Committee on Oversight and Reform
U.S. House of Representatives

Statement of
Joel Quadracci, Chairman, President & CEO
Quad, Inc.

On Behalf of the Coalition for a 21st Century Postal Service

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Good morning, Mr. Chairman, Ranking Member Jordan and Members of the Committee. I want to thank the Members of this committee and in particular, you Chairman Cummings and Mr. Meadows, along with Messrs. Connolly and Lynch for your continued leadership, commitment and bipartisan efforts on the urgent matter of restoring the Postal Service to financial stability. The Coalition for a 21st Century Postal Service (C21) believes it has become critical to enact the substance of the bipartisan bill from the 115th Congress, HR 756/6076, with some modest updating, which I will discuss later in this statement. We respectfully, but strongly, urge the Committee to move forward as swiftly as possible.

Quad is a member of C21, a large coalition of mailers and shippers, and their supply chain in paper, printing, technology and mail services. The coalition broadly represents an industry with $1.4 trillion in sales, and employing 7.5 million workers.[1] The backbone of that industry is the Postal Service and, in turn, the industry generates more than 90% of postal revenues from their own mailings, and the reply mailings and packages that they generate. I am privileged to present the coalition's point of view to the Committee today.

Quad itself is a strong participant in the industry. To reflect the scale of our offerings to our clients, Quad has evolved from being primarily a printer into a marketing solutions partner with our clients. We not only help our clients plan and produce marketing campaigns and programs but also physically deploy and measure them across print and digital channels. These integrated offerings have a foundation in print and are a key differentiator in our integrated marketing solutions platform. A platform that supports approximately 20,000 American workers across 55 locations in 26 states and services nearly 7,000 clients. Even as our company adapts to the realities of the printing industry today, we remain one of the largest mailers in the United States, accounting for over 10 billion pieces of mail each year in catalogs, periodicals, direct mail, non-profit mailings and others.

In my testimony today, I will discuss several points and make several recommendations with respect to the legislation that are not only agreed upon across the face of our industry, but jointly with the representative unions of the men and women who work so hard to make our postal system fulfill its mission every day. I should note that this an extremely rare convergence of business and labor views, and demonstrates the severity of the issues confronting our industry and the USPS and the logic of applying pragmatic solutions based on the bill from the 115th Congress, HR 756/6076.

In this testimony, I will speak to the issues underlying the current financial plight of USPS, what the industry and our company have been doing to adjust to major changes in the

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[1] Chapman and Johnson, EMA Foundation's US Mailing Industry Jobs & Revenue Study 2015, October 6, 2015,http://www.envelope.org/ipsdocuments?ecp_v=dd&ecp_dp=Postal+Transformation%2FJob+Studies%2F2015+Jobs+Study

marketplace, and then endorse the following as indispensable, from our standpoint, to the legislation:

- The imperative to address the unaffordable prefunding of retiree health benefits, which is the by far the largest source of liabilities for the Postal Service;
- The necessity to include language on service performance and measurement, reached in a compromise last Congress between Mr. Meadows and then-Senator Heitkamp; and
- Language to ensure that the Postal Regulatory Commission take into account in its statutory 10-year review of the postal rate-setting system, the financial impact of a bill produced in this Congress.

We also support as equally pivotal to an effective bill:

- Leaving decisions on mode of delivery to the professional and experienced managers at USPS; and
- Not including any changes to cost allocations currently used by USPS.

Plus, we believe USPS should be enabled to:

- Invest funds in a conservative, diversified portfolio of instruments, patterned upon the Thrift Savings Plan; and
- Compete for deliveries of wine and beer strictly in accordance with applicable state law and regulations.

USPS REMAINS A VITAL PART OF THE NATION'S ECONOMY AND INFRASTRUTURE

The financial stability of the Postal Service is a vitally important issue for communications and commerce in our country. As you know, USPS serves every citizen and business everywhere, every day. That is now more than 158 million addresses and growing. As vital as USPS is to the urban core and suburbs of our country, it is even more crucial for rural America where access to broadband is hardly universal,[2] and USPS delivers critical supplies to remote areas in addition to mail and packages. It also enables small businesses in rural areas to thrive through its pickups, as well as deliveries. Overall, the Postal Service delivered more than 146 billion letters, cards, periodicals, packages, prescriptions and much more last year alone.

That remains an impressive volume number for USPS, as does its revenues for FY 2018, some $70.6 billion. But to put them in perspective, while revenues have held relatively steady via repeated CPI-U increases and a one-time exigency surcharge, the volume number represents a decline of some 31% since its peak of 213 billion pieces in 2006. While mail volume is declining, the number of delivery points to homes and businesses continues to increase by a million or more addresses per year, and is now at an all-time high. That combination of declining volume and increased delivery points has financially hobbled the postal system – fewer pieces per stop – inhibiting investments in plants, technology, materials and a modernized delivery fleet to meet the competition and deliver the service the public needs and deserves. The Postal Service has dramatically reduced its expenses over the last decade-plus,

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[2] The FCC reports that even with recent improvements, nearly 20 million people in America are not served, by broadband. Draft 2019 Broadband Deployment Report, Federal Communications Commission, February 19, 2019.

and were we just focused on operations, it would have been near or in the black for at least the last six years.

This chart illustrates the severe decline in the Postal Service's volume and revenues, and the impact of prefunding retiree health benefits on those outcomes.

OPERATING RESULTS (in billions)

	FY 2006 ACTUAL	FY2018 ACTUAL	CHANGE	% CHANGE
Volume	213.1	146.4	(66.7)	-31.3
Revenue	$72.6	$70.7	($1.9)	(2.6)
Operating Expenses	$ 71.7	$74.4	$ 2.7	3.7
Retiree Health Benefits Payments	$1.6	$4.5	$2.9	181
Net Gain (Loss)	**$0.9**	**($3.7)**	**($4.6)**	-511

Sources: U.S. Postal Service Annual Report 2006 and Form 10-K 2018.

But it is, of course, obligated under the Postal Accountability and Enhancement Act of 2006, to annually prefund, and pay the "normal costs" of, the retirement health benefits of its employees and annuitants. The target is 100% prefunding for all employees.[3] USPS simply cannot cut enough to meet that burden, and thus has defaulted on some $43 billion in payments. It was that or stop delivering the mail. Our industry badly needs help from Congress on this issue in particular. So, with respect, I urge you and your colleagues to act as quickly as possible.

THE IMPACT OF NEW TECHNOLOGY

Technology has dramatically disrupted all of our industries forcing us all to adapt our businesses to these new realities and the Postal Service is no different. In fact, the USPS's fortunes have been impacted for both ill and good. Its core mailing business has steadily and substantially diverted to online and mobile platforms. Three months after President George Bush signed PAEA into law at the end of 2006, amidst the best year in the Postal Service's now 243-year history, Steve Jobs introduced the iPhone, there was a double digit increase in postage rates which was followed quickly by the Great Recession and the rout was on. Online and mobile availability started to multiply diversion to email, along with other options. The advent of social media, streaming and more shifted a great deal of advertising out of the postal system. All of these factors accelerated the loss of mail, and even after the recession ended the mail volumes did not return. It demonstrated the shift to electronic alternatives, and established a record that once mail is lost, it is gone permanently.

[3] The liabilities here are based on a calculation that neither uses postal-only demographics, which differ from the rest of the federal government, nor reasonable and responsible limits on who should be eligible. Current law requires payments for all employees, and not just those who are either already retired or vested within the retirement plan. This is totally at odds with private sector calculations, which follow FAS 158.

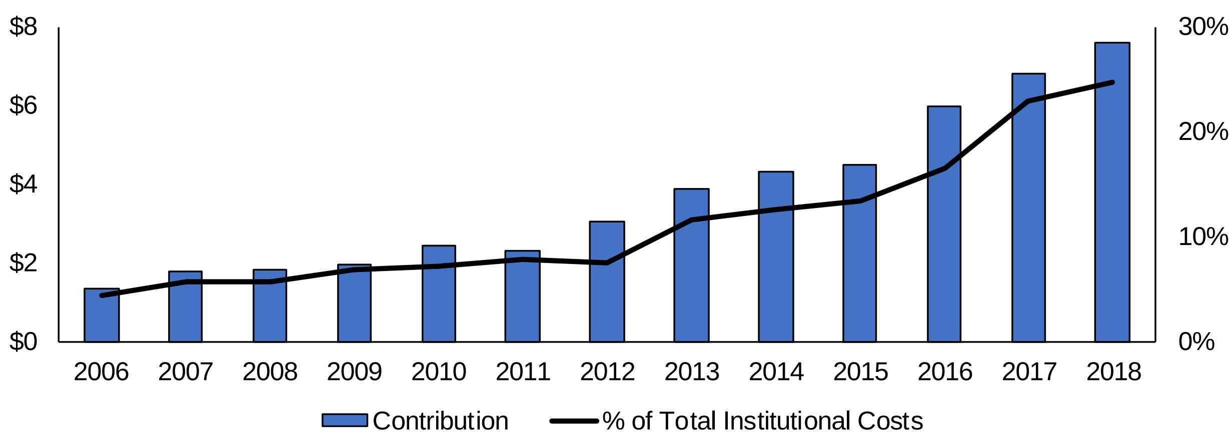
On the other side of the coin, USPS has benefited greatly from the e-commerce explosion. The package delivery side of the business has grown enormously, generating more than $7 billion toward overhead, nearly 25% of the total. This is truly a bright spot for the Service and for every mailer in this country both small and large and must be preserved,

THE POSTAL SERVICE'S COMPETITIVE PRODUCTS BUSINESS – A BRIGHT SPOT

An important bright spot for the Postal Service, its customers, and the Nation's economy as a whole is the Postal Service Competitive Products Business. This consists largely of package delivery services including Priority Mail and Priority Mail Express, First-Class Mail Package Service, Retail Package Service, Parcel Return, and Parcel Select. Indeed, without success in this business segment it would be difficult and perhaps impossible to maintain the universal, affordable mail your constituents expect and deserve and upon which the Nation's economy depends.

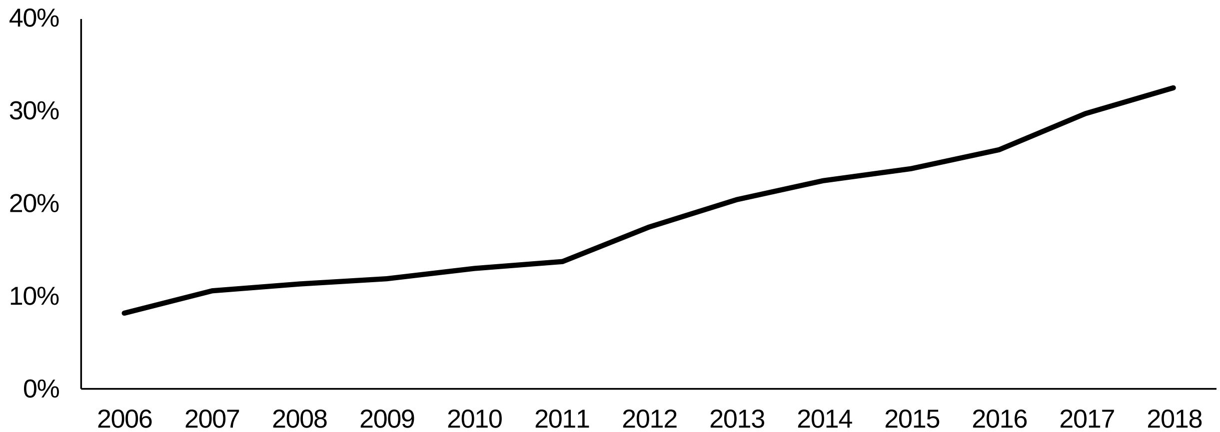
This is one area where the 2006 postal reform law (PAEA) has worked well and we suggest should be left as is. That law expands the Postal Service's ability to set market based prices and permits it to negotiate prices with customers as endorsed by the President's Task Force on the Postal Service. In exchange for this "pricing freedom," the 2006 law subjects the Postal Service to anti-trust and unfair competition laws and establishes rules that prohibit "cross subsidization." Those rules require every competitive product to cover its costs, and require the competitive product business as a whole to produce a "minimum contribution" to help pay for our universal postal system. In 2018, that "contribution," according to the PRC, was$7.6 BILLION, almost 25% of the common costs of the universal network. See chart 1.

Chart 1—Competitive Products Contribution



Competitive Products now provide nearly 33% of Postal Service revenues, up from 8% when the 2006 law took effect. See Chart 2

Chart 2—Competitive Products Revenue as % of Total USPS Revenue



The 2006 law strengthened regulatory oversight requiring annual review of costs and prices to enforce the rules and ensure a "level playing field." Oversight is a fully transparent process. In accordance with the PAEA and generally accepted economics, the regulator sets the rules under which the Postal Service must report costs annually. Any party can participate in the procedures for setting the costing rules and the annual process in which the PRC determines whether the Postal Service has complied with the PRC prescribed methods. Further any party can challenge the processes and procedures the PRC employs by petitioning the PRC. And competitors have. In its recent Annual Compliance Determination (ACD2018), the PRC discussed the history of challenges from one competitor. (See Attachment A)

Judicial review of a PRC decision is available. Last year the U.S. Circuit Court of Appeals for D.C. upheld a PRC decision modifying its costing procedures. The petitioner in that case has filed a writ of certiorari in the Supreme Court. A second appeal involving the minimum contribution requirement was recently filed in the D.C. Circuit.

In summary, the USPS package delivery business is a success. Applicable laws and regulatory oversight are more than sufficient to ensure fair competition in this increasingly important sector of the Nation's economy. And,

- Your constituents want (and deserve) a universal, frequent, affordable delivery network for mail <u>and</u> packages.
- The USPS delivery network benefits those who receive packages, those who ship them and even the competitors of the postal Service since they depend on it for package delivery in geographic areas with insufficient package density to allow them to be an efficient provider.
- The Nation's economy depends on it.
- The Postal Service's package business supports an increasing share of the cost of the overall delivery network.
- A successful Postal Service package business is essential for continued universal, frequent, affordable mail service.

FINANCIAL CHALLENGES NOTWITHSTANDING THE INCREASE IN PACKAGE BUSINESS

It is noteworthy that despite the dramatic increase in package delivery the Postal Service still has suffered net losses; in just the past three years they have seen losses of over

$12 billion, contributing to the overall defaults totaling $43 billion. This is clearly unsustainable. Financial instability and the constant threat of insolvency is obviously troubling for the Postal Service, but it is even more troubling for the American economy overall. Although the Postal Service is financially challenged it still has revenues that top $70 billion and is the backbone of the private sector mailing industry. This mailing eco-system ranges across every type of mailer and shipper as well as the printing, paper and technology industries that supply them, as well as the mail service providers which manage and facilitate many of their mailings. In short, virtually every business in America still engages with the Postal Service, most on a daily basis.

These businesses support services in a marketplace that includes cost-effective advertising, magazines, catalogs, e-commerce, prescription drug fulfillment, and what is still a huge amount of statements, bills and greeting cards, as well as an expanding package delivery segment. All of which, again, represents a private sector economy worth more than $1.4 trillion, employing some 7.5 million workers. This industry constitutes about 6% of the Gross Domestic Product (GDP). For example, the Postal Service is the primary advertising vehicle for small businesses, which as we know are the driving force behind job creation in the U.S. private sector. For some businesses and organizations, the postal system is a core business factor. That means that even in its current reduced state, USPS is a crucial part of our infrastructure and a vital cog in our economy. Moreover, those private sector workers are depending on all of us to come together, work together and put the USPS on a path to sustainability so they can go about doing their jobs and supporting their families.

QUAD'S EVOLUTION AND ONGOING PARTICIPATION IN THE POSTAL SYSTEM

While it is clear that the printing and mailing/shipping industries are a vibrant part of our economy, there is no doubt that our industries are changing and change can be challenging. For example, the primary challenge facing the printing industry, a prime business of Quad's, is the same problem the Postal Service faces: digital substitution. With proliferating alternative communications and marketing channels – email, social media, streaming, texting, websites, pop-ups and banners, mobile apps and many more in the electronic sphere – transactional mail (commercial First Class) and greeting cards and other "single piece" First Class mail, direct mail and catalog marketing all face unprecedented challenges. According to eMarketer.com, since 2010 the U.S. total estimated ad spend has increased from $152 billion to an expected $241 billion in 2019. However, even as the total advertising spend has increased the amount spent on print has declined from $45 billion to an expectation of $17 billion in 2019. Not only has the amount spent on print advertising declined but so too has the amount of time per day an average adult consumers spend with print. In 2014, on average U.S. consumers spent 32 minutes/day with a printed product and in 2019 the time spent with print has declined to 23 minutes. At the same time, in 2019 consumers now spend over 6 hours with digital media an increase of over an hour from 2014. It is clear that digital substitution is a true competitor to the mail and therefore requires the USPS to be as cost-effective and efficient as possible.

Even in the face of this competition for advertising spend from digital marketing channels we work hard to innovate and ensure print's place in this multi-channel world. Our industry has developed and incorporated QR codes and image recognition designed to send consumers to personalized online landing pages and catalogs which result in online purchases by consumers driven there by a piece of print that more than likely was delivered to them by the USPS. This strategy is working, in fact, each year Quad conducts our own survey on marketing trends and our most recent study from October, 2018 found that while Millennials spend a lot of time on the Internet, print grabs their attention. In fact, 71% of the demographic read direct mail from grocery stores followed by retail department stores at 61%. In fact, in the 30 days prior to the survey 33% of Millennials redeemed coupons they received by direct mail. This made direct mail the most used source of coupon redemption by Millennials in the U.S. Printed products have a clear place in this multi-channel world, but only if it remains cost effective and currently the largest cost for our customers is the cost of delivering the piece to the consumer.

The price of postage has continued to increase and as a result the single largest expense for our print/mailing customers nationwide is now the postage associated with delivering the printed products, ranging up to 67% of the piece. Prior to the recession, when the percentage started growing, it was approximately 33%. In order to help to control these costs, Quad and other companies provide co-mail services that combine and then ship numerous, individual clients' mail pieces together to relieve the Postal Service of significant sorting, handling and transportation costs. A large volume of the product we co-mail is sorted to the individual letter carriers and sequenced exactly in the order in which they walk their route. This reduces Postal Service costs, provides postage payers with substantial discounts and increases the opportunity for the USPS to meet service standards. These "work share" discounts were put in place in cooperation with the Postal Service allowing the private sector to be able to provide this service efficiently, saving the Postal Service added expense. Except for the ability of Quad and other mail service providers, to help clients manage their postal costs, along with in-house mailers capable of preparing their mail similarly, mail volumes would have been reduced to an even greater extent over the last decade.

Paper prices have fluctuated during over the years based on supply and demand. To ensure that we are providing our clients with the lowest possible cost and highest quality product, we have dedicated Quad staff who continually work with the paper manufacturers to coordinate with transportation companies (be they rail or over-the-road-trucking) to ensure the most cost-effective and timely delivery of paper from the mills to our plants. We've also work every day to manage the print spend for our customers and have developed and initiated standards for managing inventories and waste, all in an effort to be a low-cost provider and deliver quality products for our customers.

Above-inflation postage rate increases cannot be part of this solution. The CPI-U rate cap enacted as part of the Postal Accountability and Enhancement Act of 2006 (PAEA) has worked well to smooth out postage rate increases and provide mailers generally and our clients with much-needed price predictability and certainty.[4] These caps must be retained and action taken by Congress if the Postal Service is going to remain a viable option for marketers and mailers.

Even as Quad transforms our company to provide other marketing services for our clients we remain bullish about print. We live in a multichannel world where customers have choices. Ensuring that mailers continue to have a cost-effective and sustainable partner in the USPS is critical for the industry's long term success and in turn the success of the Postal Service itself. It is that goal that necessitates the changes that are being considered by this Committee on

[4] The expense and unpredictability of timing and percentages of rate increases, exacerbated by an extremely expensive, lengthy and complex quasi-judicial process for increasing rates were the bases on which mailers stressed the need to Congress for predictability and certainty in rate increases. Congress agreed and established a rate cap based on CPI-U and a vastly simpler, less expensive process for USPS to raise rates. *See* 39 USC Sec. 3622. It was this new process and limitation that, in our view, has kept USPS for experiencing an even more disastrous loss of volume.

Medicare integration and the adjustments to the health care prefunding requirements that I'll discuss below. Innovation is what drives our business today; we invest in new technologies and ways for print to compliment other media channels. Print is the foundation of successful multichannel strategies for both marketers and publishers but only if it remains cost-effective. Our customers do not have to mail. I want to underscore that: our customers do not have to mail, and therefore they do not have to print.

It is incumbent upon Congress, the USPS and the private sector to work together to ensure a sustainable future for the USPS and all mailers. Passing legislation as laid out in my testimony will stabilize the USPS for now, as we all consider what should come next for USPS to adjust to and effectively compete in an ever growing digital world.

C21'S VIEWS ON POTENTIAL LEGISLATION

As I mentioned, Quad is a member of C21, which represents mailers and shippers of all sizes and types, and their supply chain, and on whose behalf I have the privilege of testifying today. Quad and this entire industry stand ready to continue to work with you to ensure the future of the Postal Service for the nation, as well as the 7.5 million American families that depend on the Postal Service for their livelihood. We urge you to come together and approve, as you did in the last Congress, bipartisan legislation to achieve the goal of USPS sustainability.

We understand that consideration is being given to developing legislation based on the bipartisan bill approved by this Committee during the 115th Congress – i.e. H.R. 756/6076. Passing this legislation will bring short-term financial stabilization and will provide the time necessary to build the needed consensus on whatever future systemic changes for the USPS' business model, infrastructure or more may prove necessary to preserve it for a longer term. I would also urge the members of this committee that our industry needs your attention more often than every 10 or 15 years. The industry is dynamic and the Postal Service needs to be able to react to those changes in a positive manner all while providing the price predictability our customers need as they make long-term plans for their businesses. Passing this legislation now provides us all with the tools to think strategically for the future of the mailing industry and the USPS.

The decline in mail volumes, including from the clear shift of advertising spend to digital and mobile technologies poses a clear threat to the Postal Service's sustainability and that of the mailing industry collectively; it would already be well beyond the point of no return for self-sustainability, were it not for the unexpected and very timely e-commerce explosion. These challenges can be overcome with bold reforms, further cost-cutting and streamlining building on the Postal Service's efforts to date – the same types of tough measures that thousands of American businesses such as ours have made as our industries continued to be disrupted by the growing online opportunities for marketers and retailers.

You may have noticed I did not mention increasing postal rates. As discussed below, the industry did agree to a one-time increase of 2.15% to help USPS provide the necessary services that enable our industry to communicate with their customers. The Congressional Budget Office (CBO) scored that at nearly $8.5 billion over ten years for HR 756. However, I urge extreme caution on relying on pricing beyond this amount as a meaningful part of the overall solution. While USPS maintains its statutory monopoly on major Market Dominant products, that monopoly applies only so long as communications are in tangible form. As discussed above, there are multiple alternative "channels" to advertising on paper. Given the proliferation of inexpensive alternatives to USPS, greater price increases will drive business to remove mail from the system faster. With postage now accounting for up to 2/3 or more of the cost of a mail piece (up from about 1/3 in the mid-2000s), there is only one way for print customers to manage their budgets if the price goes up – and that will be to reduce the volume moving through the mail. It will be a simple, dispassionate business judgment necessitated by the realities of higher pricing.

From Quad's own perspective, the foregoing is underscored. For our clients, as many have told me, uncertainty and unpredictability on rates will stifle volume as they make decisions about how to spend their advertising budgets. Many clients may choose to move away from print in marketing and transactions only because they do not have confidence that the Postal Service will continue to be a viable option. As the price of postage continues to increase it creates additional uncertainty for our customers and the allure of the digital world continues to change the marketing landscape.

There are three main components to printing a bill, statement, greeting card, magazine, catalog, retail insert or direct mail piece: the cost of the content and physical printing of the item, the paper it's printed on and postage cost for delivering the printed piece. It may be tempting to address the Postal Service's financial situation by simply raising postage rates to "cover the costs," but I cannot stress enough how damaging any cost increases, including postage rates, and are to our industry. Our customers are extremely price sensitive and any increase in the cost of making their printed products has a direct negative correlation between rate increases and volume. Our customers demand predictability and affordability and if prices increase they react by reducing their volume to cover the extra postage or move away from print altogether. Of course, this hurts the revenue of the printer but also reduces the volume going to the Postal Service which further exacerbates the problem.

Similarly, although packages have long had private sector alternatives, such as UPS and FedEx, USPS had been a strong competitor and the one that would consistently deliver to remote and other sparsely populated areas due to the Universal Service Obligation (USO) of delivering to every home and business every day they deliver. In fact, those two private carriers use the USPS for some of their final mile deliveries. Today, USPS has a booming package business, and one on which it has already aggressively taken price – increasing rates some 65% over the past decade.[5] Any significant and arbitrary price increases from here would likely raise prices in shipping for all consumers and businesses. The only beneficiaries would seem to be the USPS's competitors.

C21'S RECOMMENDATIONS: UPDATING CORE ELEMENTS OF LEGISLATION TO STABiLIZE USPS

Just as the Committee sought to do in the 115th Congress with H.R. 756 and H.R. 6076, we urge the Committee to once again draw upon private sector best practices for providing and funding retiree benefits, thereby reducing future postal liabilities by tens of billions of dollars without burdening the taxpayer. Prefunding and paying the normal costs of retiree health benefits is the largest source of liability to the USPS, by far, and the single largest threat to its solvency. Therefore, we join with the postal labor unions in making the following recommendations (please note the vast majority of USPS obligation is paid for by postage payers):

[5] USPS Forms 10-K, Fiscal Years 2008 – 2018.

- Setting the prefunding target at 60% of the vested liability for retiree health benefits of postal employees and retirees. This change mirrors the best practice of the minority of large private firms that prefund such benefits (at a median level of 57%) and lowers the Postal Service's burden by **$60 billion**.[6]

- Reducing the unfunded liability for retiree health benefits by creating postal-only plans within the FEHB program that fully integrate with Medicare Part D (prescription drugs) to facilitate the same benefit provided to private sector health plans. This will lower the USPS' costs by **$25 billion.**

- Reducing the unfunded liability by mandating enrollment in Medicare Parts A and B, a private sector best practice on a prospective basis for postal employees under the age of 55 who wish to maintain FEHBP coverage in retirement, with exceptions for those who cannot benefit from enrollment due to special circumstances. This change will benefit the USPS by additional $ **billions**.

- Provide the USPS with a one-time increase in postage rates. H.R. 756 and H.R. 6076 provided for a one-time postage increase of 2.15%. While any price increase will lead to lower mail volumes, we do believe that the risk from such an increase, again only on a one-time basis is warranted to assist the USPS with getting its balance sheet corrected. This one-time increase will generate **$8.5 billion** over ten years in new revenue for the Postal Service.

Beyond the foregoing, there are several other changes the industry and our coalition believe are vital changes for rural America and for users of the system generally. We strongly urge your support for these provisions that again enjoy the mutual support of labor and business.

- Requiring improvements in service measurement and delivery, especially in rural areas, as provided in a Senate companion bill (S. 2629, sec. 211) from the 115th Congress
  - C21 joins with all four postal labor unions in supporting the service changes as proposed during the last congress by Ranking Member Meadows and Senator Heitkamp

- Ensuring that the Postal Regulatory Commission (PRC) consider relevant congressional action in its ongoing review of the rate-setting system (S. 2629, Sec. 207)
  - This is essential in that, as you know, the PRC is currently considering a rate proposal that would amount to an increase of between 28% - 43% depending on the class of mail should USPS avail itself of this pricing flexibility.

  - This language would also protect the industry from additional rate increases on top of the 2.15% rate increase that has been included as part of any legislation proposed to date

- Increasing returns for the Postal Service Retiree Health Benefits Fund by investing in a well-diversified portfolio of stocks and bonds instead of only low-yielding Treasury

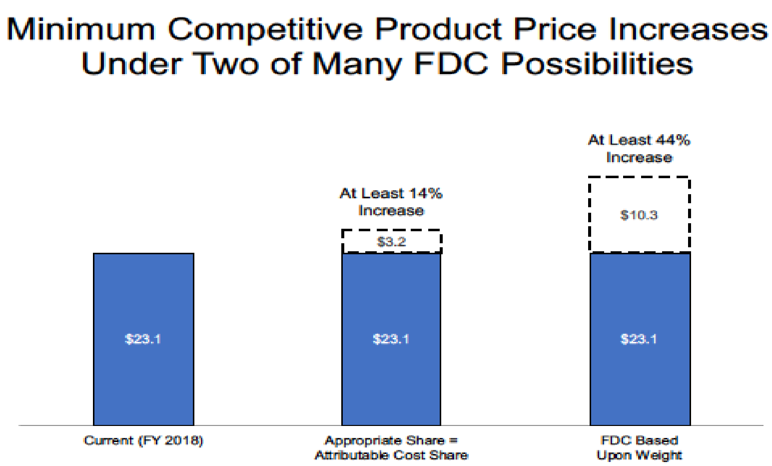
[6] Estimates in this section from U.S. Postal Service.

securities. We believe Mr. Lynch's bill, HR 760, from the 115th Congress, sets out a good framework for proceeding in this direction.

- Allowing the Postal Service to deliver beer and wine as a revenue generator. We believe USPS should be able to compete in this market, subject to the laws of all states when delivering in their respective jurisdictions. Specifically, in states where such deliveries are prohibited or restricted, USPS would be required to abide by those rules.

The stakeholders also respectfully, but strongly, request that the Committee not include in its legislation contentious provisions related to the following:

- Rescinding the authority of the independent, expert PRC to prescribe rules for measuring and distributing postal costs and imposing an arbitrary approach such as Fully Distributed Costing (FDC).
    - FDC has been rejected by the Postal Regulatory Commission and that decision has been upheld on appeal by the U.S. Circuit Court of Appeals for the D.C. Circuit.
    - The impact of employing FDC the PRC's objections would vary dramatically depending on what arbitrary standard was used to assign costs that would not be reliably tied to any specific product. For example:



    - The old U.S. Post Office Department long used fully allocated costs in its "Cost Ascertainment System." One of the signal achievements of 1970's Postal Reorganization Act was to jettison the CAS in favor of causation-based costing from evidence-based determinations of cost attributions and assignments,[7] and only competitors of the USPS will benefit, as USPS prices would be raised.

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[7] *See* the Kappel Commission Report, pp. 30 – 31 and 133-135, 1968. *See also* the Senate report on the PRA (S. Rep. No. 91-912, from 1970, and available via Lexis or via the bound legislative history of the PRA on Hein Online). As that report noted at page 17, "Express companies in the private sector of the economy have expressed their very keen desire to include language in the bill which would require the recovery of fully allocated costs for parcel post. The committee rejects the suggestion on the principle that no particular cost accounting system is recommended and no particular classification of mail is required to recover a designated portion of its cost beyond its incremental cost." Beyond incremental cost, the PRA would leave institutional-cost recovery to PRC discretion pursuant to the ratemaking criteria in the statute,

- Language that seeks to move the Postal Service's mode of delivery away from the door to curbside or centralized delivery through cluster boxes. USPS already has the authority to decide the mode of delivery and, in fact, already has three quarters or so of its addresses to the curb or through cluster boxes. We believe it best not to set artificial targets and to leave mode of delivery decisions to the postal managers who possess the relevant expertise.

I thank the Chairman, the Ranking Member and the Committee for providing me this opportunity to discuss the industry, our company and C21's views on potential legislation, given the importance of the Postal Service to the nation and to the 7.5 million families our industry supports. I look forward to working with you to enact reforms that will put the Postal Service on a path to sustainability. I applaud you for making the Postal Service a priority, and I would be happy to answer any questions that you may have.

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including the effect of rate increases on competitors. "To go beyond that point would simply be to recommend provisions of law protecting a particular economic interest or limiting the availability of a Federal parcel delivery service."

Attachment A
PRC Docket ACR2018, pp. 118, *et seq*.

The Commission works continuously to improve its costing methodologies in separate dockets that do not have statutorily-imposed deadlines.[239] As the Commission has previously stated, issues relating to costing methodology for Competitive products are appropriately addressed in those separate proceedings. *See* FY 2017 ACD at 93. A few commenters, however, express disagreement in this docket with the Commission's existing costing methodologies, particularly for Competitive products.

1. United Parcel Service Comments

As in past years, UPS filed comments in this docket contending that the Commission's costing methodologies understate the costs attributable to Competitive products.[240] UPS relies on examples that it describes as "specific deficiencies in the Postal Service's costing methodologies" from which it tries to extrapolate a general conclusion that "[t]he resulting levels of cost attribution do not hold up." *See* UPS Comments at 2-3.

UPS's concerns are outside the scope of this compliance review. While these comments are appropriately addressed in other proceedings, the Commission responds to UPS's comments because they reflect a misunderstanding of the accepted cost allocation methodologies. In this section, the Commission outlines why UPS's examples do not amount to evidence that the Commission's methodologies systematically under-allocate costs to Competitive products.

a. Historical Context

As far back as the first omnibus rate case before the Postal Rate Commission in the early 1970s, UPS has argued that the attribution of costs to products is too low and amounts to unfair competition.[241] The Commission has consistently held that, under the applicable statute, reliable proof of cost causation is necessary to "attribute" costs to products or

[239] *See*, *e.g.*, Docket No. RM2016-13, Order Adopting Final Rules on Changes Concerning Attributable Costing, December 1, 2016 (Order No. 3641).

[240] *See* UPS Comments at 1-4; Initial Comments of United Parcel Service, Inc. on United States Postal Service's Annual Compliance Report for Fiscal Year 2017, February 1, 2018, at 1-4.

[241] *See, e.g.,* Docket No. R71-1, Opinion and Recommended Decision, June 5, 1972, Volume I at 196-201; Docket No. R74-1, Opinion and Recommended Decision, August 28, 1975, at 94, 124; Docket No. R76-1, Opinion and Recommended Decision, June 30, 1976, Volume I at 243; Docket No. R77-1, Opinion and Recommended Decision, May 12, 1978, Volume I at 386-87, 394; Docket No. R80-1, Opinion and Recommended Decision, February 19, 1981, Volume I at 476, 489-90; Docket No. R84-1, Opinion and Recommended Decision, September 7, 1984, Volume I at 549; Docket No. R87-1, Opinion and Recommended Decision, March 4, 1988, Volume I at 697; Docket No. R90-1, Opinion and Recommended Decision, January 4, 1991, Volume I at V.335-36; Docket No. R94-1, Opinion and Recommended Decision, November 30, 1994, at V.112-13; Docket No. R97-1, Opinion and Recommended Decision, May 11, 1998, Volume I at 478-79; Docket No. R2000-1, Opinion and Recommended Decision, November 13, 2000, Volume I at 468-69; *see* Docket No. RM2012-3, Initial Comments of United Parcel Service on Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, April 9, 2012; *see* Docket No. RM2012-3, Reply Comments of United Parcel Service on Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, May 7, 2012; *see* Docket No. RM2016-2, Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, October 8, 2015; *see* Docket No. RM2017-1, Initial Comments of United Parcel Service, Inc. on Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, January 23, 2017; *see* Docket No. RM2017-1, Reply Comments of United Parcel Service, Inc. on Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for Competitive Products, March 9, 2017.

classes.[242] This approach to costing was affirmed by the Supreme Court,[243] and the requirement that cost attribution be based on "reliably identified causal relationships" was codified in the

PAEA when it was enacted in 2006.[244] Under the Commission's costing methodology, costs which cannot be causally attributed to a specific product or class, or to the Competitive product group, are treated as institutional, and Competitive products are required to collectively cover an appropriate share of institutional costs.[245] The Commission has also consistently found that the Postal Service does not engage in predatory pricing for its Competitive products, nor does it benefit from a competitive advantage in the marketplace.[246]

In ensuring that costing methodologies are fully vetted and accurate, the Commission's regulations provide that either the Commission or any interested person may submit a petition to initiate a proceeding to "improve the quality, accuracy, or completeness of the data or analysis of data contained in the Postal Service's annual periodic reports to the Commission[.]" 39 C.F.R. § 3050.11(a). These proceedings fall outside the scope of the Commission's annual compliance review, and the commenters are aware of the proper procedure for filing a petition for a change to a costing methodology. For example, in Docket No. RM2016-2, UPS petitioned the Commission for three proposed methodological changes that would have affected cost attribution.[247] Two of the proposed methodology changes would have expanded the range of costs which are attributable to specific products, and one would have increased the amount that Competitive products must contribute to the Postal Service's institutional costs. *See id*. The Commission rejected UPS's first proposal, but in the course of reviewing the proposal, updated its costing methodology to reflect certain additional inframarginal costs bearing a "reliably identified causal relationship" to products, classes, or groups. Order No. 3506 at 59-62. Of the other two proposals, the Commission rejected one after finding that it would not improve the quality, accuracy, or completeness of the Commission's existing methodology, and addressed the other relating to the required appropriate share of contribution for Competitive products

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[242] *See, e.g.,* Docket No. R74-1, Opinion and Recommended Decision, August 28, 1975, Volume I at 93; Docket No. R76-1, Opinion and Recommended Decision, June 30, 1976, Volume I at 75-76; Docket No. R84-1, Opinion and Recommended Decision, September 7, 1984, Volume I at 117; Order No. 3506; Docket No. RM2016-2, Notice of Errata, October 19, 2016 (Docket No. RM2016-2, Notice of Errata); Order No. 4963 at 2.

[243] *See Nat'l Ass'n of Greeting Card Publishers v. USPS*, 462 U.S. 810 (1983).

[244] Pub. Law 109-435, 120 Stat. 3198, 3201, 3205-06 (Dec. 20, 2006) (codified at 39 U.S.C. §§ 3622(c)(2), 3631(b), 3633(a)(2)).

[245] *See* 39 U.S.C. § 3633(a)(3). The Commission reviews and determines Competitive products' appropriate share of contribution to institutional costs every 5 years. 39 U.S.C. § 3633(b).

[246] *See, e.g.,* Docket No. R74-1, Opinion and Recommendation, August 28, 1975, at 290; Docket No. R76-1, Opinion and Recommended Decision, June 30, 1976, Volume I at 247-48; Docket No. R77-1, Opinion and Recommended Decision, May 12, 1978, Volume I at 394-99; Docket No. R80- 1, Opinion and Recommended Decision, February 19, 1981, Volume I at 490-94; Docket No. R84-1, Opinion and Recommended Decision, September 7, 1984, Volume I at 550-53; Docket No. R87-1, Opinion and Recommended Decision, March 4, 1988, Volume I at 714-15; Docket No. R90-1, Opinion and Recommended Decision, January 4, 1991, Volume I at V.336-40; Docket No. R94-1, Opinion and Recommended Decision, November 30, 1994, at V.113-15; Docket R97-1, Opinion and Recommended Decision, May 11, 1998, Volume I at 479-80; Docket No. R2000-1, Opinion and Recommended Decision, November 13, 2000, Volume I at 473; Docket No. R2006-1, Order and Recommended Decision, February 26, 2007, Volume I at 387-88; Order No. 26 at 73-74; Order No. 1449 at 14-25; Order No. 4963 at 107-167.

[247] *See* Docket No. RM2016-2, Petition of United Parcel Service, Inc. for the Initiation of Proceedings to Make Changes to Postal Service Costing Methodologies, October 8, 2015.

to make towards institutional costs in another docket, which the Commission was required to separately consider. Order No. 3506 at 105, 123. Order No. 3506 was affirmed by the U.S. Court of Appeals for the D.C. Circuit.[248] The Commission subsequently considered the appropriate share requirement in Docket No. RM2017-1, and as a result of that review adopted an improved formula-based approach to determine the appropriate share. *See generally*, Order No. 4963. UPS actively participated in that docket and has also been an active commenter in similar petitions filed by the Postal Service to modify existing costing methodologies.[249]

b. Specific Issues Raised by UPS

UPS features several of the same issues in this docket that it has raised in past ACR dockets and other Commission proceedings.

As a general matter, UPS states that Competitive products make up 45 percent of the Postal Service's "delivery volume by weight," which it contrasts with the attribution of 18 percent of the Postal Service's total costs to Competitive products.[250] This observation is oversimplified and could be considered misleading because it implies a one-to-one relationship between weight and cost. Postal costs are not incurred solely on the basis of weight. The Commission's cost attribution methodology identifies relationships between numerous costs and cost drivers, which include mail characteristics such as weight. To the extent heavier products incur more weight-related costs than lighter products these costs are attributed using the approved methodologies. Order No. 4402 at 46. In addition, shippers lower their costs by entering their packages into the Postal Service's network closer to the destination, bypassing many of the processing costs. Such packages will incur disproportionately low costs in comparison to their weight, which will necessarily result in a greater increase in Competitive products' share of "delivery volume by weight" than in Competitive products' share of attributable costs. This example illustrates that the difference between these two values is not, as UPS suggests, a demonstration of misattribution of costs, but instead is an entirely expected result.[251]

UPS asserts that only 18 percent of the Postal Service's total costs are attributed to Competitive products. However, the 18 percent figure cited by UPS is the percentage of total costs, rather than attributable costs.[252] A full 35 percent of the Postal Service's

[248] *See UPS v. Postal Reg. Comm'n*, 890 F.3d 1053 (D.C. Cir. 2018), *petition for cert. filed* (U.S. Dec. 26, 2018) (No. 18-853).

[249] *See, e.g.*, Docket No. RM2008-6, Costing Methods Used in Periodic Reporting (Proposals Ten and Eleven); Docket No. RM2015-7, Proposed Change in Analytical Principles (Proposal Thirteen), Docket No. RM2016-12, Proposed Change in Analytical Principles (Proposal Four); Docket No. RM2017-8, Proposed Change in Analytical Principles (Proposal Four); Docket No. RM2017-9, Proposed Change in Analytical Principles (Proposal Five); Docket No. RM2017-10, Proposed Change in Analytical Principles (Proposal Six); Docket No. RM2018-2, Revise Periodic Reporting Requirements; Docket No. RM2018-5, Proposed Change in Analytical Principles (Proposal Two); Docket No. RM2018-6, Proposed Change in Analytical Principles (Proposal Three); Docket No. RM2018-8, Proposed Change in Analytical Principles (Proposal Five).

[250] As calculated by the Commission, 21 percent of total costs were attributed to Competitive products. *See* PRC–LR–ACR2018/1, Excel file "Summary_LR1.xlsx," tab "Appendix A (Incremental Costs)," cells D21 and D83.

[251] Many of the Postal Service's costs are not weight-dependent, so even in the absence of the trend towards increasing use of dropshipping, the Commission would still not expect "delivery volume by weight" to closely track Competitive products' share of costs.

[252] *See* n.12, *supra* (discussing the Commission's calculated value of 21 percent instead of 18 percent).

attributable costs are attributed to Competitive products.[253] This is true despite the fact that Competitive products make up only 3.9 percent of total volume.[254] The average attributable cost per piece for Competitive products is $2.73,[255] compared to the average attributable cost per piece of Market Dominant mail, which is $0.19.[256] This difference in attributable cost per piece demonstrates that the costing methodology attributes costs based on the factors that drive those costs. UPS has consistently advocated in favor of fully- distributed costing, but given the statutory requirements that costs, to be attributable, must bear a reliably identified causal relationship to the product, class, or group, not all costs can be attributed to specific products, classes, or groups.[257] In addition, as the Commission has discussed in previous dockets, under sound regulatory economic practices, not all costs should be attributed.[258] Therefore, reliance on the proportion of total costs apportioned to Competitive products is particularly inapt.

(1) Issues Pertaining to Cost Attribution of Specific Activities

In addition to its general observations about the attribution of costs for Competitive products, UPS makes more specific claims regarding the purported under-attribution to Competitive products of costs incurred by new vehicles, handheld scanners, and parcel lockers. UPS Comments at 8-11, 13-16.

With regard to vehicle costs, UPS notes the increasing size of delivery vehicles and observes that there has not been a concomitant increase in the allocation of vehicle related costs to Competitive products, claiming that, as a result, vehicle costs are under attributed to Competitive products. *See id.* at 8-9. UPS points to motor vehicle service personnel, supplies, and materials, along with vehicle depreciation, as examples of how the new vehicles are being costed similarly to the older vehicles. *Id.* at 9. Vehicle costs are attributed primarily in proportion to delivery costs, which are attributed based on direct labor costs. Reflective of the variation in size and shape, direct labor costs are much higher for parcels than other mail items. Consequently, as the number of parcels increases, a greater share of vehicle costs will be attributed to parcels. *See* Order No. 4963 at 151-52.

UPS also contends that the costs of handheld scanners are under attributed to Competitive products. UPS Comments at 13-15. In particular, UPS claims that only 8 percent of Intelligent Mail Device (IMD) and 9 percent of Mobile Delivery Device (MDD) *total* depreciation costs are attributed to domestic Competitive products. *Id.* at 14. These calculations are misleading; 15 percent of IMD and 20 percent of MDD *attributable*

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[253] *See* PRC–LR–ACR2018/1, Excel file "Summary_LR1.xlsx," tab "Appendix A (Incremental Costs)," cells D21 and D78.

[254] *See* PRC–LR–ACR2018/1, Excel file "Summary_LR1.xlsx," tab "Appendix A (Incremental Costs)," cells B21 and B78.

[255] *See* PRC–LR–ACR2018/1, Excel file "Summary_LR1.xlsx," tab "Appendix A (Incremental Costs)," cell H21.

[256] *See* PRC–LR–ACR2018/1, Excel file "Summary_LR1.xlsx," tab "Appendix A (Incremental Costs)," cell H55.

[257] *See* section 4.E.1.a., *supra*.

[258] *See generally*, Order No. 3506; Docket No. RM2016-2, Notice of Errata; Order No. 4402; Order No. 4963.

depreciation costs are attributed to domestic Competitive products.[259] UPS also asserts that the "low level of competitive product cost attribution does not make sense given the Postal Service's own statements to the effect that these devices were purchased to support parcel delivery." UPS Comments at 15. UPS is incorrect in asserting that IMD and MDD scanners are used primarily for tracking package delivery. IMD scanners are used at certain locations to track the acceptance of all types of mailpieces bearing barcodes, in addition to being used to track the delivery of packages.[260] MDD scanners are used to track service performance for all types of mailpieces, in addition to being used to track the delivery of packages.[261]

UPS also states that the costs associated with parcel lockers are not properly attributed to Competitive products. It states that the Postal Service appears to be using ordinary distribution keys for cost attribution rather than attributing the purchase, installation, and maintenance costs associated with parcel lockers to Competitive products. UPS Comments at 15. Contrary to UPS's implication, the use of ordinary distribution keys to attribute costs for parcel lockers to Competitive products is entirely appropriate. The Postal Service states that parcel lockers are installed as part of, or adjacent to, Cluster Box Units (CBUs),[262] to which all types of mail are delivered, not only Competitive products. The Postal Service notes that in previous years parcel lockers were included as part of CBUs and that the number of such units is a function of the number of delivery points rather than volume, requiring that they be treated as institutional costs. *Id*. Recently parcel lockers have additionally been installed adjacent to already existing CBUs. *Id.* The Postal Service states that, as a result, the relationship between parcel volume and equipment costs for parcel lockers may be shifting, and that it intends to further investigate this issue. *See id.* The Commission notes that it was its own inquiry into this potential issue that UPS cited to support its comment.[263] The Commission is monitoring this issue and intends to follow-up on the Postal Service's investigation of cost attribution for the installation of parcel lockers.

(2) Issues Pertaining to Costing Methodology

UPS also identifies several costing methodologies related to peak season: Special Purpose Routes (SPRs), second runs, two-hour delivery, Competitive assets, and city carrier time

[259] *See* Library Reference USPS–FY18–31, December 28, 2018, Excel File "FY18Public.A.xlsx," tab "CS98.2." *See also* section 4.E.1., *supra* (discussing the difference between percent of total costs and percent of attributable costs).

[260] *See* Suzanne Newman, *Intelligent Mail Device (IMD) Full Acceptance Non-Retail System Software (RSS) Sites*, October 5, 2017, at 3, 10 (available at: *https://postalpro.usps.com/storages/2017-10/IMD%20Full%20Acceptance%20at%20Non-RSS%20Sites%20External%20Briefing.pdf*) (describing use of IMD scanners for acceptance of barcoded mail); United States Postal Service Office of the Inspector General, *Package Delivery Scanning Nationwide*, October 27, 2017, at 1 (available at: *https://www.uspsoig.gov/sites/default/files/document-library-files/2017/DR-AR-18-001.pdf*) (OIG Scanner Report) (describing use of IMD scanners for delivery scanning when MDD scanners are unavailable).

[261] *See* Docket No. PI2015-1, Library Reference USPS–LR–PI2015-1/8, February 23, 2017, file "Internal SPM Plan blackline.pdf," at 19-20 (describing use of MDD scanners for service performance tracking); OIG Scanner Report at 1 (describing use of MDD scanners for delivery scanning).

[262] *See* Responses of the United States Postal Service to Questions 1-12 of Chairman's Information Request No. 5, February 5, 2019, question 6.b. (Responses to CHIR No. 5).

[263] *See* UPS Comments at 15 (citing to Postal Service responses to CHIRs).

estimates that it claims do not allocate sufficient costs to Competitive products. *See* UPS Comments at 5-8, 11-13, 16-18, 19-22.

UPS alleges that during the peak holiday season, the Postal Service incurs higher costs due to a seasonal increase in Competitive product volume, but only a small fraction of these costs are attributed to Competitive products. UPS Comments at 5-6. As a result, it contends that the costing methodology should be changed to more closely reflect seasonal trends.
This conclusion by UPS that seasonal trends are not reflected is incorrect. This assertion overlooks the fact that the Commission's costing methodology is designed to estimate costs on an annual basis, so any seasonal differences are captured in the annual totals.
Distribution keys for costs are created on a quarterly basis[264]—to the extent that parcel volume is greater in one quarter than in others, the current methodology incorporates and reflects those data. The Commission also notes that demand for both Competitive and Market Dominant products increases during peak season, and, as a result, seasonal increases in costs are not exclusively attributable to Competitive products.[265]

For SPRs and second runs, UPS identifies an area where the Postal Service has acknowledged that existing methodologies have room for improvement.[266] This issue pertains to the measurement of time, costs, and volumes associated with second runs, and the estimation of SPR costs for each product. UPS contends that these second run data should be better measured and the SPR cost model should be updated. The Commission recently approved a methodological change to more accurately assess workhours on all types of delivery routes and the Commission continues to monitor these issues. *See* Order No. 4399.

Regarding 2-hour delivery, UPS notes the Postal Service's intention to expand the service, but observes that cost attribution for this expansion remains unknown. UPS Comments at 16. The Commission notes that a similarly time sensitive feature, same-day delivery, is offered through Competitive NSAs.[267] The Commission reviews such agreements under 39 U.S.C. § 3633(a) and 39 C.F.R. § 3015.5. In its review process, the Commission closely scrutinizes such agreements to ensure that costs incurred by special features, such as same-day delivery, are attributed to those individual agreements, and thus to Competitive products.

For its claims pertaining to Competitive assets, UPS notes that only $1.8 million of total net assets and liabilities are assigned to the Competitive Products Fund despite Competitive products producing $23 billion in revenue. *See* UPS Comments at 16. This comparison is not relevant. The Commission's rules require the Postal Service to separately identify all

[264] *See* Library Reference USPS–FY18–37, December 28, 2018, file "usps-fy18-37.preface.pdf," at 6.

[265] *See* United States Postal Service, Postal Service Econometric Estimates of Demand Elasticity for All Postal Products, FY 2018, January 28, 2019.

[266] UPS Comments at 11-12 (citing to Postal Service responses to CHIRs).

[267] *See*, *e.g.*, Docket Nos. MC2018-149 and Docket No. CP2018-215.

assets used *solely* for the provision of Competitive products. 39 C.F.R. § 3060.12(a). The Postal Service has identified $1.8 million of net assets used strictly for Competitive products. However, the Commission's rules also require the Postal Service to identify an additional portion of overall assets and liabilities to assign to Competitive products, based on the ratio of Competitive product revenue to total revenue.[268] The latter allocation includes $8.7 billion in assets assigned to Competitive products, far more than UPS asserts.[269]

Finally, UPS identifies two issues relating to city carrier street time that it characterizes as "outstanding" and that warrants the Commission's attention. UPS Comments at 19. First, UPS identifies the continued need for an alternative approach to measuring city carrier street time variability. *Id.* at 20. Second, UPS claims to identify a seasonal bias in the route evaluations used to estimate city carrier street time that results in underestimating Competitive product costs. *Id.* at 21. For the first issue, related to Docket No. RM2015-7, the Commission is continuing to investigate the potential for an alternative approach to estimating city carrier street time variability. To that end, the Commission recently instructed the Postal Service to collect and report data on a quarterly basis.[270] For the second issue, UPS misconstrues the Commission's conclusions in Docket No. RM2017-8. In that docket the Commission determined that because the Postal Service diverts packages from letter routes to SPRs during peak season to accommodate increased letter and package volume, it is unclear that any potential seasonal bias in sampling letter routes will under attribute costs to Competitive products.[271] As such, UPS is incorrect when it definitively claims that "[the Commission] underestimates the proportions that are allocated to parcels." *See* UPS Comments at 21-22.

(3) Conclusion

In addition to being outside the scope of the ACD, UPS's comments present a misunderstanding of the approved costing methodologies.

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[268] 39 C.F.R. § 3060.12(c) requires the Postal Service to identify assets that are not used solely for either Market Dominant or Competitive products, and to assign to the theoretical Competitive product enterprise a portion of such assets "using a method of allocation based on appropriate revenue or cost drivers approved by the Commission." In Docket No. RM2009-9, the Commission approved a methodology for allocating such assets based on the ratio of Competitive product revenue to total revenue. *See* Docket No. RM2009-9, Order Establishing Methodology for the Allocation of Assets and Liabilities of the Competitive Products Enterprise, June 25, 2010 (Order No. 479).

[269] USPS–FY18–39, file "USPS-FY18-39.Preface.CPF.Report.pdf," at table 4.

[270] *See* Docket No. PI2017-1, Interim Order, November 2, 2018 (Order No. 4869).

[271] Docket No. RM2017-8, Order on Analytical Principles Used in Periodic Reporting (Proposal Four), December 1, 2017, at 19-20 (Order No. 4259).

Attachment B

C21 Views Concerning the Report of the President's Task Force on the Postal System

C21 appreciates the President's creating his Task Force on the Postal System, and the Task Force members for their hard, and inclusive, work on the Report. C21 was one of a substantial number of stakeholders with whom the Task Force met in developing an informational base for their Report. The Task Force brought a great deal of additional attention to USPS, which in itself was a positive result.

The Task Force made a number of important points with which we agree. The first is that the Postal Service should continue its mission to bind the nation together, and deliver to all addresses. We believe that is vital to ensure that all Americans, including those in Rural America, receive still-vital mail and package services without discrimination or differentiation.

The second was a point the Task Force did not make. It did not recommend privatizing USPS. We agree. C21 strongly believes that privatization might balkanize the system, and quite likely render it unusable. Even if somehow sold or spun off in whole, the obstacles to success in the United States are daunting; profits without dramatic downsizing of the system and/or raising rates beyond affordability will be rather improbable to realize. Privatizations of foreign posts are simply not comparable or models for the United States. The differences in population, geography and volume of mail between the United States and, say, the United Kingdom and Finland, render comparisons virtually inapposite. And that is not to mention that privatizations overseas often took a decade or longer, with governments retaining legacy benefit costs, while prices go up and delivery goes down.

We further agree with the Task Force, however, that more outsourcing or worksharing make sense. Worksharing was a pivotal contributor to growing mail volume. It was responsible for virtually all mail volume growth subsequent to enactment of the Postal Reorganization Act, and still constitutes the vast majority of mail. The goal was to produce the "lowest combined cost," and benefit both the Postal Service and its customers. It worked. Thus, there may be additional opportunities to explore on this front, especially as technology develops further.

Third, the Task Force recommended restructuring USPS obligations, notably retiree health prefunding. We agree that retiree prefunding should be restructured to use postal demographic data, and apply only to retirees and vested employees (adopting private sector best practices under FAS 158). Beyond that, we submit that the balance of that obligation can and should be resolved through integrating the 20% or so of USPS annuitants who are not subscribed, into Medicare. Each of these annuitants has paid his or her Medicare taxes over the years, while USPS has paid the employer share. Each is eligible to enroll in Medicare right now. Were they to do so on their own motion, Medicare would, by law, have to cover them. It is also possible that an offset can be devised for any Medicare expense but, given the above, under no circumstances would Medicare for any postal workers be accurately considered a "bail-out."

Finally, we agree with the Task Force that vacant Governors' positions must be filled. USPS has badly missed the outside director guidance that Presidentially-appointed, Senate-confirmed Governors were intended to, and do, give. We encourage the President to nominate additional qualified candidates, and for the Committee to move as swiftly as it can to complete their vetting and hearings.

C21 also has grave concerns about a number of the Task Force's recommendations. We are strongly opposed to somehow dividing up the system into undefined "essential" and other streams of mail. While the Task Force took some pains to describe the differences it envisions generally, the bulk of this work would be delegated to the Postal Regulatory Commission. While we believe that the Commission does a generally excellent job of fulfilling its various statutory mandates, on a restructuring this fundamental, with all the substantive, policy and political dimensional overlays to it, our firm recommendation is that this would be a job to be retained by and in Congress.

On the notion of separating mailstreams, we are puzzled, to say the least, how this would not adversely impact economies of scale and scope. At its simplest, would it mean two postal trucks would cover the same route? It would also confuse the public. What is essential? What is not? Can't you just put a stamp on something and send it First Class?

For business, the problems come in price and service. The Task Force recommended marketing and promotional mail be charged at market rates. How can you determine a "market rate" for letters and catalog delivery protected by the letter and mail box monopolies? So, what would "market rates" be for marketing mail? Undoubtedly higher, such rates would likely have a dramatic impact on mailings from major companies that continue in the mail because of the somewhat higher ROI of the mail "channel," in contrast with various online channels (email, social media, streaming, websites, etc.), as well as broadcast, cable and print. Raising prices degrades that ROI advantage.

That brings us to the question of price elasticities. How much mail and how many packages would the Postal Service lose with sharply higher prices? Elasticities for the Postal Service used by both postal agencies relied upon by the Task Force are not only in part based on badly dated information, several decades worth, but are filled with trend analyses and other filler factors that impact accuracy. The simple fact is that USPS has raised rates at CPI-U since PAEA took effect, and so the predictive power of their elasticities for much larger increases is at best suspect.

The one exception to that, which itself was not nearly as high as "market rates" might turn out to be, the "exigent surcharge" imposed by the Commission to restore some of the revenues supposedly lost due to the Great Recession, does not change that calculus. Mailers report that they saw that increase as temporary and not worth retooling their marketing mixes among all the channels available. A permanent increase would be another matter.

The bottom line is that at this point price does matter. No longer as driven to alternatives to the mail by other factors such as novelty or convenience, ROI is now an even more central consideration. And when the price of mailing is raised, that ROI declines, making alternative channels more attractive, and costing USPS significant volume when it cannot afford to lose any more, let alone a substantial amount.

The same is true for package and parcel shipping. At their current pricing, which has been aggressively increased while volume for USPS has expanded by orders of magnitude, USPS competitive packages and parcels now provide nearly 25% of USPS overhead costs, some $7+ billion in 2018. This shipping volume due largely to the explosion in ecommerce has filled a significant part of the revenue gap created by the ongoing deflation of First Class Mail volume and revenues.

C21 believes that the surest way to kill the goose laying this golden postal revenue egg is to raise prices substantially. While USPS competitors are now encroaching on its volume because the density of package delivery has sufficiently increased in more jurisdictions to make their deliveries profitable, customers may turn to them, form their own delivery fleets, use Uber and other novel options, and otherwise divert from a USPS that would be noticeably less price-competitive.

Our coalition strongly opposes the Task Force recommendation to embrace fully distributed costing (FDC) or other major cost reallocations, as well. FDC has been rejected in academia, and in regulatory and judicial outcomes for generations. A major reason is that some costs cannot be accurately directly or indirectly attributed to any specific class of mail or product. For example, how would the salary of the Postmaster General be fully allocated? Or of a carrier who must conduct his/her route whether or not any mail or packages are delivered, or picked up. The same for the carrier's truck, fuel and maintenance. And so on. Any major reallocation of costs would necessarily have to include some form of arbitrariness.

We refer you to the statement of the Parcel Shippers Association which addressed FDC in-depth in the March 12 hearing record, and fully subscribe to their views on this subject.

We understand the financial problems confronting the Postal Service, and we commend the Chairman and the Committee for their ongoing interest in the system. Those problems may very much call for fundamental changes to the infrastructure, business model or more in order to sustain the system in coming years. But any such changes, recommended by the Task Force or otherwise, should be tested and vetted closely in hearings with experts from all stakeholding communities, and from rural, suburban and urban America.

In the interim, we strongly recommend a short-term financial stabilization approach that would lift some of the Postal Service's financial obligations and otherwise positively affect its balance sheet and operational outcomes to avoid the worst outcome of insolvency and inability to deliver the mail while Congress decides what the full suite of reforms should be. Two examples would be last Congress's HR 6076 and S. 2629, but there could be other options.