Postal Regulation in a Time of Change

A Summary of the United States Postal Regulatory Commission Findings in its §3622 Review

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EXTENDED ABSTRACT

Declining mail volume due to electronic diversion, which began around the turn of the century, and the concomitant loss in revenue, has been a vexing issue for posts around the world. Aging infrastructures, growing delivery networks, increased competition, and slow adoption of technological advances are concurrent and often resultant issues. The United States Postal Service is no exception. In 2006, after years of deliberation about how to address these issues, the Postal Accountability and Enhancement Act (PAEA) passed. In response to that bill, an entirely new system of postal ratemaking was implemented in the United States. It has now been more than 10 years since passage of that bill. Throughout those 10 years, the question of whether or not the new system has been working as intended has garnered much debate throughout the postal community and among policy makers.

In accordance with the statutory mandate set forth in 39 U.S.C. § 3622(d)(3), the Postal Regulatory Commission (Commission) was required to review the past 10 years of the existing market dominant rate and classification system to determine if the system had 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 of the system by issuing an Advance Notice of Proposed Rulemaking (ANPR) that provided notice and an opportunity for comments. This paper summarizes the Commission's findings. The following text, taken from Commission Orders No. 4257 and No. 4258 provides an overview of the paper.

The PAEA system was designed to achieve nine objectives: (1) maximize incentives to reduce costs and increase efficiency; (2) create predictable and stable rates; (3) maintain high quality service standards; (4) allow the Postal Service pricing flexibility; (5) assure adequate revenues, including retained earnings, to maintain financial stability; (6) reduce administrative burden and increase transparency of ratemaking process; (7) enhance mail security and deter terrorism; (8) establish and maintain a just and reasonable schedule for rates and classifications; and (9) allocate the total institutional costs of the Postal Service appropriately between market dominant and competitive products. These objectives reflect the goals of the PAEA to create a flexible, stable, predictable, and streamlined ratemaking system that ensures the Postal Service's financial health (in significant part through rate adjustments, cost reductions, and increased efficiency) and maintains high quality service standards and performance.

The Commission determined that all aspects of the system of ratemaking and classification of market dominant products outlined in section 3622 of Title 39, including workshare discounts, were appropriately incorporated into its review. In conducting its review, the Commission considered the evolution of the current ratemaking system. The PAEA reformed the system of setting postal rates and classifications. This marked the end of the Postal Reorganization Act (PRA) system, a cost-of-service pricing system marked by a break-even mandate where rates were set so that the total estimated revenues would equal as nearly as practicable the total estimated costs. Lengthy document and witness-laden hearings were abandoned in favor of a more streamlined rate-setting process centered on

a consumer price index for all urban consumers (CPI-U) price cap as the primary limit on rate-setting. Changes were also made to service standard performance measurement and reporting. The PAEA required the Postal Service to establish service standards and report publicly on its achievement of those standards and gave the Commission additional service performance monitoring and enforcement authority.

At the time it created the new PAEA system, Congress anticipated that the CPI-U price cap would enable the Postal Service to achieve sufficient revenues to cover all of its operating costs and statutorily mandated obligations while at the same time motivate the Postal Service to cut costs and become more efficient. The CPI-U price cap under the PAEA system was intended to allow the Postal Service to fund network expansion and necessary capital improvements because it removed the break-even restriction and allowed the Postal Service to generate retained earnings.

Shortly after the PAEA was enacted, however, the Great Recession occurred which, in concert with emergent technological trends, had a substantial negative impact on Postal Service volumes and revenues. In the aftermath of the Great Recession, there was also a rare period of deflation, which constrained the Postal Service's ability to raise rates given the CPI-U price cap. The section 3622 review requirement in the PAEA allowed the Commission to examine the system to determine whether, despite these changes and impacts, the system had achieved the nine objectives that formed the basis for its creation.

In its review, the Commission identified three principal areas of the PAEA system which encapsulate the nine objectives: (1) the structure of the ratemaking system; (2) the financial health of the Postal Service; and (3) service, and organized its ultimate findings and order around these three topical areas. After extensive review, the Commission concluded that the system achieved some of the goals of these areas, but the overall system had not achieved the objectives taking into account the factors of the PAEA.

First, with respect to the structure of the ratemaking system, the Commission concluded that the system was largely successful in achieving the goals related to the structure of the ratemaking system. The system had worked as intended to create rate adjustments that are stable and predictable with regards to both timing and magnitude; reduce the administrative burden and increase the transparency of the ratemaking system; and provide the Postal Service pricing flexibility while maintaining just prices. However, the Commission concluded that the ratemaking system had not increased pricing efficiency.

Second, with respect to finances, the Commission found that the system had not maintained the financial health of the Postal Service as intended by the PAEA. While the Postal Service had generally achieved short-term financial stability, both medium-term and long-term financial stability measures were not achieved. For the medium-term measure, the total revenue was insufficient to cover total costs. For the long-term measure, the Postal Service had not been able to generate retained earnings during the PAEA era. In its review of the financial health of the Postal Service, the Commission also found that while some cost reductions and efficiency gains occurred during the PAEA era, the incentives were not maximized in a way that allowed the Postal Service to achieve financial stability. Although the system contained a mechanism to appropriately allocate institutional costs, and was able to enhance mail security and deter terrorism, there was not an adequate mechanism to maintain reasonable rates during the PAEA era because certain products and classes failed to cover their attributable costs, further threatening the financial health of the Postal Service.

Third, the Commission determined that high quality service standards were not maintained during the past 10 years under the PAEA. While the Commission has the ability to review service performance routinely during the Annual Compliance Determination (ACD), the current system does not effectively encourage the Postal Service to maintain service standards quality.

Taken together, the Commission's analysis of each of the three principal areas of the PAEA era system lead it to conclude that while some aspects of the system of regulating rates and classes for market dominant products have worked as planned, overall, the system has not achieved the objectives of the PAEA. As a result, the Commission concurrently issued a Notice of Proposed Rulemaking, Order No. 4258, to address the shortcomings identified by the Commission in its review. The purpose of the rulemaking was to propose such modifications to existing regulations or adopt such an alternative system through new regulations that the Commission deemed necessary to achieve the objectives of 39 U.S.C. 3622(b).

The Commission determined that the best course of action was 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 proposed 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).

The proposed supplemental rate authority provides for 2 percentage points of rate authority per class of mail per calendar year for five full calendar years. The proposed performance-based rate authority 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. The Commission divided this performance-based rate authority between an operational efficiency-based standard (0.75 percentage points), and service quality-related criteria (0.25 percentage points).

In addition, 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. If the class as a whole is compensatory, no additional rate authority is provided. Because improved cost coverage for products within non-compensatory classes cannot be attained by rebalancing rates among products within such classes, the Commission proposes to provide 2 percentage points of additional rate authority for the class.

The Commission also proposed rules to phase out workshare discounts set substantially below or substantially above avoided costs. The proposed rules establish ranges with upper and lower limits for workshare discount passthroughs. The Commission proposed 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 Commission proposed a three year phase-in period for this rule.