rate docket. Postal Service Comments at 14, 202. Under its proposed forward guidance regime, the Postal Service proposes to provide information in accordance with the following schedule:

TABLE III-5—PROPOSED POSTAL SERVICE SCHEDULE OF INFORMATION RELATING TO PLANNED RATE INCREASES

Stage	Months before implementation of rate increase	Information to be provided by the Postal Service
1 .....	12	Planned target date of planned rate change.
2 .....	9	Planned percentage change in rates by class.
3 .....	6	Planned percentage change in rates by product and structural changes.
4 .....	3	Notice of specific rates and structural changes.

*Id.* at 204–05. At stages 2 through 4, the Postal Service also proposes to address the prior information provided by either affirming or revising (and explaining the reason for any deviations). *Id.*

Other commenters did not put forth specific proposals concerning the

schedule of rate adjustments. Generally, commenters discuss the business need to accurately budget for postage rate increases. For instance, Publishers Clearing House notes that it attempts to forecast postage increases to establish 3-

year budget outlooks.<sup>95</sup> SMC observes that annual rate adjustments have created consistency in budget planning

<sup>95</sup> Joint Declarations, Declaration of Wendy Smith on Behalf of Publishers Clearing House, at 2.

for advertising mailers. SMC Comments at 7.

### c. Proposed Commission Solution

The Commission proposes to enhance the schedule of regular and predictable rate adjustments. The Commission proposes to require the Postal Service to update the schedule at least once a year (at a minimum, at the time of filing the ACR). The Commission proposes to require that the schedule contain plans to adjust rates that may occur over the next 3 years, at a minimum. Specifically, the Postal Service must include the estimated filing and implementation dates (month and year) and an explanation that will allow mailers to predict with reasonable accuracy, by class, the amounts of planned rate adjustments. The Postal Service will retain the flexibility to provide a new schedule at any time. It may also deviate from the anticipated rate changes if it explains the reason for the deviation in its request to the Commission to review its notice of rate adjustment.

Requiring regular annual updates of the planned timing and magnitude of rate adjustments over a 3-year period would improve the mailing community's ability to plan budgets. The proposed changes to the schedule are also consistent with the Postal Service's current business practices to keep key stakeholders informed of planned rate changes outside of the ratemaking process. For instance, the Postal Service issued a press release in November 2009 announcing that it would not adjust market dominant rates in Calendar Year 2010.<sup>96</sup> Also, in July 2016, the Postal Service shared its plans to implement price adjustments in January 2017 with members of the industry.<sup>97</sup> Consistent with those continuing efforts, the proposed rule aims to improve accessibility of information for all mailers and minimize the need for mailers to refer to other materials. Therefore, the proposed changes also improve transparency by ensuring that the Commission and the public are aware of the Postal Service's current intent concerning future rate adjustments. The changes are also consistent with the Commission's review of the ratemaking process in Order No. 4257. *See* Order No. 4257 at 52–85, 142–46.

<sup>96</sup> U.S. Postal Service Announces 2010 Shipping Prices: Price of First-Class Postage Will Not Change, November 4, 2009, at 1.

<sup>97</sup> USPS 2017 Postal Pricing Considerations, QuadGraphics, July 25, 2016, available at <http://www.qg.com/blog/usps-2017-postal-pricing-considerations>.

### d. Commission Analysis of Alternatives

The Commission proposes to improve the transparency of planned rate adjustments while retaining a mechanism that limits the magnitude of price adjustments. The Commission considers the Postal Service's representations about its capability to predict rate adjustments and the needs of mailers to have helpful information to plan their budgets in proposing this rule.

### e. Proposed Regulatory Changes

The Commission proposes to replace existing § 3010.9 with proposed § 3010.102.

### f. Conclusion

Pursuant to its general authority to revise its regulations under 39 U.S.C. 3622(a) and 503, the Commission proposes changes to the schedule to improve transparency.

## 3. Revised Procedural Schedule for Rate Adjustment Proceedings

### a. Introduction

In Order No. 4257, the Commission determined that rate adjustment proceedings were able to be consistently adjudicated within 90 days. Order No. 4257 at 72. In each of the eight proceedings requesting to adjust rates for all classes during the PAEA era, the Postal Service filed its initial request to the Commission to review its notice of rate adjustment at least 90 days before the planned implementation date of each rate adjustment. *Id.* at 63. On average, the duration of Commission review of the eight large-scale rate proceedings in the PAEA era has been 62 days. *Id.* at 72. In six of these eight large-scale rate proceedings, there were significant issues with the Postal Service's rate adjustment filings resulting in durations of between 58 and 112 days. *Id.*

On average, the Commission sought additional information at least once in small-scale rate proceedings, resulting in an average duration of 37 days for Commission review of small-scale rate proceedings in the PAEA era. *Id.* at 75, 98. Longer review periods were due to the deficiencies in the Postal Service's filings that required correction to resolve the proceedings. *Id.* at 98. In the remainder of this section, the Commission considers potential procedural improvements.

### b. Comments

In conjunction with its recommendation to eliminate the price cap, the Postal Service committed to continuing to provide at least 90 days'

advance notice of planned rate adjustments. Postal Service Comments at 202, 206 n.398. Specifically, the Postal Service proposes establishing a requirement to provide notice of specific rate and structural changes 3 months prior to the planned implementation date. *Id.* at 205.

Other commenters did not put forth specific proposals concerning the notice requirement. While urging the Commission to retain a price cap system, MMA *et al.* favor the Postal Service's practice of providing more than 45 days advance notice of planned rate increases. MMA *et al.* Comments at 27. Similarly, SMC observes that the 90-day notice period corresponds with mailers' budget planning. SMC Comments at 7. Also, SIIA notes that its members plan their budgets early in the year. SIIA Comments at 7.

### c. Proposed Commission Solution

To facilitate the administration of rate adjustment proceedings, the Commission proposes to extend the notice period from 45 days to 90 days prior to the planned implementation of rates. This proposed change codifies the existing practice. Requiring 90-days' advance notice of the specific rate and structural changes should facilitate mailers' ability to generate budgets. It also allows adequate time for the proceeding to be adjudicated, including potential changes, while still giving mailers time to implement the planned rates on the planned date.

Commensurate with extending the notice period, the Commission also proposes to extend the deadline to comment on an initial request from 20 days to 30 days. Allowing commenters 10 additional days to formulate comments will facilitate meaningful and intelligent participation by interested persons. The Commission also extends the deadline to comment on an amended request from 7 days to 10 days. These proposed durations are consistent with extensions to the comment period made in prior proceedings.

Commensurate with extending the notice period and the comment period, the Commission also proposes to lengthen the time for the Commission to render its decision from 14 days to 21 days after the conclusion of the comment period (for both an initial and an amended request). These proposed changes will better allow the Commission to evaluate each rate proceeding.

The Commission also proposes to enumerate potential actions that it may take if the Commission determines that the Postal Service's request fails to

contain the information required by the rules appearing in proposed §§ 3010.122 and 3010.123, which prescribe the contents of a request and the required supporting technical documentation. The Commission may: inform the Postal Service of the deficiencies and provide an opportunity for the Postal Service to take corrective action, toll or otherwise modify the procedural schedule until the Postal Service takes corrective action, dismiss the request without prejudice, or take other appropriate action. This proposed change codifies existing Commission practice, which will facilitate the Commission's ability to ensure that the initial Postal Service request complies with the relevant statutory and regulatory requirements. This proposed change will also better ensure that commenters and the Commission have accurate and complete information at the beginning of a rate proceeding.

Cumulatively, these changes remain consistent with the streamlined duration of rate review in the PAEA era. The changes are also consistent with the Commission's review of the ratemaking process in Order No. 4257. *See* Order No. 4257 at 52–85, 142–46.

Rate adjustments that only propose to establish or change rates for market dominant NSAs (denoted as Type 2 Rate Adjustments under existing § 3010.7) or only to adjust rates due to extraordinary or exceptional circumstances (denoted as Type 3 Rate Adjustments under existing § 3010.8) remain unaffected by these proposed procedural changes.

#### d. Commission Analysis of Alternatives

The Commission proposes to improve the transparency of planned rate adjustments while retaining a mechanism that limits the magnitude of price adjustments. The Commission has considered the Postal Service's commitments to providing at least 90 days' advance notice of planned rate adjustments and the needs of mailers to have helpful information to plan their budgets in proposing this rule.

#### e. Proposed Regulatory Changes

The Commission proposes to replace existing §§ 3010.10 and 3010.11, which contain the existing timing requirements for notice, comments, and Commission decision, with the following proposed rules.

Proposed § 3010.121 extends the periods for the Postal Service to provide public notice and submit a request to the Commission to review its notice of rate adjustment from 45 days to 90 days. Proposed § 3010.122(b) contains a conforming change concerning the

representation of compliance with the public notice requirement.

Proposed § 3010.124(f) contains the revised timeframe allowing 30 days for public comment on the initial request. Proposed § 3010.126(b) contains the revised timeframe stating that the Commission decision will be issued within 21 days after the conclusion of the comment period.

Proposed § 3010.126(a) states that if the Commission determines that the Postal Service's request fails to contain the required information, the Commission may: Provide an opportunity for the Postal Service to take corrective action, toll or otherwise modify the procedural schedule until the Postal Service takes corrective action, dismiss the request without prejudice, or take other action as deemed appropriate by the Commission.

Proposed § 3010.126(f) contains the revised timeframe allowing 10 days for public comment on an amended request. Proposed § 3010.126(g) contains the revised timeframe stating that the Commission decision will be issued within 21 days after the conclusion of the comment period. Proposed § 3010.126(h) provides that no amended rate may take effect until 45 days after the Postal Service's amended request.

#### f. Conclusion

Pursuant to its general authority to revise its regulations under 39 U.S.C. 3622(a) and 503, the Commission proposes changes to the notice requirement (and the conforming changes to other procedural requirements) to facilitate the administration of rate proceedings.

### IV. Description of Proposed Changes to Rules Appearing in the Code of Federal Regulations

#### A. Introduction

##### 1. Affected Sections

The rules in 39 CFR part 3010, subparts A, B, C, and E. (existing §§ 3010.1 *et seq.*, 3010.10 *et seq.*, 3010.20 *et seq.*, and 3010.60 *et seq.*) are replaced in their entirety by new rules that appear in new subparts A, B, C, D, E, F, G, H, and I (proposed §§ 3010.100 *et seq.*, 3010.120 *et seq.*, 3010.140 *et seq.*, 3010.160 *et seq.*, 3010.180 *et seq.*, 3010.200 *et seq.*, 3010.220 *et seq.*, 3010.240 *et seq.*, and 3010.260 *et seq.*). Rules specific to NSAs appearing in 39 CFR part 3010, subpart D (existing § 3010.40 *et seq.*) are moved to new 39 CFR part 3020, subpart G (proposed § 3020.120 *et seq.*). Minor changes are proposed in existing §§ 3050.20(c) and 3055.2(c). The proposed rules appear

after the signature of this Order in Attachment A.

#### 2. General Restructuring

The new rules, as proposed, perform two functions: they implement the findings of this docket, and they utilize a simpler format that should be more readable, and thus, more user-friendly than the current rules. The discussions of the structure of the proposed rules and the line-by-line descriptions of the proposed rules explain how the findings of this docket have been implemented. *See* section IV, *infra*. The steps taken to simplify the format of the rules are addressed first.

The most significant simplification is a change in terminology. The current rules classify rate adjustments as either Type 1–A, 1–B, 1–C, 2, or 3. These rate adjustment types are associated with rate adjustments based on: the annual limitation only, the annual limitation and unused rate authority, a rate decrease only, an NSA, or an exigent circumstance. The use of the “Type” terminology, which is pervasive throughout the rules, both lengthens the rules (because each of these types must be defined) and makes the rules more difficult to understand (because the reader has to continuously refer back to the definitions to understand the rules). Furthermore, it is also apparent that the differences between Type 1–A, 1–B, and 1–C are in some instances nuanced and difficult to understand, and in some instances immaterial to the application of the rules.

Thus, the proposed rules replace the “Type” terminology with straightforward descriptions that identify the intent of the proceeding. The rules replace the Type 1–A, 1–B, and 1–C terminology with a single type of proceeding simply referred to as “rate adjustments” (which include a limitation on rate increases). The Type 3 terminology is replaced by rules governing “rate adjustments due to extraordinary and exceptional circumstances.” The Type 2 terminology is replaced by rules governing “requests for market dominant [NSAs].” The use of descriptive terms, instead of the “Type” terminology, is intended to improve the readability of the rules and make them more easily comprehensible.

The other significant simplification is to remove most rules concerning market dominant NSAs from 39 CFR part 3010. This proposal is based on the substance of the current NSA rules. Except for rules regulating the treatment of volumes used in general rate adjustment calculations, the majority of the rules concern the Commission's initial review

of an NSA and do not directly address potential adjustments to existing NSA rates.

Under the current rules, whenever the Postal Service proposes a new product (including a new NSA), it must first request that the product be added to the appropriate product list pursuant to the rules appearing in 39 CFR part 3020. Then, the NSA rules appearing in 39 CFR part 3010 are applied in addition to those already imposed by 39 CFR part 3020. Thus, it appears logical to combine both sets of rules within that same part, *i.e.*, 39 CFR part 3020. This further allows for deletion of duplicative material that currently appears in both 39 CFR parts 3010 and 3020.

In the event of rate adjustments for existing NSAs, under the proposed rules, the Postal Service should file pursuant to 39 CFR part 3020, and not 39 CFR part 3010. These rate adjustments typically do not implicate the requirements of 39 CFR part 3010. The focus of the review will generally be on the statutory requirements of 39 U.S.C. 3622(c)(10), which are implemented through the rules appearing in 39 CFR part 3020.

Several other minor simplifications are proposed. Some existing rules espouse aspirational goals, but fall short of imposing a requirement. For example, existing § 3010.10(b) encourages the Postal Service to provide more than 45 days for public notice of rate adjustments. Other rules merely repeat statutory requirements without imposing any new regulatory requirements. For example, existing § 3010.40 merely restates the special classifications requirements appearing in 39 U.S.C. 3622(c)(10). The proposed rules attempt to eliminate this type of aspirational and duplicative language throughout the regulations.

In certain areas, terminology is changed. For example, the current rules refer to each Postal Service request to review its notice as a “notice.” The proposed rules only refer to a “notice” when referring to a document that is directed towards the public. This includes, for example, a “notice” published in the **Federal Register** alerting the public to a Commission proceeding, or the Postal Service’s “notice” to the public that it is adjusting rates. The term “request” is used in the proposed rules to refer to the material submitted by the Postal Service to the Commission pursuant to rate adjustments. This material in fact acts as a Postal Service “request” for the Commission to review the Postal Service’s “notice” of rate adjustment.

The proposed modifications attempt to make other terminology consistent. An example is in the usage of the terminology “unused rate authority,” “banked rate authority,” and “interim rate authority.” Unused rate authority is the remaining amount of the maximum rate adjustment authority not used in any one rate adjustment proceeding. Banked rate adjustment authority is rate authority available for future rate adjustments. Interim rate authority is excess rate authority created when rate adjustments fall more than 12 months apart. Upon calculation of interim rate adjustment authority, it is immediately added to the bank for future use. Thus, it immediately becomes banked rate adjustment authority upon calculation.

### 3. Structure of the Proposed Rules

Proposed 39 CFR part 3010, the rules governing the Regulation of Rates for Market Dominant Products, is organized into the following nine subparts:

- Subpart A—General Provisions;
- Subpart B—Rate Adjustments;
- Subpart C—Consumer Price Index Rate Authority;
- Subpart D—Supplemental Rate Authority;
- Subpart E—Performance-Based Rate Authority;
- Subpart F—Non-Compensatory Classes or Products;
- Subpart G—Accumulation of Unused and Disbursement of Banked Rate Adjustment Authority;
- Subpart H—Rate Adjustments Due to Extraordinary and Exceptional Circumstances; and
- Subpart I—Workshare Discounts.

Proposed subpart A of 39 CFR part 3010 directs the reader to the appropriate starting point depending on the specific request of the Postal Service. For example, the reader is directed to proposed subpart B of 39 CFR part 3010 as the starting point to adjust market dominant rates of general applicability subject to the periodic limitations in rate increases. These are the typical, generally annual, rate adjustment proceedings. Proposed subpart B of 39 CFR part 3010 directs the reader to proposed subparts C through G of 39 CFR part 3010 to calculate the availability of rate adjustment authority in any one of these proceedings. There are five possible sources of rate adjustment authority: CPI (proposed subpart C of 39 CFR part 3010), supplemental (proposed subpart D of 39 CFR part 3010), performance-based (proposed subpart E of 39 CFR part 3010), non-compensatory (proposed subpart F of 39 CFR part 3010), and banked rate (proposed subpart G of 39 CFR part 3010).

For rate adjustments due to extraordinary and exceptional circumstances, the reader is directed to proposed subpart H of 39 CFR part 3010 as the starting point. Subject to the special procedures and requirements appearing in proposed subpart H of 39 CFR part 3010, however, the concepts espoused in proposed subparts B through G of 39 CFR part 3010 should be followed. For example, when calculating the percentage change in rates for an extraordinary or exceptional rate request, the Postal Service should apply the methodology of proposed § 3010.128. Calculation of percentage change in rates.

Proposed subpart I of 39 CFR part 3010 provides new rules concerning workshare discounts. These rules apply any time a rate that is associated with a workshare discount is adjusted, *i.e.*, for both market dominant rates of general applicability subject to the periodic limitations in rate increases, and rate adjustments due to extraordinary and exceptional circumstances.

The following new subpart is added to existing 39 CFR part 3020, Product Lists:

Subpart G—Requests for Market Dominant Negotiated Service Agreements.

The rules in this subpart are to be applied any time the Postal Service proposes the addition of a new market dominant NSA to the market dominant product list. Any time the Postal Service proposes to modify an existing market dominant NSA (either a rate or another term of the contract), the Commission will review the modifications based on an update to the material originally provided as required by proposed subpart G of 39 CFR part 3010.

### B. Line-by-Line Discussion of Changes

#### 1. Section 3010, Subpart A—General Provisions

*Section 3010.100 Applicability.* Paragraph (a) of proposed § 3010.100 identifies 39 CFR part 3010 as being applicable to rate adjustments for market dominant rates of general applicability. It also identifies the Mail Classification Schedule (MCS) posted on the Commission’s Web site as a source for current rates.

Paragraph (b) of proposed § 3010.100 acts as an index to direct the reader to the rules for periodic rate adjustments subject to regulatory limitations, the calculations of the regulatory limitations, rate adjustment due to extraordinary or exceptional circumstances, and special rules for workshare discounts.

*Section 3010.101 Definitions.* Proposed § 3010.101 replaces the definitions currently appearing in existing § 3010.1. For the most part, the purported definitions in existing § 3010.1 act more as a table of contents than as a source for definitions. This may have been necessary to give meaning to the Type 1–A, 1–B, and 1–C terminology appearing in the current rules. However, it is no longer necessary due to the elimination of this terminology. Proposed § 3010.101 provides definitions for: annual limitation, banked rate authority, class, maximum rate adjustment authority, performance-based rate authority, rate authority applicable to non-compensatory classes, rate cell (existing § 3010.23(a)(2)), rate incentive (existing § 3010.23(a)(3)), rate of general applicability (existing § 3010.1(g)), and seasonal or temporary rate.

*Section 3010.102 Schedule for regular and predictable rate adjustments.* The rules currently appearing in existing § 3010.9, concerning the Schedule for Regular and Predictable Rate Adjustments, are moved to proposed § 3010.102. Several changes are made to the current rule. To improve transparency, and ensure both the mailers and the Commission are aware of the Postal Service's current intent concerning future rate adjustments, the new rules require the Postal Service to specifically address plans to adjust rates that may occur over the next 3 years, at a minimum. The schedule that the Postal Service provides will be posted to the Commission's Web site, as is currently the case. The rules also require the Postal Service to update and file a schedule annually at the time it files its ACR pursuant to 39 U.S.C. 3652. For convenience, the Commission would prefer that the schedule be filed as part of the Annual Compliance Review docket, *i.e.*, under the applicable Annual Compliance Review docket number. As before, the Postal Service must update the schedule when necessary.

## 2. Section 3010, Subpart B—Rate Adjustments

*Section 3010.120 General.* This section identifies the rules in proposed subpart B of 39 CFR part 3010 as applicable to periodic rate adjustments subject to regulatory limitations.

*Section 3010.121 Postal Service request.* This section specifies the public notice requirement (paragraph c of proposed § 3010.121) and the requirement to submit a request to the Commission to review the Postal Service notice of rate adjustment

(paragraph d of proposed § 3010.121). These rules currently appear in existing §§ 3010.10(a)(1) and (2). The current rules are changed to extend the notice and filing periods from 45 to 90 days. With this extension, the aspirational goal of providing a longer notice, currently appearing in existing § 3010.10(b), is deleted because it is no longer necessary.

The current requirement to take into consideration how planned rate adjustments are designed to help achieve the objectives listed in 39 U.S.C. 3622(b) and take into account the factors listed in 39 U.S.C. 3622(c), appearing in existing § 3010.12(b)(7), is moved to proposed § 3010.121(b). There is no reporting requirement for this paragraph. However, planned rates that are inconsistent with this provision may be returned to the Postal Service for reconsideration.

*Section 3010.122 Contents of a request.* This section specifies the general contents of the Postal Service's request to adjust rates. Existing § 3010.12, which includes these requirements, is being divided into two separate sections. Proposed § 3010.122 will provide requirements for the general contents of a Postal Service request. The rules currently appearing in existing § 3010.12(a), (b)(8), (b)(10), (b)(11), and (b)(12), concerning the general content of a Postal Service request, are moved to proposed § 3010.122, Contents of a request. Proposed § 3010.123 will provide requirements for the technical data (calculations) necessary to support the request. Proposed § 3010.122(f) ties the general requirements of proposed § 3010.122 to the technical requirements of proposed § 3010.123. Proposed § 3010.123 encompasses the remaining items currently appearing in existing § 3010.12.

There are two notable changes from the current rules. First, the public notice period is extended from at least 45 days to at least 90 days (proposed § 3010.122(b)). Second, the Postal Service will be required to certify that it has used the most recently approved analytical principles in its request (proposed § 3010.122(h)). Currently, the Postal Service must do so, but there is no certification requirement (existing § 3010.12(f)). This change will act as reinforcement to the current requirement, and provide the Postal Service with an opportunity to identify any challenges or limitations on complying with this requirement.

*Section 3010.123 Supporting technical documentation.* This section specifies the supporting technical documentation that the Postal Service is

to provide with its request. The section begins with a description of the form for any workpapers that must be submitted with the request, *e.g.*, show all calculations, identify sources, submit in machine-readable, electronic format, link to spreadsheet cells (paragraph (a) of proposed § 3010.123). Similar requirements are currently spread throughout the rules.

Then, the remaining paragraphs describe the technical documentation that is to be provided with each request. The rules currently appearing in existing § 3010.12(b)(1), (b)(2), (b)(3), (b)(4), (b)(5), (b)(9), (c), (d), and (e), which specify technical supporting data to be filed with the Postal Service's request, are moved to proposed § 3010.123(b) through (i). These sections address the provision of data concerning: The calculation of the maximum rate adjustment authority; the schedule of banked rate authority; the calculation of the percentage change in rates; the calculation of unused rate adjustment authority; a schedule of workshare discounts; material concerning new workshare discounts; material concerning new discounts or surcharges not considered a workshare discount; and material concerning rate incentives.

A proposed § 3010.123(j) is added to require the provision of information associated with products or classes where the attributable cost for that class or product exceeded the revenue from that class or product as determined by the most recent ACD made pursuant to 39 U.S.C. 3653.

The requirements of existing § 3010.12(b)(6) concerning justifications for workshare discounts that exceed attributable costs are replaced by the material appearing in proposed subpart I of 39 CFR part 3010, Rates Applicable to Workshare Discounts and do not appear in proposed § 3010.123.

*Section 3010.124 Docket and notice.* The rules currently appearing in existing § 3010.11(a), concerning the establishment of a docket and the Commission's notice of proceedings, are moved to proposed § 3010.124. The content is unchanged except for the extension of the public comment period from 20 to 30 days.

*Section 3010.125 Opportunity for comments.* Similar rules concerning the opportunity for comment appear in existing § 3010.11(b) and (c). The wording is revised to simply allow comments on whether the planned rate adjustments comport with applicable statutory and regulatory requirements. As always, the Commission reserves the right to limit comments to those

relevant to the rate adjustment proceeding before the Commission.

*Section 3010.126 Proceedings.* This section specifies the general flow of a proceeding applicable to a request to review a notice of rate adjustment.

A new rule appearing in proposed § 3010.126(a) prescribes potential Commission action when the Postal Service's request does not substantially comply with the filing requirements concerning the contents of a request and the required supporting technical documentation. The Commission may inform the Postal Service of the deficiencies and provide an opportunity for the Postal Service to take corrective action, the Commission may toll or otherwise modify the procedural schedule until such time as the Postal Service takes corrective action, it may dismiss the request without prejudice, or take other action as deemed appropriate by the Commission.

The rules currently appearing in existing § 3010.11(d) through (k), concerning the general procedures for reviewing rate adjustments, are moved to proposed § 3010.126(b) through (j). Within this material, several time periods are modified. The time period from the conclusion of the comment period to the Commission issuing a determination is increased from 14 to 21 days. The comment period concerning any amended notice is increased from 7 to 10 days. The time period from the receipt of an amended notice to the Commission issuing a determination is increased from 14 to 21 days.

*Section 3010.127 Maximum rate adjustment authority.* This section specifies the calculation of the maximum rate adjustment authority, and imposes limitations on certain rate decreases. Proposed § 3010.127 replaces the rules currently appearing in existing § 3010.20. The fundamental differences between the current rules and the new rules are the expanded sources for potential rate adjustment authority available under the new rules. The current rules determine a maximum allowable rate adjustment based upon an annual limitation (CPI rate authority), or if the annual limitation is entirely used, the annual limitation plus available banked rate authority (up to 2 percent). The new rules add three sources of potential rate adjustment authority to the CPI rate authority (proposed subpart C of 39 CFR part 3010) and the banked rate authority (proposed subpart G of 39 CFR part 3010) when determining the maximum allowable rate adjustment: Supplemental rate authority (proposed subpart D of 39 CFR part 3010), performance-based rate authority

(proposed subpart E of 39 CFR part 3010), and non-compensatory rate authority (proposed subpart F of 39 CFR part 3010). The availability of each of these sources is subject to limitations appearing in each of the new subparts. The maximum rate adjustment authority available to the Postal Service for each class of market dominant mail is limited to the sum of the percentage points developed in each of these subparts.

Existing § 3010.20(e) imposed no limitation on the amount of a rate decrease. This provision is replaced by a requirement that the rates for non-compensatory products may not be reduced. There is no limitation on the amount of a rate decrease for any other product.

*Section 3010.128 Calculation of percentage change in rates.* This section specifies the calculation of percentage change in rates. The rules currently appearing in existing § 3010.23, concerning the calculation of percentage change in rates, and existing § 3010.24, concerning the treatment of volumes associated with NSAs and rate incentives not of general applicability, are moved to proposed § 3010.128. There is no intent to change the meaning or operation of the rules currently in place.

Paragraph (a) of proposed § 3010.128 provides the meaning of "current rate" for the purpose of this section and provides two exceptions to the definition. This material previously appeared in existing § 3010.23(a)(1).<sup>98</sup> The definitions for "rate cell" and "rate incentive" currently appearing in existing § 3010.23(a)(2) and (3) are added to other definitions appearing in proposed § 3010.101.

Paragraph (b) of proposed § 3010.128 describes the determination of volumes associated with each rate cell. This material currently appears in existing § 3010.23(d).

Paragraph (c) of proposed § 3010.128 describes the process for calculating the percentage change in rates when rates are being increased. This material currently appears in existing § 3010.23(b)(1).

Paragraph (d) of proposed § 3010.128 describes the process for calculating the percentage change in rates when rates are being decreased. This explanation currently appears in existing § 3010.23(b)(2).

Paragraph (e) of proposed § 3010.128 provides the formula for calculating the percentage change in rates. The formula

<sup>98</sup> The example included in existing § 3010.23(a)(1)(iii) is being omitted because it more appropriately belonged in a description of the rule, and not in the rule itself. The example remains factually accurate.

currently appears in existing § 3010.23(c).

Paragraph (f) of proposed § 3010.128 describes the treatment of volume associated with rate incentives where the rates are not of general applicability. This material currently appears in existing § 3010.23(e).

Paragraph (g) of proposed § 3010.128 describes the treatment of volume associated with NSAs and rate incentives not of general applicability. This material currently appears in existing § 3010.24.

*Section 3010.129 Exceptions for de minimis rate increases.* This section provides exceptions to the requirements to immediately calculate the maximum rate adjustment authority and bank unused rate adjustment authority in the case of de minimis rate increases. The rules currently appearing in existing § 3010.30 concerning de minimis rate increases are moved to proposed § 3010.129. There is no intent to change the meaning or operation of the rules currently in place. Additionally, paragraph (g) of proposed § 3010.129 is added as a reminder that rates may not be reduced for non-compensatory products.

### 3. Section 3010, Subpart C—Consumer Price Index Rate Authority

*Section 3010.140 Applicability.* This section informs the reader that rate adjustment authority is available based upon changes in the CPI. Rate adjustment authority is calculated differently depending on whether the rate adjustment is being filed 12 or more months from the previous rate adjustment (proposed § 3010.142), or less than 12 months from the previous rate adjustment (proposed § 3010.143).

*Section 3010.141 CPI-U data source.* The duplicate rules currently appearing in existing §§ 3010.21(a) and 3010.22(b), concerning the source of data for CPI-U values, are combined and moved to proposed § 3010.141.

*Section 3010.142 CPI-U rate authority when requests are 12 or more months apart.* The rules currently appearing in existing § 3010.21(b), concerning calculation of CPI-U rate authority when notices of rate adjustments are 12 or more months apart, are moved to proposed § 3010.142.

*Section 3010.143 CPI-U rate authority when requests are less than 12 months apart.* The rules currently appearing in existing § 3010.2(b) through (d), concerning calculation of CPI-U rate authority when notices of rate adjustments are less than 12 months apart, are moved to proposed § 3010.143.

4. Section 3010, Subpart D—  
Supplemental Rate Authority

*Section 3010.160 Applicability.* This section informs the reader of the availability of 2 percentage points of rate authority per class of mail per calendar year for each of the first 5 full calendar years following the effective date of these rules. The rate authority must be applied, if at all, to the first generally applicable rate increase filed within a calendar year. For each of the 5 calendar years, the rate authority becomes effective on January 1 and lapses on December 31 if unused. The unused portion may not be banked for future use. The Commission intends to also apply the no banking rule (proposed § 3010.160(b)(5)) to any attempt to circumvent the intent of this provision, such as filing a rate increase immediately followed by the filing of a rate decrease in order to create banked rate authority.

5. Section 3010, Subpart E—  
Performance-Based Rate Authority

*Section 3010.180 Applicability.* This section informs the reader of the availability of up to 1 percentage point of rate authority per class of mail per calendar year based upon the Postal Service meeting or exceeding an operational efficiency-based standard and adhering to service quality-related criteria. The Commission shall review both operational efficiency and service quality in the ACD. If the Commission determines that the requirements are met, 0.75 percentage points shall be allocated for operational efficiency, and 0.25 percentage points shall be allocated for service quality. Each determination (and allocation) is independent of the other.

The rate authority must be applied, if at all, to the first generally applicable rate increase filed within a calendar year. The rate authority becomes effective on January 1 and lapses on December 31 if unused. If unused, or if not fully used, the unused portion may not be banked for future use. The Commission intends to also apply the no banking rule (proposed § 3010.180(b)(5)) to any attempt to circumvent the intent of this provision, such as filing a rate increase immediately followed by the filing of a rate decrease in order to create banked rate authority.

*Section 3010.181 Operational efficiency-based rate authority.* This section provides the criteria for allocating 0.75 percentage points of rate authority based on operational efficiency. This rate authority shall be allocated if the average annual TFP

growth over the most recent 5 years met or exceeded 0.606 percent.

*Section 3010.182 Service quality-based rate authority.* This section provides the criteria for allocating 0.25 percentage points of rate authority based on service quality. This rate authority shall be allocated for each class of mail if the Commission finds in the appropriate ACD that all of the Postal Service's service standards (including applicable business rules) for that class during the applicable year met or exceeded the service standards in place during the prior fiscal year on a nationwide or substantially nationwide basis. This test examines the service standards and the business rules. It does not examine actual service performance such as time-to-delivery.

The Commission's finding in the ACD may be challenged. Any interested person may challenge the finding within 30 days of the ACD being issued. Once challenged, the Commission shall rule on the challenge within 60 days of the challenge being filed. The subject matter of the challenge is limited to changes in service standards or business rules that occur on a national or substantially nationwide basis. Whether or not the Postal Service is meeting its service standards shall not be the subject of this form of challenge.

6. Section 3010, Subpart F—Non-  
Compensatory Classes or Products

*Section 3010.200 Applicability.* This section informs the reader that proposed subpart F of 39 CFR part 3010 prescribes rate setting criteria for products where the attributable cost for that product exceeded the revenue from that product, *i.e.*, the product is non-compensatory. It also prescribes rate setting criteria for any class of mail where the attributable cost for that class exceeded the revenue from that class, *i.e.*, the class is non-compensatory. The Commission shall review whether or not a class or a product is compensatory in the ACD. If the Commission determines that a class or a product is non-compensatory, this subpart applies.

*Section 3010.201 Individual product requirement.* For non-compensatory products, the Postal Service shall increase the rate of the product by a minimum of 2 percentage points above the percentage increase of the class that includes the non-compensatory product. Rates for the compensatory products in the class shall be adjusted accordingly. This section does not create additional rate adjustment authority for the class.

*Section 3010.202 Class requirement and additional class rate authority.* Paragraph (a) of proposed § 3010.202 provides 2 percentage points of

additional rate authority for non-compensatory classes. Paragraph (b) of proposed § 3010.202 prescribes rate setting criteria, which requires the Postal Service to use all available rate setting authority when adjusting rates for non-compensatory classes. This includes all CPI, supplemental, performance-based, and banked (up to the 2-percent maximum) rate authority plus the additional 2 percentage points specified in proposed § 3010.202(a). This section applies only if the Postal Service chooses to adjust rates for the non-compensatory class.

Paragraph (c) of proposed § 3010.202 prescribes that the rate authority must be applied, if at all, to the first generally applicable rate increase filed within a calendar year. The rate authority becomes effective on January 1 and lapses on December 31 if unused. If unused, or if not fully used, the unused portion may not be banked for future use. The Commission intends to also apply the no banking rule (proposed § 3010.202(c)(4)) to any attempt to circumvent the intent of this provision, such as filing a rate increase immediately followed by the filing of a rate decrease in order to create banked rate authority.

7. Section 3010, Subpart G—  
Accumulation of Unused and  
Disbursement of Banked Rate  
Adjustment Authority

*Section 3010.220 General.* This section requires the Postal Service to calculate unused rate adjustment authority, and, if applicable, revise the schedule of banked rate adjustment authority, whenever it plans to adjust rates. Limited exceptions to this rule apply, such as when the Postal Service requests review of a de minimis rate adjustment.

*Section 3010.221 Schedule of banked rate adjustment authority.* The rule currently appearing in existing § 3010.26(f), concerning the schedule of banked rate adjustment authority, is moved to proposed § 3010.221. The rule has been expanded to include a list of items that should be tracked within the schedule. The schedule should include the availability of banked rate adjustment authority (before and after filing rate adjustments), along with the sources, amounts, and dates associated with any changes to the schedule.

*Section 3010.222 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed 12 months apart or less.* The rules currently appearing in existing § 3010.26(b), concerning the calculation of unused rate adjustment authority, are moved to

proposed § 3010.222(a). The calculation is changed to reflect that the maximum rate adjustment authority may include CPI, supplemental, performance-based, and non-compensatory rate authority, whereas CPI rate authority is currently the only source of new rate adjustment authority. Otherwise, there is no intent to change the meaning or operation of the rules currently in place.

Paragraph (b) of proposed § 3010.222 imposes a requirement where a class of mail is non-compensatory. In that instance, unused rate adjustment authority cannot be generated or banked. Potential unused rate adjustment authority that may be banked is assumed to be zero. This also forecloses the possibility of banking negative rate authority in times of deflation.

Paragraph (c) of proposed § 3010.222 limits the maximum amount of unused rate adjustment authority that can be banked to the unused portion of the CPI rate authority.

*Section 3010.223 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed more than 12 months apart.* The rules currently appearing in existing § 3010.26(c), concerning the calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed more than 12 months apart, are moved to proposed § 3010.223(a) through (c). The rules are restructured to make it clear that interim rate adjustment authority must be calculated first and that amount immediately added to the bank. Then, unused rate adjustment authority may be calculated.

The material currently appearing in existing § 3010.26(c)(2), which provides the formula for calculating the interim rate adjustment authority, is moved to proposed § 3010.223(b). There is no intent to change the meaning or operation of this rule.

The rules currently appearing in existing § 3010.26(b), concerning the calculation of unused rate adjustment authority, are moved to proposed § 3010.223(c) (Note that this is essentially the same calculation as appears in proposed § 3010.222(a) above). The calculation is changed to reflect that the maximum rate adjustment authority may include CPI, supplemental, performance-based, and non-compensatory rate authority, whereas CPI rate authority is currently the only source of new rate adjustment authority. Otherwise, there is no intent to change the meaning or operation of the rules currently in place.

Paragraph (d) of proposed § 3010.222 imposes a requirement where a class of mail is non-compensatory. In that instance, unused rate adjustment authority cannot be generated or banked. Potential unused rate adjustment that may be banked is assumed to be zero. This also forecloses the possibility of banking negative rate authority in times of deflation.

Paragraph (e) of proposed § 3010.222 limits the maximum amount of unused rate adjustment authority that can be banked to the unused portion of the CPI rate authority.

*Section 3010.224 Calculation of unused rate adjustment authority for rate adjustments that only include rate decreases.* The rules currently appearing in existing § 3010.27, concerning the calculation of unused rate adjustment authority for rate adjustments that only include rate decreases, are moved to proposed § 3010.224. The calculation is changed to reflect that the maximum rate adjustment authority may include CPI, supplemental, performance-based, and non-compensatory rate authority, whereas CPI rate authority is currently the only source of new rate adjustment authority. Otherwise, there is no intent to change the meaning or operation of the rules currently in place.

Paragraph (c) in proposed § 3010.224 limits the maximum amount of unused rate adjustment authority that can be banked to the unused portion of the CPI rate authority, referenced back to the most recent rate adjustment filing that involved a rate increase.

Paragraph (f) of proposed § 3010.224 concerning possible interactions with exigent rate requests, currently appearing in existing § 3010.6(b)(2), is added to this rule.

*Section 3010.225 Application of banked rate authority.* This section explains how previously banked rate authority may be applied to a rate adjustment request. The current rule appearing in existing § 3010.25, which states that all CPI rate authority must be used before banked rate authority can be used, is moved to proposed § 3010.225(b). The rule is changed to reflect that the proposed rate adjustment authority may include CPI, supplemental, performance-based, and non-compensatory rate authority, whereas CPI rate authority is currently the only source of new rate adjustment authority. Otherwise, there is no intent to change the meaning or operation of the rule currently in place.

The rule currently appearing in existing § 3010.29, which limits use of banked rate adjustment authority to 2 percent in any 12-month period, is moved to proposed § 3010.225(c).

Direction is added to modify the schedule of banked rate adjustment authority, whenever this authority is used, as of the date of the final order accepting the rates.

The rule currently appearing in existing § 3010.26(d), which explains how interim rate authority may be used, is moved to proposed § 3010.225(d).

The rule currently appearing in existing § 3010.28, which explains that banked rate adjustment authority must be used utilizing the first-in-first-out method beginning 5 years before the filing date of the instant notice, is moved to proposed § 3010.225(e). The wording is changed for consistency with other paragraphs of this section.

The rule currently appearing in existing § 3010.26(e), which explains that banked rate adjustment authority lapses 5 years from the filing date of the request leading to its calculation, is moved to proposed § 3010.225(f).

#### 8. Section 3010, Subpart H—Rate Adjustments Due to Extraordinary and Exceptional Circumstances

The rules currently appearing in 39 CFR part 3010, subpart E (existing § 3010.60 *et seq.*), concerning exigent rate increases, are moved to 39 CFR part 3010, subpart H (proposed § 3010.240 *et seq.*). There is no intent to change the meaning or operation of the rules currently in place. However, the order in which the material appears has changed, along with some material being reorganized amongst paragraphs.

#### 9. Section 3010, Subpart I—Workshare Discounts

*Section 3010.260 Applicability.* This subpart establishes rate design criteria for workshare discounts. The percentages of avoided costs that may be passed through to a customer in the form of a workshare discount are limited, and must fall within defined bands. The percentage passed through is defined as the workshare discount offered by the Postal Service divided by the cost avoided by the Postal Service for not providing the applicable service.

*Section 3010.261 Passthrough requirement.* Two passthrough bands are established, one for Periodicals (75 to 125 percent), and one for all other classes (85 to 115 percent). Workshare passthroughs that fall within the applicable bands are accepted without further justification. Workshare passthroughs that fall outside the applicable bands, and that do not fall within one of the exceptions discussed below, are subject to return to the Postal Service for adjustment. *See* proposed § 3010.126(d).

*Section 3010.262 Exceptions for noncompliant discounts.* This section establishes a grace period of 3 years to bring existing workshare passthroughs, and newly created future, workshare passthroughs into compliance with this subpart. If the Postal Service asserts that either grace period applies, it also must submit a plan (with each request to review a notice of rate adjustment) explaining how the applicable passthrough will be brought into compliance with this subpart before the expiration of the grace period. Failure to submit a plan where it can be reasonably concluded that rates will be brought into compliance before the end of the grace period, will result in the remand of the discount. *See* proposed § 3010.126(d).

#### 10. Section 3020, Subpart G—Requests for Market Dominant Negotiated Service Agreements

Whenever a new NSA is proposed, a primary consideration is whether the agreement is properly classified as either market dominant or competitive. The starting point for considering the proper classification is the rules appearing in 39 CFR part 3020. Those rules govern the MCS and the addition, deletion, or transfer of a product to either the market dominant product list or the competitive product list. The rules currently appearing in 39 CFR part 3010, subpart D generally assist in the analysis required by 39 CFR part 3020. The remainder of the rules governing the regulation of rates appearing in 39 CFR part 3010 are generally not implicated. Thus, the rules currently appearing in existing 39 CFR part 3010, subpart D, concerning NSAs, are moved to proposed 39 CFR part 3020, subpart G.

In several instances, the rules currently appearing in 39 CFR part 3010, subpart D are duplicative of the rules appearing in 39 CFR part 3020. Moving these provisions allows for streamlining of the rules. There is no intent to change the meaning or operation of the rules currently in place. The move should clarify that a proposal to add a new NSA is to be filed pursuant to 39 CFR part 3020. Furthermore, in most instances adjustments to rates for existing NSAs require a review of the material previously provided pursuant to 39 CFR part 3020. Again, the rules governing the regulation of rates appearing in 39 CFR part 3010 are generally not implicated. Thus, requests concerning the adjustment of rates for NSAs should be filed as a contract update pursuant to 39 CFR part 3020.

*Existing § 3010.40 Negotiated service agreements.* This rule merely

repeats the statutory requirements of 39 U.S.C. 3622(c)(10) and is being deleted. This statutory requirement is effectively analyzed using the supporting material that will be provided under proposed § 3020.121.

*Existing § 3010.41 Notice.* This rule is duplicative of the notice requirements currently appearing in 39 CFR part 3020 applicable to new NSAs and is being deleted.

*Existing § 3010.44 Proceedings for type 2 rate adjustments.* Paragraph (a) of existing § 3010.44 is duplicative of the docketing and notice requirements currently appearing in 39 CFR part 3020 applicable to new NSAs and is being deleted. The requirements appearing in existing § 3010.44(b) and (c) are being incorporated into the general requirements of proposed § 3020.120.

*Section 3020.120 General.* This rule explains that the requirements of 39 CFR part 3020, subpart G, which are specific to market dominant NSAs, impose requirements in addition to those appearing elsewhere in 39 CFR part 3020, which are applicable to adding products to a product list. It also incorporates the existing requirements currently appearing in existing § 3010.44(b) and (c) as discussed above.<sup>99</sup>

*Section 3020.121 Additional supporting justification for negotiated service agreements.* The rules currently appearing in existing § 3010.42, concerning additional supporting information, are moved to proposed § 3020.121 with the following changes. The requirement for the availability of similar NSAs to similarly situated mailers, currently appearing in existing § 3010.40(c), is included in the new rule. The requirement to produce evidence that the Postal Service has provided notice at least 45 days before a new rate can go into effect, currently appearing in existing § 3010.42(c), has been deleted.

*Section 3020.122 Data collection plan and report for negotiated service agreements.* The rules currently appearing in existing § 3010.43, concerning a data collection plan, are moved to proposed § 3020.122 without change.

#### 11. Section 3050, Periodic Reporting

*Section 3050.20 Compliance and other analyses in the Postal Service's section 3652 report.* The workshare

discount provision in § 3050.20(c) has been superseded by the provisions of proposed 39 CFR part 3010, subpart I—Workshare Discounts. Paragraph (c) of existing § 3050.20 is modified by removing the phrase “discounts greater than avoided costs,” from the sentence “It shall address such matters as non-compensatory rates, discounts greater than avoided costs, and failures to achieve stated goals for on-time delivery standards.”

#### 12. Section 3055, Subpart A—Annual Reporting of Service Performance

*Section 3055.2 Contents of the annual report of service performance achievements.* Paragraph (c) of existing § 3055.2 currently requires the reporting of the applicable service standard(s) for each product. This paragraph is expanded to require the Postal Service to also provide a description of and reason for any changes to service standards, or to certify that no changes to service standards have been made, since the last report.

### V. Administrative Actions

#### A. Assignment of Public Representative

Pursuant to 39 U.S.C. 505, Richard A. Oliver shall continue to serve as an officer of the Commission (Public Representative) to represent the interests of the general public in this proceeding. *See* Order No. 3673 at 11.

#### B. Request for Comments and Reply Comments

The Commission will accept comments and reply comments concerning whether the proposed changes outlined by this rulemaking achieves the objectives in 39 U.S.C. 3622(b). Comments are due no later than March 1, 2018. Reply comments are due no later than March 30, 2018.

Commission rules require that comments (including reply comments) be filed online according to the process outlined at 39 CFR 3001.9(a), unless a waiver is obtained. Additional information regarding how to submit comments online can be found at: <http://www.prc.gov/how-to-participate>. All comments accepted will be made available on the Commission's Web site (<http://www.prc.gov>).

### VI. Ordering Paragraphs

#### It is ordered:

1. Pursuant to 39 U.S.C. 505, Richard A. Oliver shall continue to serve as an officer of the Commission (Public Representative) to represent the interests of the general public in this proceeding.

<sup>99</sup>Note that there is a requirement for the Postal Service to provide at least a 45-day notice whenever it adds, removes, or adjusts a rate applicable to an NSA. There is no similar statutory requirement governing the Commission's time for consideration of the addition, removal, or transfer of an NSA to a product list.

2. Comments regarding the proposed rulemaking are due no later than March 1, 2018.

3. Reply comments regarding the proposed rulemaking are due no later than March 30, 2018.

4. The Secretary shall arrange for publication of this order in the **Federal Register**.

By the Commission.

**Stacy L. Ruble,**  
*Secretary.*

Supplemental Views of Vice Chairman Mark Acton, Supplemental Views of Commissioner Nanci E. Langley, Commissioner Tony Hammond  
Dissenting.

Supplemental Views of Vice Chairman Mark Acton

The United States Postal Service faces tests in nearly every conceivable scenario as it, a venerable institution instrumental in the founding of our Nation, moves further into the 21st century. Many of the Postal Service's greatest challenges are not a primary result of the rates that it charges its customers and partners. Comprehensive legislative reform is best suited for brokering compromise and tailoring outcomes in this landscape where such divergent interests must coexist. The last few years have seen significant bipartisan efforts in Congress to craft such reform, and it has yet to come to fruition. The Commission does not have the ability to allow the Postal Service to re-amortize unfunded liabilities, administer employee benefits differently, change the frequency of delivery, or deliver profitable items restricted by statute. In short, there is no action the Commission can take to substitute for meaningful legislative reform, and I urge Congress to continue to work toward that goal.

The Commission, however, cannot shirk its lawful responsibility to review and, if necessary, propose and implement regulations to address flaws in the market dominant ratemaking system. If the Commission determines that the PAEA's range of objectives are not being met, the law empowers the Commission to attempt improvements via the use of one tool alone—reform to the system for regulating rates and classes for market dominant products. In other words, this singular device—the ratemaking system—may be wielded by the regulator in an effort to achieve these objectives.

The Commission, including its expert legal and technical staff, has undertaken a time and resource intensive effort to review the previous 10 years' experience under the PAEA and chart a

path forward that is responsive to its statutory duty. I have the highest regard for the Postal Service and its customers. As a Postal Rate and Postal Regulatory Commissioner, my record is replete with examples of my concern for postal customers' interests and sensitivity to rate adjustments. I look forward to hearing from the mailing community with comments that demonstrate, based on solid quantitative technical and well-supported legal analysis, how the Commission's proposal may be improved.

Mark Acton.

Supplemental Views of Commissioner Nanci E. Langley

As the Commission has recognized in its annual reports to the President and Congress, there is a tension between the restrictions of an inflation-based price cap on market dominant price increases and the objectives established in section 3622(b), in particular, the objective that the Postal Service has adequate revenues and retained earnings in order to maintain financial stability.<sup>100</sup> This instant rulemaking proposes one approach to regulating market dominant rates, which may satisfy the objectives of the PAEA. However, it is only one of many possible approaches. Interested parties, especially users of the mail, now have an opportunity to critique this approach and/or propose alternative solutions through the comment and reply comment periods.

For this reason, I approve moving forward with this rulemaking and will continue to work actively in establishing a ratemaking system that provides the necessary balance to ensure the financial viability of the Postal Service with affordable and predictable rates for ratepayers.

Nanci E. Langley.  
Dissenting Views of Commissioner Tony Hammond

I respectfully disagree with the Commission's decision to propose the changes contained in this Order because, rather than balancing all the objectives of 39 U.S.C. 3622, the proposed changes elevate the financial stability objective above the others.

As I explained in my concurring statement to Order No. 4257, the existing ratemaking system has not provided the Postal Service with

revenues adequate to maintain financial stability. However, I have also concluded that a significant portion of the Postal Service's financial instability results from an overly aggressive retiree health benefits prefunding schedule—which warrants a legislative solution—and from the Postal Service's decision in 2007 not to pursue the final cost-of-service rate increase authorized by the PAEA. Therefore, I would propose a one-time price increase that raises the Postal Service's finances to the level needed to ensure stability absent those two factors, while leaving the price cap intact for future rate adjustments.

In contrast, the changes proposed in this Order essentially constitute a return to the PRA's cost-of-service rates, but without any of the protections of the PRA framework.

The PRA afforded the Postal Service the ability to recover all its costs through price increases, but accordingly made it forgo pricing flexibility and subjected it to significant regulatory scrutiny. The PAEA freed up the Postal Service's flexibility to set prices as it sees fit. But, it also simultaneously imposed the constraint of an overall price cap to protect customers.

The changes proposed in this Order would grant the Postal Service the benefits of both systems and require of it the sacrifices of neither.

I am especially troubled by what effect these changes may have if the Postal Service's finances deteriorate in unforeseen ways. This Order is committed to price increases that deliver revenues equaling the sum of all the Postal Service's costs, whatever they may be, with additional revenues to cover long-term capital expenditures. This is a laudable goal. But, if the Postal Service's costs (particularly its structural costs) increase unexpectedly, the logic of this Order would require ever-increasing prices, even if that would drive away mail volume at a rate that could put the Postal Service out of business.

A second concern I have is the questionable regulatory complexity that this Order seeks to overlay on what has been, until now, a straightforward and pragmatic ratemaking system. For example, tying 0.75 percent of pricing authority to Commission-approved efficiency and 0.25 percent of pricing authority to Commission-approved service performance creates unnecessary regulatory hurdles.

Of course, we must go through a formal process seeking public input in order to replace the current system and this proposal is no more than a starting point. All the Commissioners agree that some change is needed to the

<sup>100</sup> Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2016, January 12, 2017, at 24; Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2015, January 6, 2016, at 22; and Postal Regulatory Commission, Annual Report to the President and Congress, Fiscal Year 2014, January 5, 2015, at 20.

ratemaking system. But, we disagree on the exact changes that would be most prudent. I look forward to comments on how to craft a balanced change, one that provides the Postal Service with a fair level of additional revenue while continuing to ensure that all of the objectives of 39 U.S.C. 3622 are met. In this regard, I note that the exigent surcharges that were in effect from 2014 to 2016 appeared not to result in any significant volume loss. Therefore, they may serve as a useful starting point for analyses.

I am hopeful that, with the input of all stakeholders, the Commission can arrive at a balanced resolution to this review process.

Tony Hammond.

#### List of Subjects

##### 39 CFR Part 3010

Administrative practice and procedure, Postal Service.

##### 39 CFR Part 3020

Administrative practice and procedure.

##### 39 CFR Part 3050

Administrative practice and procedure, Reporting and recordkeeping requirements.

##### 39 CFR Part 3055

Administrative practice and procedure, Reporting and recordkeeping requirements.

For the reasons discussed in the preamble, the Commission proposes to amend Chapter III of title 39 of the Code of Federal Regulations as follows:

#### ■ 1. Revise part 3010 to read as follows:

### PART 3010—REGULATION OF RATES FOR MARKET DOMINANT PRODUCTS

#### Subpart A—General Provisions

- Sec.
- 3010.100 Applicability.
  - 3010.101 Definitions.
  - 3010.102 Schedule for regular and predictable rate adjustments.

#### Subpart B—Rate Adjustments

- 3010.120 General.
- 3010.121 Postal Service request.
- 3010.122 Contents of a request.
- 3010.123 Supporting technical documentation.
- 3010.124 Docket and notice.
- 3010.125 Opportunity for comments.
- 3010.126 Proceedings.
- 3010.127 Maximum rate adjustment authority.
- 3010.128 Calculation of percentage change in rates.
- 3010.129 Exceptions for de minimis rate increases.

#### Subpart C—Consumer Price Index Rate Authority

- 3010.140 Applicability.
- 3010.141 CPI-U data source.
- 3010.142 CPI-U rate authority when requests are 12 or more months apart.
- 3010.143 CPI-U rate authority when requests are less than 12 months apart.

#### Subpart D—Supplemental Rate Authority

- 3010.160 Applicability.

#### Subpart E—Performance-Based Rate Authority

- 3010.180 Applicability.
- 3010.181 Operational efficiency-based rate authority.
- 3010.182 Service quality-based rate authority.

#### Subpart F—Non-compensatory Classes or Products

- 3010.200 Applicability.
- 3010.201 Individual product requirement.
- 3010.202 Class requirement and additional class rate authority.

#### Subpart G—Accumulation of Unused and Disbursement of Banked Rate Adjustment Authority

- 3010.220 General.
- 3010.221 Schedule of banked rate adjustment authority.
- 3010.222 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed 12 months apart or less.
- 3010.223 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed more than 12 months apart.
- 3010.224 Calculation of unused rate adjustment authority for rate adjustments that only include rate decreases.
- 3010.225 Application of banked rate authority.

#### Subpart H—Rate Adjustments Due to Extraordinary and Exceptional Circumstances

- 3010.240 General.
- 3010.241 Contents of a request.
- 3010.242 Supplemental information.
- 3010.243 Docket and notice.
- 3010.244 Public hearing.
- 3010.245 Opportunity for comments.
- 3010.246 Deadline for Commission decision.
- 3010.247 Treatment of banked rate adjustment authority.

#### Subpart I—Workshare Discounts

- 3010.260 Applicability.
- 3010.261 Passthrough band requirement.
- 3010.262 Exceptions for noncompliant discounts.

Authority: 39 U.S.C. 503; 3622.

#### Subpart A—General Provisions.

##### § 3010.100 Applicability.

(a) The rules in this part implement provisions in 39 U.S.C. chapter 36, subchapter I, establishing the system of ratemaking for market dominant products. These rules are applicable

whenever the Postal Service proposes to adjust a rate of general applicability for any market dominant product, which includes the addition of a new rate, the removal of an existing rate, or a change to an existing rate. Current rates may be found in the Mail Classification Schedule appearing on the Commission's Web site at [www.prc.gov](http://www.prc.gov).

(b) Rates may be adjusted either subject to the rules appearing in subpart B of this part, which includes a limitation on rate increases, or subject to the rules appearing in subpart H of this part, which does not include a limitation on rate increases, but requires either extraordinary or exceptional circumstances. The rules applicable to the calculation of the limitations on rate increases appear in subparts C through G of this part. The rules for workshare discounts, which are applicable whenever market dominant rates are adjusted, appear in subpart I of this part.

##### § 3010.101 Definitions.

(a) The definitions in paragraphs (b) through (k) of this section apply in this part.

(b) “Annual limitation” means the annual limitation on the percentage change in rates equal to the change in the Consumer Price Index for all Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files a request to review rate adjustments as determined by the Commission.

(c) “Banked rate authority” means unused rate adjustment authority accumulated for future use pursuant to these rules.

(d) A “class” of mail means the First-Class Mail, USPS Marketing Mail, Periodicals, Package Services, or Special Services groupings of market dominant Postal Service products or services. Generally, the regulations in this part are applicable to individual classes of mail.

(e) “Maximum rate adjustment authority” means the maximum percentage change in rates available to a class for any planned increase in rates. It is based upon the consumer price index rate authority, and any available supplemental rate authority, banked rate authority, performance-based rate authority, and rate authority applicable to non-compensatory classes.

(f) “Performance-based rate authority” means rate authority which is available to all classes where the Postal Service meets or exceeds operational efficiency-based standards or adheres to service quality-related criteria as determined in the most recent Annual Compliance Determination.

(g) “Rate authority applicable to non-compensatory classes” means rate authority available to classes where revenue was insufficient to cover attributable costs as determined in the most recent Annual Compliance Determination.

(h) “Rate cell” means each and every separate rate identified in any planned rate adjustment for rates of general applicability.

(i) “Rate incentive” means a discount that is not a workshare discount and that is designed to increase or retain volume, improve the value of mail for mailers, or improve the operations of the Postal Service.

(j) “Rate of general applicability” means a rate applicable to all mail meeting standards established by the Mail Classification Schedule, the Domestic Mail Manual, and the International Mail Manual. A rate is not a rate of general applicability if eligibility for the rate is dependent on factors other than the characteristics of the mail to which the rate applies. A rate is not a rate of general applicability if it benefits a single mailer. A rate that is only available upon the written agreement of both the Postal Service and a mailer, a group of mailers, or a foreign postal operator is not a rate of general applicability.

(k) A “seasonal or temporary rate” is a rate that is in effect for a limited and defined period of time.

**§ 3010.102 Schedule for regular and predictable rate adjustments.**

(a) The Postal Service shall develop a Schedule for Regular and Predictable Rate Adjustments applicable to rate adjustments subject to this part. The Schedule for Regular and Predictable Rate Adjustments shall:

(1) Schedule rate adjustments at specific regular intervals,  
 (2) provide estimated filing and implementation dates (month and year) for future rate adjustments for each class of mail expected over a minimum of the next 3 years, and

(3) provide an explanation that will allow mailers to predict with reasonable accuracy, by class, the amounts of future scheduled rate adjustments.

(b) The Postal Service shall file a current Schedule for Regular and Predictable Rate Adjustments annually with the Commission at the time it files its Annual Compliance Determination Report pursuant to 39 U.S.C. 3652. The Commission shall post the current schedule on the Commission’s Web site at [www.prc.gov](http://www.prc.gov).

(c) Whenever the Postal Service deems it appropriate to change the Schedule for Regular and Predictable

Rate Adjustments, it shall file a revised schedule.

(d) The Postal Service may vary the magnitude of rate adjustments from those estimated by the Schedule for Regular and Predictable Rate Adjustments. In such case, the Postal Service shall provide an explanation for such variation with its rate adjustment filing.

**Subpart B—Rate Adjustments**

**§ 3010.120 General.**

This subpart describes the process for the periodic adjustment of rates subject to the percentage limitations specified in § 3010.127 which are applicable to each class of mail.

**§ 3010.121 Postal Service request.**

(a) In every instance in which the Postal Service determines to exercise its statutory authority to adjust rates for a class of mail, the Postal Service shall comply with the requirements specified in paragraphs (b) through (d) of this section.

(b) The Postal Service shall take into consideration how the planned rate adjustments are designed to help achieve the objectives listed in 39 U.S.C. 3622(b) and take into account the factors listed in 39 U.S.C. 3622(c).

(c) The Postal Service shall provide public notice of its request and planned rates in a manner reasonably designed to inform the mailing community and the general public that it intends to adjust rates no later than 90 days prior to the intended implementation date of the rate adjustment.

(d) The Postal Service shall transmit a request to review its notice of rate adjustment to the Commission no later than 90 days prior to the intended implementation date of the rate adjustment.

**§ 3010.122 Contents of a request.**

(a) The request shall include the items specified in paragraphs (b) through (j) of this section.

(b) A representation or evidence that public notice of the planned changes has been issued or will be issued at least 90 days before the effective date(s) for the planned rates.

(c) The intended effective date(s) of the planned rates.

(d) A schedule of the planned rates, including a schedule identifying every change to the Mail Classification Schedule that will be necessary to implement the planned rate adjustments.

(e) The identity of a responsible Postal Service official who will be available to provide prompt responses to requests for clarification from the Commission.

(f) The supporting technical documentation as described in § 3010.123.

(g) A demonstration that the planned rate adjustments are consistent with 39 U.S.C. 3626, 3627, and 3629.

(h) A certification that all cost, avoided cost, volume, and revenue figures submitted with the request are developed from the most recent applicable Commission approved analytical principles.

(i) For a rate adjustment that only includes a decrease in rates, a statement of whether the Postal Service elects to generate unused rate adjustment authority.

(j) Such other information as the Postal Service believes will assist the Commission to issue a timely determination of whether the planned rate adjustments are consistent with applicable statutory policies.

**§ 3010.123 Supporting technical documentation.**

(a) Supporting technical documentation shall include the items specified in paragraphs (b) through (j) of this section, as applicable to the specific request. This information must be supported by workpapers in which all calculations are shown and all relevant values (*e.g.*, rates, CPI-U values, billing determinants) are identified with citations to original sources. The information must be submitted in machine readable, electronic format. Spreadsheet cells must be linked to underlying data sources or calculations (not hard coded), as appropriate.

(b) The maximum rate adjustment authority, by class, as summarized by § 3010.127 and calculated separately for each of subparts C through G of this part, as appropriate.

(c) A schedule showing the banked rate adjustment authority available, by class, and the available amount for each of the preceding 5 years calculated as required by subpart G of this part.

(d) The calculation of the percentage change in rates, by class, calculated as required by § 3010.128.

(e) The amount of new unused rate adjustment authority, by class, if any, that will be generated by the rate adjustment calculated as required by subpart G of this part, as applicable.

(f) A schedule of the workshare discounts included with the planned rates, and a companion schedule listing the avoided costs that underlie each such discount.

(g) Whenever the Postal Service establishes a new workshare discount rate, it must include with its filing:

(1) A statement explaining its reasons for establishing the discount;

(2) All data, economic analyses, and other information relied on to justify the discount; and

(3) A certification based on comprehensive, competent analyses that the discount will not adversely affect either the rates or the service levels of users of postal services who do not take advantage of the discount.

(h) Whenever the Postal Service establishes a new discount or surcharge rate it does not view as creating a workshare discount, it must include with its filing:

(1) An explanation of the basis for its view that the discount or surcharge rate is not a workshare discount; and

(2) A certification that the Postal Service applied approved analytical principles to the discount or surcharge rate.

(i) Whenever the Postal Service includes a rate incentive with its planned rate adjustment, it must include with its filing:

(1) If the rate incentive is a rate of general applicability, sufficient information to demonstrate that the rate incentive is a rate of general applicability; and

(2) A statement of whether the Postal Service has excluded the rate incentive from the calculation of the percentage change in rates under § 3010.128.

(j) For each class or product where the attributable cost for that class or product exceeded the revenue from that class or product as determined by the most recent Annual Compliance Determination issued pursuant to 39 U.S.C. 3653, a demonstration that the planned rates comply with the requirements in subpart F of this part.

#### § 3010.124 Docket and notice.

(a) The Commission will establish a docket for each rate adjustment filed by the Postal Service, promptly publish notice of the filing in the **Federal Register**, and post the filing on its Web site. The notice shall include the items specified in paragraphs (b) through (g) of this section.

(b) The general nature of the proceeding.

(c) A reference to legal authority under which the proceeding is to be conducted.

(d) A concise description of the planned changes in rates, fees, and the Mail Classification Schedule.

(e) The identification of an officer of the Commission to represent the interests of the general public in the docket.

(f) A period of 30 days from the date of the filing for public comment.

(g) Such other information as the Commission deems appropriate.

#### § 3010.125 Opportunity for comments.

Public comments should focus on whether planned rate adjustments comport with applicable statutory and regulatory requirements.

#### § 3010.126 Proceedings.

(a) If the Commission determines that the request does not substantially comply with the requirements of §§ 3010.122 and 3010.123, the Commission may:

(1) Inform the Postal Service of the deficiencies and provide an opportunity for the Postal Service to take corrective action;

(2) Toll or otherwise modify the procedural schedule until such time the Postal Service takes corrective action;

(3) Dismiss the request without prejudice; or

(4) Take other action as deemed appropriate by the Commission.

(b) Within 21 days of the conclusion of the public comment period the Commission will determine, at a minimum, whether the planned rate adjustments are consistent with applicable law, *e.g.*, the maximum rate adjustment authority as summarized by § 3010.127, and calculated pursuant to subparts C through G of this part, as applicable, the non-compensatory classes and products requirements pursuant to subpart F of this part, the workshare discount limitations pursuant to subpart I of this part, and 39 U.S.C. 3626, 3627, and 3629, and issue an order announcing its findings.

(c) If the planned rate adjustments are found consistent with applicable law, they may take effect.

(d) If planned rate adjustments are found inconsistent with applicable law, the Commission will notify and require the Postal Service to respond to any issues of noncompliance.

(e) Following the Commission's notice of noncompliance, the Postal Service may submit an amended request that describes the modifications to its planned rate adjustments that will bring its rate adjustments into compliance. An amended request shall be accompanied by sufficient explanatory information to show that all deficiencies identified by the Commission have been corrected.

(f) The Commission will allow a period of 10 days from the date of the filing of an amended request for public comment.

(g) The Commission will review the amended request together with any comments filed for compliance and within 21 days issue an order announcing its findings.

(h) If the planned rate adjustments as amended are found to be consistent with applicable law, they may take

effect. However, no amended rate shall take effect until 45 days after the Postal Service files its request specifying that rate.

(i) If the planned rate adjustments in an amended request are found to be inconsistent with applicable law, the Commission shall explain the basis of its determination and suggest an appropriate remedy. Noncompliant rates may not go into effect.

(j) A Commission finding that a planned rate adjustment is in compliance with the maximum rate adjustment authority as summarized by § 3010.127 and calculated pursuant to subparts C through G of this part, as applicable, the workshare discount limitations pursuant to subpart I of this part, and 39 U.S.C. 3626, 3627, and 3629 is decided on the merits. A Commission finding that a planned rate adjustment does not contravene other policies of 39 U.S.C. chapter 36, subchapter I is provisional and subject to subsequent review.

#### § 3010.127 Maximum rate adjustment authority.

(a) The maximum rate adjustment authority available to the Postal Service for each class of market dominant mail is limited to the sum of the percentage points developed in:

(1) Subpart C—Consumer Price Index Rate Authority;

(2) Subpart D—Supplemental Rate Authority;

(3) Subpart E—Performance-Based Rate Authority;

(4) Subpart F—Non-compensatory Classes or Products; and

(5) Subpart G—Accumulation of Unused and Disbursement of Banked Rate Adjustment Authority.

(b) For any product where the attributable cost for that product exceeded the revenue from that product as determined in the most recent Annual Compliance Determination, rates may not be reduced.

#### § 3010.128 Calculation of percentage change in rates.

(a) For the purpose of calculating the percentage change in rates, the current rate is the rate in effect when the Postal Service files the request with the following exceptions.

(1) A seasonal or temporary rate shall be identified and treated as a rate cell separate and distinct from the corresponding non-seasonal or permanent rate. When used with respect to a seasonal or temporary rate, the current rate is the most recent rate in effect for the rate cell, regardless of whether the seasonal or temporary rate is available at the time the Postal Service files the request.

(2) When used with respect to a rate cell that corresponds to a rate incentive that was previously excluded from the calculation of the percentage change in rates, the current rate is the full undiscounted rate in effect for the rate cell at the time of the filing of the request, not the discounted rate in effect for the rate cell at such time.

(b) For the purpose of calculating the percentage change in rates, the volumes for each rate cell shall be obtained from the most recent available 12 months of Postal Service billing determinants with the following permissible adjustments.

(1) The Postal Service shall make reasonable adjustments to the billing determinants to account for the effects of classification changes such as the introduction, deletion, or redefinition of rate cells. The Postal Service shall identify and explain all adjustments. All information and calculations relied upon to develop the adjustments shall be provided together with an explanation of why the adjustments are appropriate.

(2) Whenever possible, adjustments shall be based on known mail characteristics or historical volume data, as opposed to forecasts of mailer behavior.

(3) For an adjustment accounting for the effects of the deletion of a rate cell when an alternate rate cell is not available, the Postal Service should adjust the billing determinants associated with the rate cell to zero. If the Postal Service does not adjust the billing determinants for the rate cell to zero, the Postal Service shall include a rationale for its treatment of the rate cell with the information required under paragraph (b)(1) of this section.

(c) For a rate adjustment that involves a rate increase, for each class of mail and product within the class, the percentage change in rates is calculated in three steps. First, the volume of each rate cell in the class is multiplied by the planned rate for the respective cell and the resulting products are summed.

Second, the same set of rate cell volumes are multiplied by the corresponding current rate for each cell and the resulting products are summed. Third, the percentage change in rates is calculated by dividing the results of the first step by the results of the second step and subtracting 1 from the quotient. The result is expressed as a percentage.

(d) For rate adjustments that only involve a rate decrease, for each class of mail and product within the class, the percentage change in rates is calculated by amending the workpapers attached to the Commission's order relating to the most recent request to adjust rates that involved a rate increase to replace the

planned rates under the most recent request that involves a rate increase with the corresponding planned rates applicable to the class from the request involving only a rate decrease.

(e) The formula for calculating the percentage change in rates for a class described in paragraph (c) of this section is as follows:

Percentage change in rates =

$$\left( \sum_{i=1}^N (R_{i,n})(V_i) / \sum_{i=1}^N (R_{i,c})(V_i) \right) - 1$$

Where:

N = number of rate cells in the class

i = denotes a rate cell (i = 1, 2, . . . , N)

R<sub>i,n</sub> = planned rate of rate cell i

R<sub>i,c</sub> = current rate of rate cell i (for rate adjustment involving a rate increase) or rate from most recent rate adjustment involving a rate increase for rate cell i (for a rate adjustment only involving a rate decrease)

V<sub>i</sub> = volume of rate cell i

(f) Treatment of rate incentives.

(1) Rate incentives may be excluded from a percentage change in rates calculation. If the Postal Service elects to exclude a rate incentive from a percentage change in rates calculation, the rate incentive shall be treated in the same manner as a rate under a negotiated service agreement (as described in § 3010.128(g)).

(2) A rate incentive may be included in a percentage change in rates calculation if it meets the following criteria:

(i) The rate incentive is in the form of a discount or can be easily translated into a discount;

(ii) Sufficient billing determinants are available for the rate incentive to be included in the percentage change in rate calculation for the class, which may be adjusted based on known mail characteristics or historical volume data (as opposed to forecasts of mailer behavior); and

(iii) The rate incentive is a rate of general applicability.

(g) Treatment of volume associated with negotiated service agreements and rate incentives that are not rates of general applicability.

(1) Mail volumes sent at rates under a negotiated service agreement or a rate incentive that is not a rate of general applicability are to be included in the calculation of percentage change in rates under this section as though they paid the appropriate rates of general applicability. Where it is impractical to identify the rates of general applicability (e.g., because unique rate categories are created for a mailer), the volumes associated with the mail sent under the terms of the negotiated service

agreement or the rate incentive that is not a rate of general applicability shall be excluded from the calculation of percentage change in rates.

(2) The Postal Service shall identify and explain all assumptions it makes with respect to the treatment of negotiated service agreements and rate incentives that are not rates of general applicability in the calculation of the percentage change in rates and provide the rationale for its assumptions.

#### § 3010.129 Exceptions for de minimis rate increases.

(a) The Postal Service may request review of a de minimis rate increase without immediately calculating the maximum rate adjustment authority or banking unused rate adjustment authority. For this exception to apply, requests to review de minimis rate adjustments must be filed separately from any other request to adjust rates.

(b) Rate adjustments resulting in rate increases are de minimis if:

(1) For each affected class, the rate increases do not result in the percentage change in rates for the class equaling or exceeding 0.001 percent; and

(2) For each affected class, the sum of all rate increases included in de minimis rate increases since the most recent rate adjustment resulting in a rate increase, or the most recent rate adjustment due to extraordinary and exceptional circumstances, that was not a de minimis rate increase does not result in the percentage change in rates for the class equaling or exceeding 0.001 percent.

(c) If the rate adjustments are de minimis, no unused rate adjustment authority will be added to the schedule of banked rate adjustment authority maintained under subpart G of this part as a result of the de minimis rate increase.

(d) If the rate adjustments are de minimis, no rate decreases may be taken into account when determining whether rate increases comply with paragraphs (b)(1) and (2) of this section.

(e) In the next request proposing to increase rates for a class that is not a de minimis rate increase:

(1) The maximum rate adjustment authority shall be calculated as if the de minimis rate increase had not been filed; and

(2) For purposes of calculating the percentage change in rates, the current rate shall be the current rate from the de minimis rate increase.

(f) The Postal Service shall file supporting workpapers with each request to review a de minimis rate increase that demonstrate that the sum of all rate increases included in de

minimis rate increases since the most recent rate adjustment resulting in a rate increase that was not de minimis, or the most recent rate adjustment due to extraordinary and exceptional circumstances, does not result in a percentage change in rates for the class equaling or exceeding 0.001 percent.

(g) For any product where the attributable cost for that product exceeded the revenue from that product as determined in the most recent Annual Compliance Determination, rates may not be reduced.

### Subpart C—Consumer Price Index Rate Authority

#### § 3010.140 Applicability.

The Postal Service may adjust rates based upon changes in the consumer price index identified in § 3010.141. If requests involving rate increases are filed 12 or more months apart, rate adjustments are subject to a full year limitation calculated pursuant to § 3010.142. If requests involving rate increases are filed less than 12 months apart, rate adjustments are subject to a partial year limitation calculated pursuant to § 3010.143.

#### § 3010.141 CPI-U data source.

The monthly CPI-U values needed for the calculation of rate adjustment limitations under this section shall be obtained from the Bureau of Labor Statistics (BLS) Consumer Price Index—All Urban Consumers, U.S. All Items, Not Seasonally Adjusted, Base Period 1982–84 = 100. The current Series ID for the index is “CUUR0000SA0.”

#### § 3010.142 CPI-U rate authority when requests are 12 or more months apart.

(a) If a request involving a rate increase is filed 12 or more months after the most recent request involving a rate increase, then the calculation of an annual limitation for the class (full year limitation) involves three steps. First, a simple average CPI-U index is calculated by summing the most recently available 12 monthly CPI-U values from the date the Postal Service files its request and dividing the sum by 12 (Recent Average). Second, a second simple average CPI-U index is similarly calculated by summing the 12 monthly CPI-U values immediately preceding the Recent Average and dividing the sum by 12 (Base Average). Third, the full year limitation is calculated by dividing the Recent Average by the Base Average and subtracting 1 from the quotient. The result is expressed as a percentage, rounded to three decimal places.

(b) The formula for calculating a full year limitation for a request filed 12 or

more months after the last request is as follows: Full Year Limitation = (Recent Average/Base Average) – 1.

#### § 3010.143 CPI-U rate authority when requests are less than 12 months apart.

(a) If a request involving a rate increase is filed less than 12 months after the most recent request involving a rate increase, then the annual limitation for the class (partial year limitation) will recognize the rate increases that have occurred during the preceding 12 months. When the effects of those increases are removed, the remaining partial year limitation is the applicable restriction on rate increases.

(b) The applicable partial year limitation is calculated in two steps. First, a simple average CPI-U index is calculated by summing the 12 most recently available monthly CPI-U values from the date the Postal Service files its request and dividing the sum by 12 (Recent Average). Second, the partial year limitation is then calculated by dividing the Recent Average by the Recent Average from the most recent previous request (Previous Recent Average) applicable to each affected class of mail and subtracting 1 from the quotient. The result is expressed as a percentage, rounded to three decimal places.

(c) The formula for calculating the partial year limitation for a request filed less than 12 months after the last request is as follows: Partial Year Limitation = (Recent Average/Previous Recent Average) – 1.

### Subpart D—Supplemental Rate Authority

#### § 3010.160 Applicability.

(a) This subpart allocates supplemental rate authority of 2 percentage points per class per annum. The rate authority provided in this subpart is available in each of the first 5 full calendar years following the effective date of these rules.

(b) Any rate authority allocated under this subpart:

(1) Shall be made available to the Postal Service as of January 1 of each calendar year;

(2) Must be included in the calculation of the maximum rate adjustment authority in the first generally applicable rate adjustment filed in any calendar year;

(3) Shall lapse if not used in the first generally applicable rate adjustment filed in any calendar year;

(4) Shall lapse if unused, on December 31 of the applicable calendar year; and

(5) May not be used to generate unused rate authority, nor shall it affect existing banked rate authority.

### Subpart E—Performance-Based Rate Authority

#### § 3010.180 Applicability.

(a) This subpart allocates performance-based rate authority of up to 1 percentage point for each class of mail, which is available upon meeting or exceeding an operational efficiency-based standard and adhering to service quality-related criteria as determined by the most recent Annual Compliance Determination issued pursuant to 39 U.S.C. 3653. Of this rate authority, 0.75 percentage points is allocated based on meeting the operational efficiency-based rate authority requirements appearing in § 3010.181. Of this rate authority, 0.25 percentage points is allocated based on meeting the service quality-based rate authority requirements appearing in § 3010.182.

(b) Any rate authority allocated under this subpart:

(1) Shall be made available to the Postal Service as of January 1 of each calendar year as determined by the most recent Annual Compliance Determination;

(2) Must be included in the calculation of the maximum rate adjustment authority in the first generally applicable rate adjustment filed in any calendar year;

(3) Shall lapse if not used in the first generally applicable rate adjustment filed in any calendar year;

(4) Shall lapse if unused, on December 31 of the applicable calendar year; and

(5) May not be used to generate unused rate authority, nor shall it affect existing banked rate authority.

#### § 3010.181 Operational efficiency-based rate authority.

Operational efficiency-based rate authority shall be allocated for each class of mail if the Postal Service's average annual total factor productivity growth over the most recent 5 years meets or exceeds 0.6 percent as determined by the most recent Annual Compliance Determination issued pursuant to 39 U.S.C. 3653.

#### § 3010.182 Service quality-based rate authority.

(a) Service quality-based rate authority shall be allocated for a class of mail if all of the Postal Service's service standards (including applicable business rules) for that class during the applicable fiscal year meet or exceed the service standards in place for the prior fiscal year on a nationwide or

substantially nationwide basis as determined by the most recent Annual Compliance Determination issued pursuant to 39 U.S.C. 3653.

(b) Any interested person may file a challenge to the Commission's determination to allocate service quality-based rate authority within 30 days of the Commission issuing the Annual Compliance Determination. The scope of such a challenge shall be limited to whether or not the Postal Service's service standards (including applicable business rules) during the applicable fiscal year met or exceeded the service standards in place for the prior fiscal year on a nationwide or substantially nationwide basis. The Commission shall issue an order which rules on any challenge within 60 days of the filing of the challenge. The order shall specify how much, if any, service quality-based rate authority is authorized for the upcoming calendar year.

#### **Subpart F—Non-Compensatory Classes or Products**

##### **§ 3010.200 Applicability.**

This subpart is applicable to a class or product where the attributable cost for that class or product exceeded the revenue from that class or product as determined by the most recent Annual Compliance Determination issued pursuant to 39 U.S.C. 3653. Section 3010.201 is applicable where the attributable cost for a product within a class, exceeded the revenue from that particular product. Section 3010.202 is applicable where the attributable cost for an entire class exceeded the revenue from that class.

##### **§ 3010.201 Individual product requirement.**

Whenever the Postal Service files a request affecting a class of mail which includes a product where the attributable cost for that product exceeded the revenue from that product, as determined by the most recent Annual Compliance Determination issued pursuant to 39 U.S.C. 3653, the Postal Service shall increase the rates for that product by a minimum of 2 percentage points above the percentage increase for that class. This section does not create additional rate authority applicable to any class of mail.

##### **§ 3010.202 Class requirement and additional class rate authority.**

(a) This section provides 2 percentage points of additional rate authority for any class of mail where the attributable cost for that class exceeded the revenue from that class as determined by the most recent Annual Compliance

Determination issued pursuant to 39 U.S.C. 3653.

(b) When the Postal Service files the first generally applicable rate adjustment in any calendar year affecting a class of mail where the attributable cost for that class exceeded the revenue from that class, the Postal Service must use all available rate authority, including consumer price index rate authority, supplemental rate authority, performance-based rate authority and banked rate authority, plus an additional 2 percentage points.

(c) Any rate authority allocated under this subpart:

(1) Shall be made available to the Postal Service as of January 1 of each calendar year as determined by the most recent Annual Compliance Determination;

(2) Must be included in the calculation of the maximum rate adjustment authority change in rates in the first generally applicable rate adjustment filed in any calendar year;

(3) Shall lapse if unused, on December 31 of the applicable calendar year; and

(4) May not be used to generate unused rate authority, nor shall it affect existing banked rate authority.

#### **Subpart G—Accumulation of Unused and Disbursement of Banked Rate Adjustment Authority**

##### **§ 3010.220 General.**

Unless a specific exception applies, unused rate adjustment authority, on a class-by-class basis, shall be calculated for each request filed by the Postal Service. Unused rate adjustment authority shall be added to the schedule of banked rate authority in each instance, and be available for application to rate adjustments pursuant to the requirements of this subpart.

##### **§ 3010.221 Schedule of banked rate adjustment authority.**

Upon the establishment of unused rate adjustment authority, the Postal Service shall devise and maintain a schedule that tracks the establishment and subsequent use of banked rate authority on a class-by-class basis. At a minimum, the schedule must track the amount of banked rate authority available immediately prior to the filing of a request and the amount of banked rate authority available upon acceptance of the rates included in the request. It shall also track all changes to the schedule, including the docket numbers of Commission decisions affecting the schedule, the dates and amounts that any rate authority was generated or subsequently expended, and the

expiration dates of all rate adjustment authority. The schedule shall be included with any request purporting to modify the amount of banked rate adjustment authority.

##### **§ 3010.222 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed 12 months apart or less.**

(a) When requests that involve a rate increase are filed 12 months apart or less, unused rate adjustment authority for a class is equal to the difference between the maximum rate adjustment authority as summarized by § 3010.127 and calculated pursuant to subparts C through G of this part, as appropriate, and the percentage change in rates for the class calculated pursuant to § 3010.128, subject to the limitations described in paragraphs (b) and (c) of this section.

(b) Unused rate adjustment authority cannot be generated and is assumed to be 0 percent for classes subject to § 3010.202. Class requirement and additional class rate authority.

(c) For requests that involve a rate increase, unused rate adjustment authority cannot exceed the unused portion of rate authority determined pursuant to subpart C of this part, Consumer Price Index Rate Authority.

##### **§ 3010.223 Calculation of unused rate adjustment authority for rate adjustments that involve a rate increase which are filed more than 12 months apart.**

(a) When requests that involve a rate increase are filed more than 12 months apart, any interim rate adjustment authority must first be added to the schedule of banked rate authority before the unused rate adjustment authority is calculated.

(b) Interim rate adjustment authority for a class is equal to the Base Average applicable to the second request (as developed pursuant to § 3010.142) divided by the Recent Average utilized in the first request (as developed pursuant to § 3010.142) and subtracting 1 from the quotient. The result is expressed as a percentage and immediately added to the schedule of banked rate authority as of the date the request is filed.

(c) Unused rate adjustment authority for a class is equal to the difference between the maximum rate adjustment authority as summarized by § 3010.127 and calculated pursuant to subparts C through G of this part, as appropriate, and the percentage change in rates for the class calculated pursuant to § 3010.128, subject to the limitations described in paragraphs (d) and (e) of this section.

(d) Unused rate adjustment authority cannot be generated and is assumed to be 0 percent for classes subject to § 3010.202, Class requirement and additional class rate authority.

(e) For requests that involve a rate increase, unused rate adjustment authority cannot exceed the unused portion of rate authority determined pursuant to subpart C of this part, Consumer Price Index Rate Authority.

**§ 3010.224 Calculation of unused rate adjustment authority for rate adjustments that only include rate decreases.**

(a) For requests that only include rate decreases, unused rate adjustment authority for a class is calculated in two steps. First, the difference between the maximum rate adjustment authority as summarized by § 3010.127 and calculated pursuant to subparts C through G of this part, as appropriate for the most recent rate adjustment that involves a rate increase and the percentage change in rates for the class calculated pursuant to § 3010.128(d) is calculated. Second, the unused rate adjustment authority generated in the most recent rate adjustment that involves a rate increase is subtracted from that result.

(b) Unused rate adjustment authority generated under paragraph (a) of this section for a class shall be added to the unused rate adjustment authority generated in the most recent rate adjustment that involves a rate increase on the schedule maintained under § 3010.221. For purposes of § 3010.224, the unused rate adjustment authority generated under paragraph (a) of this section for a class shall be deemed to have been added to the schedule maintained under § 3010.221 on the same date as the most recent request that involves a rate increase.

(c) For requests that only include rate decreases, the sum of unused rate adjustment authority generated under paragraph (a) of this section and the unused rate adjustment authority generated in the most recent rate adjustment that involves a rate increase cannot exceed the unused portion of rate adjustment authority determined pursuant to subpart C of this part, Rate Authority Based Upon Consumer Price Index in the most recent rate adjustment that involves a rate increase.

(d) Unused rate adjustment authority generated under paragraph (a) of this section shall be subject to the limitation under § 3010.225, regardless of whether it is used alone or in combination with other existing unused rate adjustment authority.

(e) For requests that only include rate decreases, unused rate adjustment

authority generated under this section lapses 5 years from the date of filing of the most recent request that involves a rate increase.

(f) A request that only includes rate decreases that is filed immediately after a rate adjustment due to extraordinary or exceptional circumstances (*i.e.*, without an intervening rate adjustment involving a rate increase) may not generate unused rate adjustment authority.

**§ 3010.225 Application of banked rate authority.**

(a) Banked rate authority may be applied to any planned rate adjustment subject to the limitations appearing in (b) through (f) of this section.

(b) Banked rate authority may only be applied to a proposal to adjust rates after applying rate authority based upon the consumer price index pursuant to subpart C of this part, supplemental rate authority subject to subpart D of this part, the performance-based rate authority pursuant to subpart E of this part, and the rate authority applicable to non-compensatory classes pursuant to subpart F of this part.

(c) A maximum of 2 percentage points of banked rate authority may be applied to a rate adjustment for any class in any 12-month period. If banked rate authority is used, it shall be subtracted from the schedule of banked rate adjustment authority as of the date of the final order accepting the rates.

(d) Subject to (b) and (c) of this section, interim rate adjustment authority may be used to make a rate adjustment pursuant to the request that led to its calculation. If interim rate adjustment authority is used to make such a rate adjustment, the interim rate adjustment authority generated pursuant to the request shall first be added to the schedule of banked rate adjustment authority pursuant to § 3010.221 as the most recent entry. Then, any interim rate adjustment authority used in accordance with this paragraph shall be subtracted from the existing banked rate adjustment authority using a first-in, first-out (FIFO) method, beginning 5 years before the instant request.

(e) Banked rate authority for a class must be applied, using a first-in, first-out (FIFO) method, beginning 5 years before the instant request.

(f) Banked rate adjustment authority calculated under this section shall lapse 5 years from the date of filing of the request leading to its calculation.

**Subpart H—Rate Adjustments Due to Extraordinary and Exceptional Circumstances**

**§ 3010.240 General.**

The Postal Service may request to adjust rates for market dominant products due to extraordinary or exceptional circumstances pursuant to 39 U.S.C. 3622(d)(1)(E). The rate adjustments are not subject to rate adjustment limitations or the restrictions on the use of unused rate adjustment authority. The rate adjustment request may not include material classification changes. The request is subject to public participation and Commission review within 90 days.

**§ 3010.241 Contents of a request.**

(a) Each exigent request shall include the items specified in paragraphs (b) through (i) of this section.

(b) A schedule of the planned rates.

(c) Calculations quantifying the increase for each affected product and class.

(d) A full discussion of the extraordinary or exceptional circumstances giving rise to the request, and a complete explanation of how both the requested overall increase and the specific rate adjustments requested relate to those circumstances.

(e) A full discussion of why the requested rate adjustments are 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.

(f) A full discussion of why the requested rate adjustments are reasonable and equitable as among types of users of market dominant products.

(g) An explanation of when, or under what circumstances, the Postal Service expects to be able to rescind the exigent rate adjustments in whole or in part.

(h) An analysis of the circumstances giving rise to the exigent request, which should, if applicable, include a discussion of whether the circumstances were foreseeable or could have been avoided by reasonable prior action.

(i) Such other information as the Postal Service believes will assist the Commission to issue a timely determination of whether the requested rate adjustments are consistent with applicable statutory policies.

**§ 3010.242 Supplemental information.**

The Commission may require the Postal Service to provide clarification of its request or to provide additional information in order to gain a better understanding of the circumstances

leading to the request or the justification for the specific rate adjustments requested. The Postal Service shall include within its request the identification of one or more knowledgeable Postal Service official(s) who will be available to provide prompt responses to Commission requests for clarification or additional information.

**§ 3010.243 Docket and notice.**

(a) The Commission will establish a docket for each request to adjust rates due to extraordinary or exceptional circumstances, publish notice of the request in the **Federal Register**, and post the filing on its Web site. The notice shall include the items specified in paragraphs (b) through (g) of this section.

(b) The general nature of the proceeding.

(c) A reference to legal authority under which the proceeding is to be conducted.

(d) A concise description of the proposals for changes in rates, fees, and the Mail Classification Schedule.

(e) The identification of an officer of the Commission to represent the interests of the general public in the docket.

(f) A specified period for public comment.

(g) Such other information as the Commission deems appropriate.

**§ 3010.244 Public hearing.**

(a) The Commission will hold a public hearing on the Postal Service request. During the public hearing, responsible Postal Service officials will appear and respond under oath to questions from the Commissioners or their designees addressing previously identified aspects of the Postal Service's request and supporting information.

(b) Interested persons will be given an opportunity to submit to the Commission suggested relevant questions that might be posed during the public hearing. Such questions, and any explanatory materials submitted to clarify the purpose of the questions, should be filed in accordance with § 3001.9 of this chapter, and will become part of the administrative record of the proceeding.

(c) The timing and length of the public hearing will depend on the nature of the circumstances giving rise to the request and the clarity and completeness of the supporting materials provided with the request.

(d) If the Postal Service is unable to provide adequate explanations during the public hearing, supplementary written or oral responses may be required.

**§ 3010.245 Opportunity for comments.**

(a) Following the conclusion of the public hearings and submission of any supplementary materials, interested persons will be given the opportunity to submit written comments on:

(1) The sufficiency of the justification for an exigent rate adjustment;

(2) The adequacy of the justification for adjustments in the amounts requested by the Postal Service; and

(3) Whether the specific rate adjustments requested are reasonable and equitable.

(b) An opportunity to submit written reply comments will be given to the Postal Service and other interested persons.

**§ 3010.246 Deadline for Commission decision.**

Requests under this subpart seek rate relief required by extraordinary or exceptional circumstances and will be treated with expedition at every stage. It is Commission policy to provide appropriate relief as quickly as possible consistent with statutory requirements and procedural fairness. The Commission will act expeditiously on the Postal Service request, taking into account all written comments. In every instance a Commission decision will be issued within 90 days of the filing of an exigent request.

**§ 3010.247 Treatment of banked rate adjustment authority.**

(a) Each request will identify the banked rate adjustment authority available as of the date of the request for each class of mail and the available amount for each of the preceding 5 years.

(b) Rate adjustments may use existing banked rate adjustment authority in amounts greater than the limitations described in § 3010.225.

(c) Increases will exhaust all banked rate adjustment authority for each class of mail before imposing additional rate adjustments in excess of the maximum rate adjustment for any class of mail.

**Subpart I—Workshare Discounts**

**§ 3010.260 Applicability.**

This subpart establishes bands for the percentages of avoided costs that may be passed through to a customer in the form of a workshare discount. For the purpose of this subpart, the percentage passthrough for any workshare discount shall be calculated by dividing the workshare discount by the cost avoided by the Postal Service for not providing the applicable service and expressing the result as a percentage.

**§ 3010.261 Passthrough requirement.**

(a) Except as provided in § 3010.262, all percentage passthroughs for workshare discounts must be set within the bands as specified in paragraphs (b) through (c) of this section.

(b) 75 percent to 125 percent for Periodicals.

(c) 85 percent to 115 percent for all other classes.

**§ 3010.262 Exceptions for noncompliant discounts.**

(a) For workshare discounts in existence on the effective date of this subpart that do not comply with the requirements of § 3010.261, there shall be a 3 year grace period from the effective date of this subpart to bring the applicable percentage passthroughs into compliance with the requirements of § 3010.261.

(b) For new workshare discounts established after the effective date of this subpart that do not comply with the requirements of § 3010.261, there shall be a 3 year grace period from the establishment of the new workshare discount to bring the applicable percentage passthroughs into compliance with the requirements of § 3010.261.

(c) In each request proposing to adjust a rate associated with a workshare discount subject to the exceptions in paragraphs (a) or (b) of this section, the Postal Service shall submit a plan to bring the percentage passthroughs into compliance with the requirements of § 3010.261 prior to the expiration of the exception.

**PART 3020—PRODUCT LISTS**

■ 2. The authority citation for part 3020 continues to read as follows:

**Authority:** 39 U.S.C. 503; 3622; 3631; 3642; 3682.

■ 3. Add subpart G to read as follows:

**Subpart G—Requests for Market Dominant Negotiated Service Agreements**

Sec.

3020.120 General.

3020.121 Additional supporting justification for negotiated service agreements.

3020.122 Data collection plan and report for negotiated service agreements.

**§ 3020.120 General.**

This subpart imposes additional requirements whenever there is a request to add a negotiated service agreement to the market dominant product list. The additional supporting justification appearing in § 3020.121 also should be provided whenever the

Postal Service proposes to modify the terms of an existing market dominant negotiated service agreement. Commission findings that the addition of a special classification is not inconsistent with 39 U.S.C. 3622 are provisional and subject to subsequent review. No rate(s) shall take effect until 45 days after the Postal Service files a request for review of a notice of a new rate or rate(s) adjustment specifying the rate(s) and the effective date.

**§ 3020.121 Additional supporting justification for negotiated service agreements.**

(a) Each request shall also include the items specified in paragraphs (b) through (j) of this section.

(b) A copy of the negotiated service agreement.

(c) The planned effective date(s) of the planned rates.

(d) The identity of a responsible Postal Service official who will be available to provide prompt responses to requests for clarification from the Commission.

(e) A statement identifying all parties to the agreement and a description clearly explaining the operative components of the agreement.

(f) Details regarding the expected improvements in the net financial position or operations of the Postal Service (39 U.S.C. 3622(c)(10)(A)(i) and (ii)). The projection of change in net financial position as a result of the agreement shall be based on accepted analytical principles. The projection of change in net financial position as a result of the agreement shall include for each year of the agreement:

(1) The estimated mailer-specific costs, volumes, and revenues of the Postal Service absent the implementation of the negotiated service agreement;

(2) The estimated mailer-specific costs, volumes, and revenues of the Postal Service which result from implementation of the negotiated service agreement;

(3) An analysis of the effects of the negotiated service agreement on the contribution to institutional costs from mailers not party to the agreement;

(4) If mailer-specific costs are not available, the source and derivation of the costs that are used shall be provided, together with a discussion of the currency and reliability of those costs and their suitability as a proxy for the mailer-specific costs; and

(5) If the Postal Service believes the Commission's accepted analytical

principles are not the most accurate and reliable methodology available:

(i) An explanation of the basis for that belief; and

(ii) A projection of the change in net financial position resulting from the agreement made using the Postal Service's alternative methodology.

(g) An identification of each component of the agreement expected to enhance the performance of mail preparation, processing, transportation, or other functions in each year of the agreement, and a discussion of the nature and expected impact of each such enhancement.

(h) Details regarding any and all actions (performed or to be performed) to assure that the agreement will not result in unreasonable harm to the marketplace (39 U.S.C. 3622(c)(10)(B)).

(i) A discussion in regard to how functionally similar negotiated service agreements will be made available on public and reasonable terms to similarly situated mailers.

(j) Such other information as the Postal Service believes will assist the Commission to issue a timely determination of whether the requested changes are consistent with applicable statutory policies.

**§ 3020.122 Data collection plan and report for negotiated service agreements.**

(a) The Postal Service shall include with any request concerning a negotiated service agreement a detailed plan for providing data or information on actual experience under the agreement sufficient to allow evaluation of whether the negotiated service agreement operates in compliance with 39 U.S.C. 3622(c)(10).

(b) A data report under the plan is due 60 days after each anniversary date of implementation and shall include, at a minimum, the following information for each 12-month period the agreement has been in effect:

(1) The change in net financial position of the Postal Service as a result of the agreement. This calculation shall include for each year of the agreement:

(i) The actual mailer-specific costs, volumes, and revenues of the Postal Service;

(ii) An analysis of the effects of the negotiated service agreement on the net overall contribution to the institutional costs of the Postal Service; and

(iii) If mailer-specific costs are not available, the source and derivation of the costs that are used shall be provided, including a discussion of the currency and reliability of those costs,

and their suitability as a proxy for the mailer-specific costs.

(2) A discussion of the changes in operations of the Postal Service that have resulted from the agreement. This shall include, for each year of the agreement, identification of each component of the agreement known to enhance the performance of mail preparation, processing, transportation, or other functions in each year of the agreement.

(3) An analysis of the impact of the negotiated service agreement on the marketplace, including a discussion of any and all actions taken to protect the marketplace from unreasonable harm.

**PART 3050—PERIODIC REPORTING**

■ 4. The authority citation for part 3050 continues to read as follows:

**Authority:** 39 U.S.C. 503; 3651; 3652; 3653.

■ 5. Amend § 3050.20 by revising paragraph (c) to read as follows:

**§ 3050.20 Compliance and other analyses in the Postal Service's section 3652 report.**

\* \* \* \* \*

(c) It shall address such matters as non-compensatory rates and failures to achieve stated goals for on-time delivery standards. A more detailed analysis is required when the Commission observed and commented upon the same matter in its Annual Compliance Determination for the previous fiscal year.

**PART 3055—SERVICE PERFORMANCE AND CUSTOMER SATISFACTION REPORTING**

■ 6. The authority citation for part 3055 continues to read as follows:

**Authority:** 39 U.S.C. 503; 3622(a); 3652(d) and (e); 3657(c).

■ 7. Amend § 3055.2 by revising paragraph (c) to read as follows:

**§ 3055.2 Contents of the annual report of service performance achievements.**

\* \* \* \* \*

(c) The applicable service standard(s) for each product. If there has been a change to a service standard(s) since the previous report, a description of and reason for the change shall be provided. If there have been no changes to service standard(s) since the previous report, a certification stating this fact shall be provided.

\* \* \* \* \*

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