Postal Regulatory Commission
Submitted 12/10/2020 4:06:35 PM
Filing ID: 115313
Accepted 12/10/2020
Order No. 5777

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Chairman;
Michael Kubayanda, Vice Chairman;
Mark Acton;
Ann C. Fisher; and
Ashley E. Poling

Public Inquiry on the Universal
Service Obligation Valuation Methodology

Docket No. PI2021-1

NOTICE AND ORDER PROVIDING AN OPPORTUNITY TO COMMENT WITH RESPECT TO UNIVERSAL SERVICE OBLIGATION VALUATION METHODOLOGY

(Issued December 10, 2020)

I. INTRODUCTION

In this docket, the Commission intends to revisit the methodology it uses to estimate the cost of the Postal Service's universal service obligation (USO), which the Commission last considered in 2008.[1] In particular, the Commission seeks to determine whether all of the assumptions underlying that methodology remain valid in light of changed conditions over the intervening twelve years. To that end, the Commission seeks public comment with respect to the current USO valuation methodology, including any suggested modifications or enhancements.

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[1] *See* Report on Universal Postal Service and the Postal Monopoly, December 19, 2008 (2008 USO Report).

II. BACKGROUND

Section 702 of the Postal Accountability and Enhancement Act (PAEA), Pub. L. 109-435, 120 Stat. 3198 (2006), required the Commission to submit a report to the president and Congress on “universal postal service and the postal monopoly in the United States....” This report was required to include “a comprehensive review of the history and development of universal service...,” as well as “the scope and standards of universal service...provided under current law....” PAEA, Pub. L. 109-435, § 702(a)(2), 120 Stat. 3198 (2006). The Commission released the report on December 19, 2008. *See* 2008 USO Report. The Commission found that the USO consisted of seven different attributes: geographic scope; product range; access; delivery; pricing; service quality; and an enforcement mechanism. *Id.* at 18-33.

In completing the report, the Commission was also required to estimate the costs of the USO. *Id.* at 101. Generally speaking, these costs are calculated as the difference between the amount of profit the Postal Service earns while fulfilling its USO and the amount of profit the Postal Service could theoretically earn if it were not required to provide universal service, or any specific component thereof. *Id.* at 101-102. The Commission identified various USO elements based on statutory requirements or on what Congress might be expected to include if it were to specifically define a postal USO. For each element, the Commission determined what level of service a theoretical profit-maximizing Postal Service without a USO would provide. *Id.* at 119-143. The difference in profit between the former and the latter can be thought of as the cost of providing universal service. *Id.*

The Commission updates its estimate of the cost of the USO each year in its Annual Report to the President and Congress based on the methodological approach adopted in the 2008 USO Report.[2] That methodological approach is dependent on

[2] *See* 39 U.S.C. 3651(b); *see, e.g.*, Postal Regulatory Commission, FY 2019 Annual Report to the President and Congress, January 21, 2020, at 41-51 (FY 2019 Annual Report). The most recent estimate of the USO’s cost was $5.21 billion. *See* FY 2019 Annual Report at 42, Table IV-1.

assumptions concerning what a profit-maximizing Postal Service would do absent a particular USO mandate. 2008 USO Report at 121. Such assumptions are necessarily based on economic, technological, legislative, and societal considerations at the time they are made. The assumptions underlying the 2008 USO Report were thoroughly debated at that time, with contractors retained by both the Commission and the Postal Service presenting differing assumptions and the Commission ultimately exercising its judgment as to which assumptions it found to be the most reasonable. *Id.* at 119-143.

In Docket No. PI2014-1, the Commission interpreted “other public services or activities” under 39 U.S.C. 3651(b)(1)(C) to include statutorily-required offerings and “public facing” actions by the Postal Service.[3] Applying the framework developed in that docket, the Commission in the FY 2019 Annual Report clarified its interpretation of the scope of the USO, determining that it should include the net cost of the Postal Inspection Service. FY 2019 Annual Report at 49. The methodologies used to estimate the cost of all other elements of the USO have remained essentially unchanged from the 2008 USO Report.[4]

Much has changed in the United States since 2008—economically, technologically, and societally. Consequently, revisiting the assumptions underlying the 2008 USO Report is appropriate in order to ensure that the Commission’s valuation of the USO continues to reflect the environment in which the Postal Service operates.

III. DISCUSSION

The Commission invites comment with respect to any and all aspects of the current USO valuation methodology. The Commission has also identified two USO

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[3] Docket No. PI2014-1, Order Interpreting 39 U.S.C. § 3651(b)(1)(C), November 17, 2015, at 24 (Order No. 2820).

[4] One notable exception is that the methodology for estimating the cost of 6-day delivery reflects refined and more comprehensive costs based on the Commission’s findings in its Advisory Opinion on Elimination of Saturday Delivery. *See* Docket No. N2010-1, Advisory Opinion on Elimination of Saturday Delivery, March 24, 2011; Postal Regulatory Commission, FY 2011 Annual Report to the President and Congress, December 21, 2011, at 41 (FY 2011 Annual Report).

components in particular with valuation assumptions that appear to be ripe for revisiting—frequency of delivery and maintaining small post offices. It is important to note that the Commission is not proposing or recommending changes to these or any other USO components at this time. Rather, the Commission is seeking input into whether the level of service that a theoretical profit-maximizing Postal Service without a USO would provide has changed since 2008. This is necessary in order to place an accurate value on the cost of the USO, and to evaluate that cost through a transparent process.

A. Frequency of Delivery

In the 2008 USO Report, the Commission noted that in every year since 1984 Congress has inserted language into postal appropriation legislation requiring that 6-day delivery shall continue "at the 1983 level." 2008 USO Report at 20, 22, 29, 123. The insertion of this language into appropriation legislation has continued since 2008, and thus 6-day delivery continues to constitute the current USO requirement for frequency of delivery.

In terms of valuing this USO component, the Commission sought in the 2008 USO Report to determine what the minimum frequency of delivery would be for a theoretical profit-maximizing Postal Service without a USO. *Id.* at 123-131. The Commission considered assumptions by the two separate contractors. The contractor hired by the Commission concluded that the minimum frequency of delivery would be 3 days per week. *Id.* at 124. The contractor hired by the Postal Service concluded that the Postal Service would theoretically maximize profits by varying frequency of delivery to equalize volume across 3-digit ZIP Codes, or potentially even 5-Digit ZIP Codes or mail routes. *Id.* at 131. The two contractors reached different conclusions with regard to what the cost savings associated with reducing delivery frequency would be. *Id.* at 124-131.

The Commission determined that the minimum frequency of delivery for a theoretical profit-maximizing Postal Service without a USO would be 5 days per week.

Id. at 123. It based this conclusion on the fact that "frequency of delivery is generally a priority for businesses," and "bills, remittances, and date-specific advertising remain major sources of revenue." *Id.* (footnote omitted). The Commission found that "[w]ithout at least 5-day delivery, it would be difficult for the mail to remain an attractive channel for communications of this kind." *Id.* This conclusion did not make any differentiation between mail types or mail destinations. The Commission accepted as most reasonable an estimate that reducing delivery frequency from 6 to 5 days would have increased the Postal Service's FY 2007 net income by $1.930 billion (2 percent of the Postal Service's total costs). *Id.* at 123-124.

Since FY 2007, the mail mix has changed significantly. According to the Postal Service, it has lost about a third of First-Class Mail and USPS Marketing Mail volume.[5] At the same time, package volumes have nearly doubled and have become the Postal Service's primary source of revenue growth, although the Postal Service reports that growth has begun to slow since FY 2017 as commercial customers have begun insourcing more of their last mile deliveries. Postal Service Five-Year Strategic Plan at 8. In the time since the 2008 USO Report, the Postal Service has also begun delivering some packages on Sundays, thereby in some circumstances providing greater delivery frequency than what is required by the USO.[6]

A theoretical profit-maximizing Postal Service without a USO might differentiate the frequency of delivery of letters and flats from that of packages. The Commission therefore seeks input as to whether, in the absence of a requirement for 6-day delivery, the Postal Service would be likely to provide different frequency of delivery for different types of mail. The Commission also seeks input as to what the minimum frequency of delivery would be for each type of mail (*e.g.*, letters, flats, or packages).

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[5] *See* United States Postal Service, The U.S. Postal Service Five-Year Strategic Plan FY2020-FY2024, available at: *https://about.usps.com/strategic-planning/five-year-strategic-plan-2020-2024.pdf*, at 8 (Postal Service Five-Year Strategic Plan).

[6] *See* Docket Nos. MC2014-1 and CP2014-1, Order Adding Parcel Select and Parcel Return Service Contract 5 to the Competitive Product List, October 29, 2013 (Order No. 1863).

A theoretical profit-maximizing Postal Service without a USO might also provide different levels of service to high-density, as opposed to low-density, areas.[7] It could deliver more frequently to high-density areas, and less frequently to low-density areas. Alternatively, it could implement a surcharge for delivery to low-density areas. The Commission seeks input as to how a theoretical profit-maximizing Postal Service without a USO would be most likely to address delivering to areas that differ in density.

In sum, the Commission seeks to better understand whether a theoretical profit-maximizing Postal Service without a USO in today's operating environment would maintain uniform 5-day delivery as previously assumed, or whether it might differentiate delivery frequency either between different types of mail, or between high-density and low-density areas, or both.

B. Maintaining Small Post Offices

The Postal Service is required to "establish and maintain postal facilities of such character and in such locations, that postal patrons throughout the Nation will, consistent with reasonable economies of postal operations, have ready access to essential postal services." 39 U.S.C. 403(b)(3). In the 2008 USO Report, the Commission noted that in developing rural free delivery services in the early 20th century, Congress substituted rural carrier services for the services of small post offices in many rural areas. 2008 USO Report at 136. The Commission also noted that since FY 1985, Congress had added language to annual appropriations bills that prohibited the Postal Service from using appropriated funds to close or consolidate small rural and other small post offices, but the Commission acknowledged that this did not appear to bar the Postal Service from using other funds to close or consolidate small post offices

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[7] In this context, density can be interpreted as geographic density of delivery points (delivery points per square mile), or alternatively as "mail density" (volume per delivery point). Commenters who address this topic are requested to specify how they would define density as used to determine the provision of different frequency of delivery to different areas.

because the Postal Service had closed or consolidated hundreds of small post offices since 1985. *Id.*

Two contractors addressed this issue in the 2008 USO Report. They differed as to how many small post offices would be closed in the absence of a USO—the contractor hired by the Commission concluded that a theoretical profit-maximizing Postal Service without a USO would close all post offices in Cost Ascertainment Groups (CAGs) K and L, while the contractor hired by the Postal Service concluded that it would close post offices in CAGs H through L.[8] The Commission found the first scenario (CAGs K and L) to be more plausible, and accepted a valuation based on adjusting the gross savings from closing such post offices with the cost of replacement services and the amount of lost revenue, which came to $0.586 billion. *Id.* at 138. In accepting this valuation, the Commission also adopted the assumption of one of the two contractors that rural carrier services could be substituted for small post offices in the absence of a USO. *Id.* at 137.

The Commission invites interested persons to comment on whether a theoretical profit-maximizing Postal Service without a USO would utilize other alternatives besides rural carrier services in place of CAGs K and L, and whether additional post offices besides CAGs K and L would be eliminated. Since postal customers can access products and services online and at grocery stores, office supply chains, pharmacies, and other retail outlets, it is unclear whether the assumption that only CAGs K and L would be replaced or consolidated still holds. It is also possible that post offices could

[8] *Id.* at 137-138. CAGs classify post offices based on revenue units. A revenue unit is the average amount of revenue per fiscal year from postal rates and fees for 1,000 pieces of originating mail and Special Service transactions. CAG H-J offices have 190-949 revenue units; CAG K offices have 36–189 revenue units; and CAG L offices have less than 36 revenue units. *See* United States Postal Service, Glossary of Postal Terms, available at: *https:// usps.com/publications/pub32* (Publication 32).

be replaced by Contract Postal Units (CPUs)[9] or Automated Postal Centers (APCs).[10] Therefore, the Commission seeks input from interested persons on whether to revise the assumptions regarding which post offices would be closed by a theoretical profit-maximizing Postal Service without a USO and what replacement services would be utilized.

IV. COMMENTS

The Commission invites interested persons to identify components of the current USO valuation methodology where the underlying assumptions about how a theoretical profit-maximizing Postal Service without a USO would behave are no longer compelling. The Commission further seeks suggestions concerning how to revise any outdated assumptions, as well as what data and analytical methods would be necessary to incorporate any suggested changes into the calculation of the USO's cost. Comments are due March 15, 2021. Material filed in this docket will be available for review on the Commission's website, *http://www.prc.gov*.

Pursuant to 39 U.S.C. 505, Kenneth R. Moeller is appointed to serve as an officer of the Commission (Public Representative) to represent the interests of the general public in this docket.

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[9] A CPU is a supplier-owned or supplier-leased site operated by the supplier, under contract with the Postal Service to provide postal products and services to the public at Postal Service prices. *See* Publication 32.

[10] An APC is a self-service kiosk that allows customers to mail letters, flats, and packages; buy stamps and some Special Services; and mail international letters. It also offers ZIP Code and tracking lookup and provides information on different services. *See* Publication 32.

V. ORDERING PARAGRAPHS

It is ordered:

1. The Commission establishes Docket No. PI2021-1 for the purpose of considering potential changes to the Commission's valuation methodology for the Universal Service Obligation.

2. Interested persons may submit written comments on any or all aspects of the Universal Service Obligation valuation methodology no later than March 15, 2021.

3. Pursuant to 39 U.S.C. 505, Kenneth R. Moeller is appointed to serve as Public Representative in this proceeding.

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

By the Commission.

Erica A. Barker
Secretary