NO DATE FOR ORAL ARGUMENT HAS BEEN SET

No. 14-1010

**UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT**

UNITED STATES POSTAL SERVICE,
Petitioner,

v.

POSTAL REGULATORY COMMISSION,
Respondent,

ALLIANCE OF NONPROFIT MAILERS, ET AL.,
Intervenors for Respondent.

**On Petition for Review of an Order of the
Postal Regulatory Commission, Docket No. R2013-11**

**PAGE-PROOF OPENING BRIEF FOR PETITIONER
UNITED STATES POSTAL SERVICE**

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April 15, 2014

CERTIFICATE AS TO PARTIES, RULINGS, AND RELATED CASES

Pursuant to Circuit Rule 28(a)(1), Petitioner United States Postal Service hereby provides this certificate as to parties, rulings, and related cases, which includes the disclosure required by Circuit Rule 26.1.

A. Parties and *Amici*

This is a petition for review of agency action. Petitioner in No. 14-1010 is the United States Postal Service. Respondent is the Postal Regulatory Commission ("PRC").

Twenty-one entities that participated in the proceedings before the PRC have intervened in support of the PRC: the Alliance of Nonprofit Mailers; the American Catalog Mailers Association; the Association for Postal Commerce; the Association of Marketing Service Providers; the Direct Marketing Association, Inc.; the Envelope Manufacturers Association; the Greeting Card Association; the Major Mailers Association; MPA – The Association of Magazine Media; the National Association of Presort Mailers; the National Newspaper Association, Inc.; the National Postal Policy Council; the Newspaper Association of America; the Printing Industries of America; Quad/Graphics, Inc.; the Saturation Mailers Coalition; the Software & Information Industry Association/American Business Media; Valassis Direct Mail, Inc.; Valpak Direct Marketing Systems, Inc.; Valpak Dealers' Association, Inc.; and the American Forest & Paper Association.

B. Rulings Under Review

The United States Postal Service seeks review of PRC Order Number 1926, *Order Granting Exigent Price Increase*, dated December 24, 2013, in Docket Number R2013-11.

C. Related Cases

This matter has not previously been before this Court or any other court, but a case involving the same parties and presenting similar issues was before this Court in *United States Postal Service v. Postal Regulatory Commission*, No. 10-1343, 640 F.3d 1263 (D.C. Cir. 2011) (Henderson, Tatel, and Brown, JJ.).

There is a related case pending in this Court, seeking review of the same PRC Order that is the subject of this petition. That related case, *Alliance of Nonprofit Mailers, et al., v. Postal Regulatory Commission*, No. 14-1009, was filed on the same day as the instant petition by seventeen of the above-listed entities who have moved to intervene in the instant petition. The United States Postal Service has intervened in that proceeding in support of the PRC. By order dated January 28, 2014, this Court ordered that this case (No. 14-1010) and the related case (No. 14-1009) be consolidated.

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[*] Authorities on which this brief chiefly relies are marked with an asterisk.

GLOSSARY OF ABBREVIATIONS

Commission or PRC	Postal Regulatory Commission
PAEA	Postal Accountability and Enhancement Act, P.L. 109-435, 120 Stat. 3198 (2006)
USPS or Postal Service	United States Postal Service

INTRODUCTION

The "Great Recession" that began in December 2007 wreaked havoc on the U.S. economy, and had an especially severe impact on the U.S. Postal Service ("USPS" or "Postal Service"). Mail volume plummeted more than 20% between 2007 and 2010. In past recessions, mail volume returned to normal shortly after the recession ended, but the Great Recession was different. Mail-intensive sectors of the economy—including real estate, mortgage and credit card lending, and advertising—were hit the hardest by the recession and faced a slow and difficult recovery. As a result, USPS continued incurring massive losses even after the recession nominally ended in 2009. Moreover, many of the Postal Service's most significant costs—such as its nationwide delivery network, the requirement to deliver mail six days per week, and benefits for retired workers—arise from congressional mandates and cannot be cut in response to falling mail volume.

In July 2010, USPS filed a request for an "exigent" rate increase with the Postal Regulatory Commission ("Commission" or "PRC") to recoup a portion of its losses incurred due to the recession. Under the Postal Accountability and Enhancement Act of 2006, USPS may seek a rate adjustment for market-dominant products above the rate of inflation if it shows that: (1) it incurred losses "due to either extraordinary or exceptional circumstances"; and (2) the proposed rate adjustment is "reasonable and equitable and necessary" to enable USPS to continue providing "postal services of the kind and quality adapted to the needs of the United States." 39 U.S.C. § 3622(d)(1)(E). The Commission agreed that the Great Recession qualified as an "extraordinary or exceptional" circumstance, but initially denied the proposed rate increase on the ground that the Postal Service had not linked its losses to the recession with sufficient particularity. This Court remanded that order as an improper interpretation of the statute. *See U.S. Postal Serv. v. PRC*, 640 F.3d 1263 (D.C. Cir. 2011).

On remand, the Postal Service filed a renewed request for an exigent rate increase. That request was supported by a comprehensive econometric analysis showing that between 2008 and 2012, USPS lost 189.7 billion pieces of mail due to the recession, which translates into roughly $25.7 billion of lost "contribution" towards the Postal Service's institutional costs. USPS sought to recover a portion of that loss through a 4.3% rate increase.

By a 2-1 vote, the Commission allowed USPS to recoup only a fraction of the amount requested. In particular, the majority held that it would no longer deem the Postal Service's losses to be "due to" the recession once a so-called "new normal" had been reached for each class of mail. The Commission further held that it would not recognize mail volume lost in one year as also lost in later years, even when that volume remained lost and did not return to the system. And the Commission refused to consider the effects of several variables in the Postal

Service's models that were designed to reflect the fact that the Great Recession had fundamentally changed the relationship between mail volume and macroeconomic trends. The Postal Service's models showed that it had lost $7.7 billion of contribution due to the recession in 2012 *alone*, but the Commission allowed it to recoup just $2.8 billion for the *entire* recession. This petition followed.

JURISDICTIONAL STATEMENT

This petition challenges a final PRC order issued on December 24, 2013, which granted, in part, the Postal Service's request for an exigent rate increase. This Court has jurisdiction under 39 U.S.C. § 3663, which provides that a person "adversely affected or aggrieved by a final order or decision of the [Commission]" may seek review in this Court.

USPS has standing under Article III and 39 U.S.C. § 3663 because it is "adversely affected or aggrieved" by the PRC's final order. The Order directly injures USPS by refusing to grant all of the relief sought in the request for an exigent rate increase.

STATUTES AND REGULATIONS

The relevant provision of the Postal Accountability and Enhancement Act of 2006, 39 U.S.C. § 3622, is reproduced in the Addendum to this brief.

STATEMENT OF THE ISSUES

1. Whether the Commission's analysis of the mail volume lost "due to" the Great Recession was arbitrary, capricious, and contrary to the plain meaning of "due to" as construed by this Court.

2. Whether the Commission arbitrarily and capriciously refused to consider portions of the Postal Service's econometric models that reflected the fact that the Great Recession had fundamentally changed the relationship between mail volume and macroeconomic trends.

STATEMENT OF THE CASE

A. The Postal Accountability and Enhancement Act of 2006

For many years, rates for postal services were designed to allow the Postal Service to recover its costs and break even. *See*, *e.g.*, *UPS v. U.S. Postal Serv.*, 184 F.3d 827, 830 (D.C. Cir. 1999). Critics of that system claimed that it gave the Postal Service little incentive to cut costs or operate efficiently. Congress responded in December 2006 by enacting the Postal Accountability and Enhancement Act ("PAEA"), P.L. 109-435, 120 Stat. 3198, which dramatically changed the nature of postal ratemaking. The PAEA replaced the old cost-based ratemaking system with a price cap for "market-dominant" postal products.[1]

[1] Market-dominant products are those provided exclusively or predominantly by the Postal Service, including first-class mail, standard mail, and periodicals. *See* 39 U.S.C. § 3621. Separate regulations govern "competitive products" that compete with offerings by private companies. *Id.* § 3631.

Under the new system, price increases for market-dominant products are generally limited to the inflation rate. *See* 39 U.S.C. § 3622(d)(1)(A). This system was intended to "create predictability and stability in rates" while also "maximiz[ing] incentives to reduce costs and increase efficiency." *Id.* § 3622(b)(1), (2).

At the same time, Congress recognized that there may be circumstances that render strict compliance with the price cap unfeasible. Congress thus included a safety valve in the PAEA that allows the Postal Service to adjust rates upward in response to "exigent" circumstances. The relevant provision states that "notwithstanding" the usual price cap, "rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances, provided that the Commission determines … that such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. *Id.* § 3622(d)(1)(E). The Commission must act on a request for an exigent rate increase "within 90 days." *Id.*

B. The Postal Service's First Request for an Exigent Rate Increase and This Court's Remand

USPS suffered extraordinary and unprecedented losses as a result of the "Great Recession" that began in December 2007. Market-dominant mail volume grew nearly 5% between 2002 and 2007, but fell more than 20% between 2007 and

2010. JA__(POIR_6_Q.1). That exceeded the decline associated with *all other recessions combined* since the creation of the Postal Service. And those losses left USPS in an especially precarious financial position because many of its fixed institutional costs—such as its nationwide delivery network, six-day mail service, and benefits for retired workers—stem from congressional mandates and cannot be cut in response to falling mail volume.

On July 6, 2010, citing "the dramatic, rapid, and unprecedented decline in mail volume" that resulted primarily from the "depth and severity of the current recession," the Postal Service submitted its first-ever request for an exigent rate increase. *See* Exigent Request, Docket R2010-4 (July 6, 2010). The Commission agreed with USPS that "the recent recession, and the decline in mail volume experienced during the recession," qualified as an "extraordinary or exceptional circumstance." Order 547, Docket R2010-4, at 3 (Sept. 30, 2010). The Commission nonetheless denied the proposed rate adjustment, holding that the Postal Service had not shown that the requested adjustment was "due to" the recession. *Id.* at 3. According to the Commission, USPS had failed to "quantify the impact of the recession on postal finances, address how the requested rate increases relate to the recession's impact on postal volumes, or identify how the requested rates resolve the crisis at hand." *Id.* at 4.

USPS sought review in this Court, arguing that the Commission had required too tight of a correlation between the amount of the requested rate adjustment and the losses incurred as a result of the exigent circumstance. This Court granted the petition for review in part, holding that—contrary to the Commission's view—the Commission's interpretation of "due to" was not unambiguously required by the statute. *See USPS*, 640 F.3d at 1266-68. The Court held that "the plain meaning of 'due to' mandates a causal relationship between the amount of a requested adjustment and the exigent circumstances' impact on the Postal Service." *Id.* at 1267; *see id.* ("due to" means "because of").

But the Court concluded that the PAEA is ambiguous as to "how close the relationship must be, that is how much of the proposed adjustment must be due to the exigent circumstance." *Id.* For example, the phrase "due to" can mean "'due *in part* to' as well as 'due *only* to.'" *Id.* at 1268. It would "not be incorrect to say that the requested rate increase is 'due to' the extraordinary factor simply because it is also 'due to' other factors as well." *Id.* The Court thus remanded to the Commission to "fill the statutory gap by determining how closely the amount of the adjustments must match the amount of the revenue lost as a result of the exigent circumstances." *Id.*

On remand, the Commission issued Order 864, which set the standard for exigent rate increases going forward. *See* JA__-__(Order_864). Consistent with this Court's decision, the Commission interpreted "due to" as requiring the Postal Service to show the "net adverse financial impact" of the exigent circumstance. JA__(*Id.*_48). USPS does not need to quantify that impact with "absolute precision," but need only use "supportable methods commensurate with the amount of the proposed adjustment." JA__-__(*Id.*_48-49); *see* JA__(*id.*_52) (Postal Service "is not expected to engage in 'a quixotic search for perfect proportionality'"). The Postal Service has long "demonstrated an ability to develop and refine methodologies for measuring and projecting costs" using "sophisticated data collection and estimation methodologies," and "[s]uch tools are available in exigent rate case proceedings as they have been in other Commission contexts." JA__-__(*Id.*_49-50). In short, USPS is "simply expected to support its exigent request with credible proof." JA__(*Id.*).

As applied to the Great Recession, the Commission determined that "the net adverse financial impact would consist of the lost contribution associated with the volume declines from the 2008-2009 recession." JA__(*Id.*_45). The Commission ordered USPS to quantify that amount by "factor[ing] out the financial impact of non-exigent circumstances." JA__(*Id.*_48).

C. The Postal Service's Renewed Request for an Exigent Rate Increase

USPS renewed its request for an exigent rate increase on September 26, 2013. JA__-__(Exigent_Request). In support of that request, the Postal Service relied on models prepared by economist Thomas Thress, who has been involved in "developing econometric models for the purpose of volume forecasting" for the Postal Service for 21 years. JA__(POIR_3_Q.2). Thress' methodology was not invented for purposes of this litigation. Consistent with the Commission's instructions in Order 864, Thress' models were premised on "a set of calculations which underlie all of the Postal Service's demand equation analysis and volume forecasts." JA__(Thress_Statement_5).

Applying that longstanding methodology, Thress decomposed the Postal Service's volume losses between 2008 and 2012 into "those stemming from the recession and those stemming from other factors." JA__(Exigent_Request_9). He concluded that the Great Recession was primarily responsible for USPS's massive losses over that period. As Thress explained, mail-intensive sectors of the economy—such as real estate, banking, mortgage and credit card lending, and advertising—suffered disproportionately from the recession, and were much slower to recover than other sectors. JA__(Thress_Statement_5-6). As a result, USPS continued to suffer adverse effects even after the recession nominally ended in 2009. In previous recessions, "mail volume trends were essentially the same after the recession as before." JA__(*Id.*_7). But mail volume remained lethargic in the wake of the Great Recession. For example, from 2010 to 2012, First-Class

Mail volume declined at an annual rate of 5.8% even as employment and other macroeconomic factors returned to positive growth. JA__(*Id.*).

Consistent with this Court's decision and the Commission's instructions on remand, Thress' models "factor[ed] out the financial impact of non-exigent circumstances." JA__(Order_864_at_48). In particular, the models accounted for volume lost as a result of customers' substitution of electronic correspondence for mail, also known as "electronic diversion." Thress concluded that "the progression of electronic diversion" reduced market-dominant mail volume by approximately 3 billion pieces in 2007 and another 2.9 billion pieces in 2008, and he excluded those amounts—as well as similar year-after-year amounts for 2009 through 2012—from his estimate of the Postal Service's losses due to the Great Recession. *See* JA__(Thress_Reply_5-6); JA__(Thress_Statement_10).[2]

Thress ultimately concluded that during the five-year period between 2008 and 2012, USPS lost 189.7 billion pieces of mail due to the Great Recession—not counting 39.1 billion pieces lost to electronic diversion—which deprived the Postal

[2] Thress also refuted some commenters' suggestion that electronic diversion had *sharply increased* beginning in 2007 or 2008. *See* JA__(Thress_Reply_6-7); JA__(POIR_3_Q.1). Most of the key technologies that had driven electronic diversion—such as e-mail, electronic bill payments, and broadband access—had existed for years and were nearing a saturation point by the time the Great Recession began.

Service of roughly $25.7 billion in "contribution" towards its institutional costs.[3] JA__(Exigent_Request_11); JA__-__, __-__(USPS_Reply_15-16_45-46); JA__ (Thress_Statement_10). For fiscal year 2012 *alone*, mail volume was 53.5 billion pieces lower than it would have been if the recession had not occurred, and contribution for that year was $7.7 billion lower. JA__(Exigent_Request_9-11); *see* JA__(Nickerson_Statement_4_n.2); JA__(Thress_Statement_7). USPS requested an exigent rate increase averaging 4.3%, spread "as close to uniform as practicable" across market-dominant mail services. JA__(Exigent_Request_7-8). That rate increase would yield additional annual contribution of $1.78 billion, which is approximately 25% of the Postal Service's actual annual losses due to the Great Recession. JA__(*Id.*_10).

After calculating its losses "due to" the recession, USPS addressed the other statutory requirements for an exigent rate increase. *See* 39 U.S.C. § 3622(d)(1)(E). The Postal Service explained that an exigent increase was "necessary" to continue providing adequate postal services because its "present and forecasted liquidity position is dangerously low." JA__ (Exigent_Request_13-17). And USPS outlined the many ways in which it had operated "under best practices of honest,

[3] The Postal Service has two types of costs. "Attributable" costs vary with mail volume and are linked to specific products and services. *See* 39 U.S.C. § 3631(b). In contrast, "institutional" costs are generally fixed and do not vary with volume. USPS seeks to charge rates that will allow each product to cover its attributable costs and make a reasonable "contribution" towards offsetting institutional costs.

efficient, and economical management." For example, despite its large base of fixed institutional costs that cannot be cut in response to volume fluctuations, the Postal Service has taken significant steps to streamline operations, reduce work hours, and improve efficiency. JA__(*Id.*_18-35). Finally, USPS also explained that the proposed rate increase was "reasonable and equitable" because it sought to recover only a fraction of the total losses caused by the recession, and the rate increases would be spread equitably among different classes of market-dominant mail. JA__(*Id.*_35).

D. The Order Under Review

The Commission reaffirmed that the Great Recession was an "extraordinary or exceptional circumstance." JA__(Order_44). The Commission granted the proposed 4.3% rate adjustment but, by a 2-1 vote, sharply limited its duration so as to yield $2.8 billion in total contribution, significantly less than the amount USPS sought to recoup (which itself was only a fraction of the loss suffered because of the recession). The dissenting Commissioner would not have limited the duration of the increase in this manner, and would have permitted USPS to recover *annual* contribution of $1.78 billion.

The majority concluded that once a so-called "new normal" had been reached, the Postal Service's losses would cease being "due to" the recession. JA__(Order_83-94). The "new normal" was essentially the point in time—based on a four-factor test the Commission created *sua sponte* and announced for the first time in the Order—where the full extent of the Postal Service's new economic reality in the wake of the recession was known.

Although the premise of the "new normal" analysis appears to be that the Postal Service can immediately adjust its costs once it understands the scope and permanence of its volume losses, *see* JA__(Order_86), the Commission did not mention the Postal Service's massive base of fixed institutional costs that could no longer be defrayed because of the persistently lower volumes produced by this "new normal." Nor did the Commission acknowledge that USPS continued to suffer from the effects of the recession long after the broader economy had begun to recover. And the Commission further held that it would not recognize volume losses as cumulative—*i.e.*, it would treat mail volume as having been lost in only a *single* year, even if that lost mail volume did not return in subsequent years due to the ongoing effects of the recession, and irrespective of whether the "new normal" had been reached under the Commission's newly created four-factor test. JA__(*Id.*_94-96).

The Commission also rejected several core aspects of the Postal Service's econometric analysis. The Postal Service's models used several "linear intervention variables" to account for the fact that the Great Recession caused a fundamental shift in the relationship between mail volume and underlying macroeconomic trends. But the Commission refused to consider those variables in calculating lost mail volume, on the ground that the Great Recession was merely a "cyclical" event rather than a long-term trend insofar as mail is concerned. JA__(*Id.*_82-83).

These holdings had a staggering impact of the size of the exigent rate adjustment. The Postal Service's models showed that it had lost $7.7 billion of contribution "due to" the recession in FY 2012 alone, but the Commission concluded that USPS had lost an *aggregate total* of $2.8 billion between 2008 and 2011 and *nothing* in 2012. JA__(*Id.*_106).

The Commission largely agreed with USPS on the other statutory elements. It determined that an exigent rate increase was "necessary" to help the Postal Service confront its ongoing liquidity crisis. JA__(*Id.*_115-22). And the Commission further concluded that USPS was engaging in "best practices of honest, efficient, and economical management" within statutory constraints imposed by Congress (such as the universal service mandate). JA__(*Id.*_122-36). The Commission also held that the Postal Service's proposed exigent rate increase of 4.3% was reasonable and equitable, and was unlikely to result in "rate shock" for mailers. JA__, __(*Id.*_155-57_166-69).

In sum, the Commission concluded that the Postal Service incurred a "quantifiable one-time contribution loss" of $2.8 billion due to the Great

Recession, and it allowed USPS to impose a 4.3% surcharge on market-dominant products until that "fixed amount" has been recovered. JA__(*Id.*_180-85). The Commission expected that it would take "longer than a year, but less than two" to recover that amount, and it instructed the Postal Service to provide quarterly reports about the status of its recoupment efforts. JA__(*Id.*).

Vice-Chairman Taub dissented. He believed the majority had improperly "moved the goal posts" about the evidentiary showing required for a rate adjustment by "dismiss[ing] critical aspects of the Postal Service's data that are based on expert analysis and estimation methodologies." JA__(Dissent_3-4). He emphasized that Thress' models and analysis were "a credible attempt to distinguish the causes of the volumes lost," and that the majority inappropriately held USPS to a "strict[er] level of precision" than the standards articulated in the Commission's previous orders. JA__(*Id.*_3-4).

Vice-Chairman Taub also sharply criticized the Commission's "new normal" analysis, emphasizing that "[t]he record before the Commission demonstrates that the Great Recession, and its impact on mail volumes, continues to have a negative impact on the Postal Service" even after a "new normal" has been reached, and that the "new normal" is itself "due to" the recession. JA__(*Id.*_4-5). He further explained that USPS's institutional costs are driven by its large and growing delivery network, and are a function of "universal service obligations and service standards" rather than changes in mail volume. JA__(*Id.*_6). It was thus unrealistic for the Commission to expect USPS to quickly adapt to a "new normal" because "unlike entities in the private sector, USPS cannot suddenly eliminate institutional costs in response to volume declines by shrinking the size and scale of its networks." JA__(*Id.*_5).

SUMMARY OF ARGUMENT

I. This Court remanded the Commission's previous exigent rate increase order because the Commission erred in interpreting the "due to" element of the statute. The order under review fares no better. The Commission's approach to calculating the Postal Service's losses "due to" the Great Recession was plagued by several serious methodological errors that render the Commission's analysis arbitrary, capricious, and contrary to the clear terms of the statute.

A. The Commission's decision is premised on the demonstrably false assumption that mail volume can be lost "due to" the recession in only a *single* year. To the contrary, losses are often cumulative, and pieces of mail should be counted as "lost" in *each year* they were not sent as a result of the recession. If a person who previously sent 12 pieces of mail per year did not send any mail between 2008 and 2010 because of the recession, USPS would have lost 12 pieces of mail each year, for a total loss of 36 pieces. Under the Commission's approach, however, this would be arbitrarily treated as a single loss of 12 pieces. The

Commission's "count once" rule is an unreasonable interpretation of the "due to" element, and results in a significant under-counting of the Postal Service's true losses.

B. Based on a four-factor test it invented *sua sponte*, the Commission further held that mail volume losses may no longer be deemed "due to" the recession once a "new normal" had been reached for each class of mail. But the very notion of a "new normal" underscores ongoing effects "due to" the recession. If the Great Recession had been more like previous recessions, mail volume would have simply returned to *normal*, not a permanently lower "new normal."

The Commission's "new normal" analysis also conflates the different elements of the exigent-rate provision. Under the "due to" inquiry, the sole question is whether the recession *caused* the Postal Service's losses. Other provisions of the statute—specifically, the requirement that any rate adjustment be "reasonable and equitable and necessary"—address whether USPS should be allowed to *recover* for those losses. Any concerns about whether USPS is doing enough to adapt to changed circumstances are properly addressed through the "reasonable and equitable and necessary" inquiry, not the "due to" inquiry. For the same reason, the Commission's "new normal" analysis is flatly inconsistent with other parts of the Order in which the Commission correctly recognized that an exigent rate adjustment *was* "necessary" even though USPS had been aggressively cutting costs and increasing efficiency.

The new normal analysis also requires a remand for the independent reason that it is wholly inconsistent with earlier Commission orders addressing the standard for granting an exigent rate increase, and the Commission adopted a novel four-factor test for when the "new normal" applies without adequate notice and opportunity for comment.

C. Even if the Commission's "new normal" approach were appropriate more generally—and it is not—the Commission still under-counted the Postal Service's losses by arbitrarily setting the point at which the "new normal" has been reached. USPS's estimates of lost mail volume were based on a highly granular analysis of each *sub-class* of mail; for example, there were three separate sub-classes of First-Class Mail and four separate sub-classes of Standard Mail. Yet the Commission lumped all of those sub-classes together and analyzed lost volume at the broadest possible "class" level. As a result, the Commission overlooked the differences *within* each class of mail, and significantly under-counted the Postal Service's true losses resulting from the recession.

II. The Commission also arbitrarily chose to jettison several variables from the Postal Service's models that were designed to capture the way in which the Great Recession fundamentally altered the *relationship* between mail volume and macroeconomic conditions. The Great Recession was not just a cyclical downturn, as it had powerful long-term effects on consumer behavior—*i.e.*, consumers did not spend as freely after the recession and were less willing to take on debt. The Postal Service's econometric models included "linear intervention variables" that estimated the effect of those long-term trends on mail volume. Bafflingly, the Commission ignored all of this evidence (as well as its own prior conclusions) and held that the Great Recession was merely a "cyclical" event. That holding was arbitrary and capricious, and resulted in a reduction of billions of dollars from the amount USPS will be allowed to recover through an exigent rate adjustment.

STANDARD OF REVIEW

The Order must be held unlawful if it is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A); *see* 39 U.S.C. § 3663 (Commission actions reviewed under APA standards). While the Court will not "substitute its judgment for that of the [Commission]," the Commission must "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Motor Vehicle Mfrs. Ass'n v. State Farm,* 463 U.S. 29, 43 (1983).

The Commission's action must be set aside as arbitrary and capricious if it is "'illogical on its own terms.'" *GameFly v. PRC*, 704 F.3d 145, 148 (D.C. Cir. 2013). The Court does not hesitate to remand when it finds that the Commission has "proceed[ed] in a slapdash manner" by issuing an order "rife with anomalies." *LePage's v. PRC*, 642 F.3d 225, 230-31 (D.C. Cir. 2011).

ARGUMENT

I. The Commission's Analysis Of The Mail Volume Lost "Due To" The Great Recession Was Fundamentally Flawed And Misconstrued The Statutory Text.

To be eligible for an exigent rate adjustment, USPS must show that it incurred losses "due to either extraordinary or exceptional circumstances." 39 U.S.C. § 3622(d)(1)(E). The Order must be remanded because the Commission has adopted a fundamentally flawed interpretation of the "due to" requirement that renders its analysis arbitrary, capricious, and contrary to law.

A. The PRC's Conclusion That Mail Volume "Lost" in One Year Cannot Remain Lost in Subsequent Years Is Arbitrary, Capricious, and Contrary to Law.

1. The Commission has never disputed that the Great Recession lasted more than one year. *See* Order 547 at 79 ("the recession officially began in December 2007 … and ended in June 2009"). And the *effects* of the recession continued—and are continuing—long after its official end date. Indeed, it is the recession's protracted nature, combined with its especially severe impact on mail-intensive sectors of the economy, that make it an extraordinary circumstance warranting an exigent rate increase. Unlike past recessions, mail volume did not rebound to previous levels after the recession ended; indeed, several market-dominant mail services either declined or barely increased even as the broader economy began growing again. JA__(Thress_Statement_5-7).

The Commission acknowledged that the recession impacted mail volume over multiple years. But it nonetheless decided to count pieces of mail as "lost" only in the *first* year the recession wiped them from the Postal Service's books, even if those pieces of mail remained lost and did not return in subsequent years. *See* JA__(Order_95-96). In short, the Commission concluded that "volume is lost once." JA__(*id.*_96). That conclusion is arbitrary and capricious and a patently unreasonable interpretation of the PAEA's "due to" element.

In particular, the Commission ignored the fact that losses are often *cumulative*, and functionally identical pieces of mail can be lost "due to" the recession in more than one year. If pieces of mail were lost as a result of the recession in 2008, and the recession kept those pieces of mail from returning in 2009, the loss was attributable to the recession in *both* years, and should be counted as such in the calculation of lost mail volume. As the Postal Service explained, "it is important to recognize that 'lost' volume in any given year can be volume that is lost for the first time in that year, or volume that was first lost in a previous year and continues to be lost in the subsequent year."

JA__(USPS_Reply_Comments_13-14); *see* JA__(*id.*_14) ("The financial effect of a piece of lost mail in any given year is the same whether that piece was first lost in the year in question, or whether the piece was first lost in a previous year and has simply not returned in the year in question.").

To take a concrete example, assume that a person had been sending 12 pieces of mail each year to pay his monthly cable bill, but then canceled his cable subscription in December 2007 after losing his job as a result of the recession, and did not re-start his cable service until he found a new job in January 2011. Clearly, the loss of mail volume would not be limited to 2008. Instead, between 2008 and 2010, USPS would have lost 12 pieces of mail from this customer *each year* "due to" the recession—36 pieces of mail total. But under the Commission's approach, this would be treated as only a one-time loss of 12 pieces of mail. The effect of the Commission's "volume is lost once" rule is to dramatically and arbitrarily under-count the Postal Service's actual losses "due to" the Great Recession.

2. Despite the importance of this basic methodological issue, the Commission offered only two brief rationales for its "count once" approach, both of which are wholly without merit.

First, the Commission stated that any other rule would make it "impossible … to calculate the total amount lost due to the exigent circumstance, the Great Recession" because there is no obvious point at which the Commission would stop counting the lost volume. JA__(Order_95). In other words, the Commission expressed concern that, without the "count once" rule, USPS would "use the exigency provision to circumvent the price cap indefinitely." JA__(*Id.*_96).

But there are multiple responses to this first concern. Most fundamentally, the Commission's concern with the Postal Service using permanent losses due to exigent circumstances "to circumvent the price cap indefinitely" is properly addressed elsewhere in the statute. That concern provides no basis to artificially truncate the calculation of losses that are quite clearly "due to" the Great Recession. For purposes of the "due to" element of the statute, the sole inquiry is whether the exigent event *caused* USPS to lose mail volume. *See USPS*, 640 F.3d at 1267 ("[t]he plain meaning of 'due to' is 'because of'"). But even if the Postal Service makes that threshold showing, the Commission may still deny or restrict an exigent rate increase based on the other statutory factors. In particular, the Commission may deny a rate adjustment that is not "reasonable and equitable and necessary" to allow USPS to continue providing "the kind and quality [of postal services] adapted to the needs of the United States." 39 U.S.C. § 3622(d)(1)(E). Any concerns about a rate increase lasting too long or being too large are properly addressed through the "reasonable and equitable and necessary" part of the statutory test, not through a cramped and implausible interpretation of the "due to" element. *See also infra* pp. 31-36.

But even if the Commission were right that it needed to pick some period after which it should stop counting, the Commission itself managed to do just that elsewhere in its order without resorting to its "count once" rule. *See* JA__(Order_94) (listing precisely when Commission would stop counting for each class of mail under its "new normal" analysis).[4] Thus, at a bare minimum, there is no basis to stop counting lost mail volume after one year when that same mail volume was missing for the same reason in subsequent years within the period the Commission itself determined marked the duration of the Great Recession's effects.

Moreover, the Postal Service submitted the *precise* figures the Commission claims it would be "impossible" to compute. The Thress analysis calculated annual mail volume losses, broken down according to both class and year. *See* JA__, __(Thress_Statement_4_8-10). The calculation of total volume losses requires only the simple addition of the volume lost for each year USPS incurred losses due to the recession.[5] The Commission was thus flatly wrong to suggest that the Postal

[4] To be sure, for the reasons discussed below, USPS strongly disagrees with the Commission's selection of the specific endpoints for its analysis based on the "new normal."

[5] For example, the Commission found that USPS lost 582.7 million pieces of First-Class Mail due to the recession in FY 2008 and an *additional* 1,863.9 million pieces in FY 2009. JA__(Order_101). It follows quite easily that the aggregate loss in FY 2009 was 2,446.6 million pieces (1,863.9 + 582.7), *not* 1,863.9 million,

Service's approach would make it "impossible … to calculate the total amount lost due to the exigent circumstance." JA__(Order_95); *see Advocates for Highway & Auto Safety v. Fed. Motor Carrier Safety Admin.*, 429 F.3d 1136, 1146 (D.C. Cir. 2005) (agency's "baffling" decision to disregard economic analysis in the record rendered its decision arbitrary and capricious).

As a second justification for its "count once" approach, the Commission suggested that once USPS loses a piece of mail, it becomes "aware of that loss and [can] adjust[] its expectations." JA__(Order_96). That holding is part and parcel of the Commission's broader holding regarding the "new normal," conflates the "due to" causation prong with separate statutory requirements, and is meritless for all of the same reasons discussed below in Part I.B. The Postal Service has a massive base of fixed institutional costs to fulfill obligations imposed by Congress, and it is wholly unrealistic to expect USPS to "adjust" those institutional costs in response to short-term changes in volume. *See* JA__(Dissent_6) (USPS "lacks the ability to react as quickly as private companies might in response to adverse circumstances" because of its "universal service obligations and service standards").

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and the cumulative two-year loss over FY 2008-09 was 3,029.3 million pieces (2,446.6 + 582.7), *not* 2,444.6 million.

Indeed, the Commission's "count once" rule is even more unrealistic than its "new normal" analysis (discussed below). The premise of the "new normal" analysis is that once a "new normal" had been reached in the wake of the Great Recession, any ongoing losses were no longer "due to" the recession because the Postal Service had become aware of the full extent of the recession's impact on mail volume and should have been able to adjust operations to the lower volumes. JA__(Order_86). The "volume is lost once" rule, in contrast, assumes that USPS is able to adjust its operations *every year* in response to volume declines. In other words, the Commission has required the Postal Service to immediately adapt to volume losses before it knows the full extent of those losses or whether they are permanent, and even before the Great Recession has ended or the so-called "new normal" has arrived. The "count once" rule is thus blatantly inconsistent with other aspects of the Commission's own analysis, in addition to being arbitrary and capricious and contrary to law in its own right.

* * *

In sum, the Commission's basic but critical methodological error of counting losses in only one year conflates incremental volume losses with aggregate volume losses, and wholly disregards the fact that losses are often cumulative and equivalent pieces of mail can be lost more than once. This Court need not calculate the precise monetary impact of the Commission's error in order to grant the petition for review, as any such quantification can be performed by the Commission in the first instance on remand. *See PPG Industries v. United States*, 52 F.3d 363, 365-66 (D.C. Cir. 1995) ("Under settled principles of administrative law, when a court reviewing agency action determines that an agency made an error of law, the court's inquiry is at an end: the case must be remanded to the agency for further action consistent with the corrected legal standards."). In all events, this error *alone* caused the Commission to underestimate the Great Recession's impact by approximately 9.82 billion additional pieces of lost mail and $1.19 billion in lost contribution.

B. The PRC's "New Normal" Analysis Misconstrues the Meaning of the Statute and Is Arbitrary and Capricious.

Having erred in determining how to count the losses "due to" the recession, the Commission then compounded that error by arbitrarily deciding when to stop counting. The Postal Service provided extensive evidence showing that even after the Great Recession nominally ended in July 2009, it continued to have a powerful *ongoing* effect on long-run trends in mail volumes. *See* JA__ (Renewed_Request_11) ("[I]t was plain to anyone who lived through the recession that its effects did not instantaneously disappear in July 2009."); JA__ (Thress_Statement_7); JA__(Thress_Reply_9-11). Even after the recession ended, sectors of the economy that use large volumes of mail—such as real estate, banking, and advertising—continued to fare poorly, and there was a large gap between actual mail volume and what volume *would have been* if the recession had never occurred. JA__(*Id.*_9-14); JA__(Thress_Statement_5-6).

The Commission largely ignored that analysis. Instead, the Commission concluded that once the recession plateaued and a "new normal" had taken hold, any further losses incurred by the Postal Service were no longer "due to" the recession. JA__(Order_85-86). Because the Commission had not previously identified the "new normal" as a relevant legal benchmark, no commenter proposed a test for determining what the "new normal" was or when it had been reached, *see* JA__(Order_86), and so the Commission simply created a test from whole cloth. The Commission concluded that a "new normal" arrived when "all or most" of four things happened: (1) macroeconomic indicators demonstrate a "return to near historic positive trends"; (2) the rate of change on mail volumes is "positive"; (3) USPS "regains its ability to predict or project mail volumes; and (4) USPS "demonstrates an ability to adjust operations to the lower volumes." JA__(Order_86).

The Commission's "new normal" framework conflates and misapplies the statutory criteria, is flatly inconsistent with other portions of the Order, and was adopted without proper notice. The Commission's resulting order is arbitrary and capricious and contrary to law, and requires a remand.

1. The PAEA authorizes exigent rate increases to recover losses "due to either extraordinary or exceptional circumstances." 39 U.S.C. § 3622(d)(1)(E). The sole question for purposes of the "due to" element is whether USPS demonstrated that the exigent event *caused* the loss. As this Court has explained, "[t]he plain meaning of 'due to' is 'because of.'" *USPS*, 640 F.3d at 1267.

The Commission's "new normal" analysis is a patently unreasonable interpretation of "due to." If mail volume falls by 20% during a recession before stabilizing at a new, lower level, this hardly means that the effects of the recession are over. To the contrary, there is still a 20% volume gap each year "due to" the ongoing effects of the recession; if the recession had not occurred, volume would have been 20% higher. Indeed, the very notion of a permanently lower "new normal" underscores the long-term losses "due to" (*i.e.*, caused by) the recession. In a lesser economic downturn, volume would return to normal, not settle at a *new* normal.

Indeed, that is precisely what the data show. In previous recessions, mail volume trends were "essentially the same after the recession as before." JA__(Thress_Statement_7); JA__(Thress_Reply_10). But the Great Recession of 2007 to 2009 was not just a downturn in the business cycle. It was accompanied by a financial crisis and mortgage meltdown, and had especially severe effects on sectors that are heavy users of mail. As a result, mail volumes continued to have negative or barely positive growth even as the broader economy began to recover. JA__(Thress_Statement_6-7). The Postal Service thus continued to incur losses "due to" the recession even after the recession had nominally ended. Indeed, it is only because of the unique severity of this recession that mail volume was stuck in a permanently lower "*new* normal"; after all previous recessions, mail volume trends had returned to a "*normal* normal" once the recession ended. *See* JA__(Thress_Reply_10).

As Vice-Chairman Taub asked rhetorically in his dissent, "[h]ow is this 'new normal' **not** 'due to' the exigent circumstance—the Great Recession?" JA__(Dissent_5). Mail volume in 2011 and 2012 was "substantially below what it would have been in the absence of the Great Recession," and the Commission failed to appreciate that "regardless of the volume loss found due to the Great Recession, the financial harm of that loss *does not end immediately*" once things stabilize. JA__(*Id.*_6) (emphasis added). Although there may be some disagreement over *how long* the impact of the recession lasted, "there can be no reasonable disagreement that it persists for some time." JA__(*Id.*).

To take another example, if California seceded from the United States and formed its own postal service, the U.S. Postal Service would incur a sharp loss of mail volume. Those losses would rather quickly stabilize at a new and permanently lower level. But there is no serious question that USPS would incur an ongoing gap in mail volume "due to" California's secession even after the so-called new normal for the 49-State Union had been reached.

2. The Commission's "new normal" analysis improperly conflates the question of whether the recession *caused* the loss with the entirely separate question of whether the Postal Service should be allowed to *recover* for the full extent of that loss through an exigent rate increase. Those questions are distinct, and they are addressed in separate provisions of the statute.

Under the statute, the first question is simply whether USPS incurred losses "due to"—*i.e.*, "because of"—the exigent event. *USPS*, 640 F.3d at 1267. If so, the Commission then moves on to the second question of whether "such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." 39 U.S.C. § 3622(d)(1)(E). The two inquiries are separate, as the Commission itself has recognized. *See* JA__(Order_22-23) (noting distinct meaning of "due to" requirement and "reasonable and equitable and necessary" requirement).

The very test the Commission fashioned underscores that its new normal inquiry conflates distinct parts of the statute. A core part of the Commission's test for determining whether the "new normal" had been reached is an evaluation of whether USPS "regain[ed] its ability to predict or project mail volumes" and "demonstrate[d] an ability to adjust operations to the lower volumes." JA__(Order_86). But those considerations have nothing to do with the basic but-for causation question of whether USPS incurred losses "due to" the recession.

Instead, the Postal Service's ability to *adapt* to an exigent circumstance plainly belongs in the second step of the analysis: whether a rate adjustment is or remains "necessary" to enable USPS to continue providing services "of the kind and quality adapted to the needs of the United States" under "best practices of honest, efficient, and economical management." *Id.* § 3622(d)(1)(E). Indeed, the Commission acknowledged elsewhere that that "the Postal Service's *response to the extraordinary or exceptional circumstances* … inform[s] the determination of whether the Request is necessary." JA__(Order_123) (emphasis added).

In other words, if USPS can adjust its operations in response to an exigency, then a rate increase might not satisfy the "necessary" element of the statute. Yet the Commission's "new normal" analysis injects that same inquiry into the threshold question of whether the recession *caused* the Postal Service's losses. The Commission's "new normal" analysis is contrary to law because it muddles and collapses what should have been two separate elements of the statutory inquiry. The Commission apparently recognized this tension in its analysis, noting that "how the Postal Service has reacted to the volume loss in terms of shedding mail capacity or how it should adjust its network to the new normal … might be relevant to the 'necessary' analysis," but that inquiry is "independent" of the "[q]uantification of such losses." JA__(Order_97-98). The Commission nonetheless proceeded with its "new normal" test as part of its calculation of losses "due to" the recession.

3. Because the Commission blurred the two separate prongs of the statutory test, the Order is also internally inconsistent and self-contradictory. *See LePage's*, 642 F.3d at 230-31 (agency action "rife with anomalies" was arbitrary and capricious). In its "new normal" analysis, the Commission concluded—in a single paragraph—that the Postal Service should have been able to "adjust its operations to react to lower mail volumes" by 2010 for most market-dominant services. JA__(Order_94). But that is flatly contrary to Part V of the Order, which addresses whether the proposed rate adjustment was "necessary" to "maintain and continue" postal services of "the kind and quality adapted to the needs of the United States." 39 U.S.C. § 3622(d)(1)(E). In that section, the Commission exhaustively explained why USPS needs an exigent rate increase because it *cannot* simply adjust to changed conditions. *See* JA__(Order_107-38).

Unlike a private business, the Postal Service must comply with a series of external statutory mandates that severely limit its ability to cut costs or streamline operations. Most notably, Congress requires USPS to "provide prompt, reliable, and efficient services to patrons in all areas and [to] render postal services to all communities." 39 U.S.C. § 101(a). Because of that statutorily-imposed universal service mandate, the Postal Service has a massive base of fixed "institutional costs" that cannot simply be cut in response to changes in mail volume. According to the Commission, "[t]he primary driver of institutional cost, other than [retiree health benefits], is the street portion of delivery costs." Financial Analysis 2013, Docket ACR2013 at 23 (Mar. 18, 2014), *available at* http://1.usa.gov/1imJ3K2. Those costs typically "do not vary with volume because the carriers must travel the delivery route regardless of the amount of mail they are carrying." *Id*.[6]

A number of commenters in this proceeding argued that the Commission should refuse to grant an exigent rate increase because USPS was not doing enough to cut costs and streamline operations. *See* JA__(Order_128-30) (summarizing comments). But the Commission *rejected* those arguments. JA__(Order_131-36). As the Commission explained, "the unique framework within which the Postal Service must operate is a relevant consideration in determining what constitutes best practices." JA__(Order_127). Any analysis of the Postal Service's operations must necessarily consider USPS's "efforts to

[6] A recent example of an external mandate precluding USPS from shedding institutional costs is the Postal Service's proposal to switch from six-day to five-day mail delivery. The Commission criticized that proposal, and Congress passed a Continuing Resolution renewing the six-day delivery requirement.

comply with statutory and regulatory requirements," such as the universal service mandate. JA__(*Id.*).

The Commission determined in Part V of the Order that USPS "'is making strides over time to cope with volume declines consistent with how the PAEA was intended to function.'" JA__(Order_131). Indeed, the Commission spent several pages describing the many ways in which the Postal Service sought to cut costs and promote efficiency within the bounds of its statutory constraints and mandates. JA__-__(Order_131-36).

The difference between Part V of the Order and the "new normal" analysis is striking. The Commission determined in Part V that USPS needed an exigent rate adjustment *in addition to* the many steps it was taking to cut costs within the bounds of its statutory constraints. But the "new normal" analysis in Part IV was used to cut off a significant portion of the requested rate adjustment on the ground that USPS should have been able to "adjust its operations to react to lower mail volumes" for most classes of mail by the beginning of 2010. JA__(Order_94). The Commission got it right in Part V. As Vice-Chairman Taub explained, "[t]he 'new normal' appears to assume the Postal Service could shed its fixed (institutional) cost obligations instantaneously with exogenous events." JA__(Dissent_6). But that assumption has no basis in reality, as the Commission well knows, *see* 2013 Financial Analysis, *supra* at 23, and as it reinforced in

Part V: "Universal service standards and obligations, rather than mail volume, are in many respects the more critical drivers" of the Postal Service's massive network costs. JA__(Dissent_6).

4. Finally, and perhaps the root cause of the substantive problems with the Commission's "new normal" analysis, the Commission created its four-factor "new normal" framework out of whole cloth, without the benefit of input from USPS (or the mailers, for that matter). An agency violates both the APA and due process principles when it "announc[es] its decision *sua sponte* without prior notice to the parties." *Public Serv. Comm'n of Kentucky v. FERC*, 397 F.3d 1004, 1011-12 (D.C. Cir. 2005); *see id*. at 1012 (finding order arbitrary and capricious where agency "failed to place the parties on notice that its … order would contemplate an incentive-based premium").

Order 864, which the Commission adopted in the wake of this Court's remand, describes the showing USPS must make to establish that it incurred losses "due to" the Great Recession. Under that order, the Postal Service was "simply expected to support its exigent request with credible proof," and to ensure that its models "factor[ed] out the financial impact of non-exigent circumstances, such as the continuing effects of electronic diversion." JA__, __(Order_864_at_48_52).

Nothing in Order 864 remotely suggested that the effects of the recession would be deemed over once a "new normal" had been reached, nor did it articulate the criteria that would be used to determine when the new normal had arrived. Yet, in this proceeding, the Commission invented a four-factor test *sua sponte*, and used that test to severely reduce the magnitude of the exigent rate adjustment. JA__(Order_86). Indeed, the Commission candidly acknowledged that "[n]o commenter has suggested a test for determining when the new normal has arrived." JA__(*Id.*). That is undoubtedly because none of the concerned parties was notified that the "new normal" was a legally relevant concept under the "due to" clause in need of a four-part test.

As Vice-Chairman Taub emphasized in his dissent, the Commission essentially introduced "*four new standards* to determine the end of what can be calculated 'due to' the exigent event, centered on a view of what is a purported 'new normal.'" JA__(Dissent_4). That new test was adopted "with no opportunity for input or comment," and was contrary to the Commission's earlier orders regarding the scope of the "due to" inquiry. JA__(*Id.*). For this reason alone, the Order must be remanded to ensure that interested parties have notice and an opportunity to comment on all aspects of the Commission's methodology.

* * *

The Commission's "new normal" analysis badly misinterprets the scope of the "due to" inquiry, conflates and misapplies the elements of the statute, is flatly inconsistent with other provisions of the Order, and was adopted without sufficient notice. That analysis was central to the Commission's Order, and the "new normal" error combined with the "count once" error resulted in an under-counting of the Postal Service's losses by approximately 80.4 billion pieces of mail and $8.7 billion of contribution over the five-year period between 2008 and 2012.

C. Even if the "New Normal" Framework Is Somehow Valid, the Commission Arbitrarily and Capriciously Calculated Loss Based on Broad Classes of Mail Rather Than Specific Sub-Classes.

Even if the Commission's "new normal" framework were a proper basis for cutting off USPS's recession-induced losses—and it is not—the Commission committed a separate counting error by applying the "new normal" analysis at a much-too-high level of generality, thereby drawing the "new normal" line at an arbitrary point in time.

The Postal Service's detailed econometric analysis catalogued losses down to the "category" or "sub-class" level. For example, for First-Class Mail, Thress provided three separate demand equations for "First-Class Single-Piece Letters, Cards, and Flats," "First-Class Workshared Letters, Cards, and Flats," and "First-Class International Letters, Cards, and Flats." JA__(Order_46). And Thress employed four different equations for Standard Mail: Standard Regular Mail, Standard ECR Mail, Standard Nonprofit Mail, and Standard Nonprofit ECR Mail. Each sub-class of mail has unique characteristics and is affected differently by broader macroeconomic trends, and the Postal Service's models were designed to capture those distinctions.

The Commission, however, arbitrarily glossed over those important differences. Rather than providing a granular analysis as USPS had done, the Commission lumped all of the sub-classes together and conducted its "new normal" analysis at the much-broader class level (*e.g.*, "First Class Mail," "Standard Mail," "Periodicals," and "Package Services."). *See* JA_(Order_92-93).

Assessing a "new normal" date by class, instead of category, clouds the fact that different sub-classes of mail plateaued at different times. For example, the Commission determined that First Class Mail reached the "new normal" as a class at the end of FY 2010. *See* JA__(Order_93-94). But different categories of mail *within* that class reached the "new normal" at different times: FY2010 for First-Class International Mail, FY2011 for First-Class Presort Mail, and FY2012 for First-Class Single Piece Mail.

Setting the "new normal" endpoints by class rather than sub-class—compounded by the "count once" error discussed above—led the Commission to underestimate the Great Recession's impact by 30.9 billion pieces of lost mail volume and $3.81 billion of lost contribution between 2008 and 2012. Even accepting the notion that losses can no longer be "due to" the recession once a "new normal" is reached—and accepting all of the Commission's findings concerning the econometric modeling of the recession's impact—correcting these counting errors alone would have more than doubled the volume and contribution losses the Commission ultimately recognized. *See* JA__(Order_106) (finding 25.2 billion pieces of lost volume and $2.76 billion of lost contribution).

The Commission offered no explanation for its rejection of the far-more-specific category-based data in favor of a broader, class-based analysis. The entire purpose of the proceedings before the Commission was to calculate losses due to the recession, and it is baffling that the Commission would not embrace the most precise data available. The Commission's failure to offer a rationale for this arbitrary distinction does not reflect reasoned agency decision-making, and is sufficient to warrant a remand. *See LePage's*, 642 F.3d at 231-32 (remanding so that Commission could "explain its departure from the … order" and "adopt a reasoned rationale" for the classification); *Am. Radio Relay League v. FCC*, 524 F.3d 227, 233 (D.C. Cir. 2008) (while courts will "show considerable deference to an agency's expertise," they still require "[a]t least a modicum of reasoned analysis").

II. The Commission's Estimation Techniques Were Arbitrary And Capricious.

The Commission committed another fundamental error in its analysis of the effects of the Great Recession by ignoring the factors that made *this* recession more drastic and severe than an ordinary economic downturn. Unlike cyclical dips in the economy that preceded it, this recession fundamentally shifted the relationship between mail volume and other macroeconomic variables, a point the Commission implicitly recognized with its "new normal" concept. Reflecting this fundamental change in economic conditions, the Postal Service's request for an exigent rate request was not premised on the existence of a slight economic slowdown. Rather, the circumstances of the Great Recession that made it so clearly extraordinary are *precisely* those factors that reflect the fundamental shift in the interaction among macroeconomic variables.

The Postal Service's analysis accounted for the particular severity and magnitude of the recession by calculating the value of the fundamentally altered relationship between mail volume and underlying macroeconomic factors. JA__(Thress_Statement_7). As Mr. Thress explained, one "distinct" feature of the Great Recession is that it "affected not only the cyclical demand for goods and services but it also had a significant impact on long-run macro-economic trends." JA__(POIR_1_Q.9). That is, "people are not spending as freely as they did before the recession even if their employment and income situation has returned to the pre-recession level," and consumers are "far less willing to take on debt." JA__(*Id.*). These "changes in consumer behavior have had a significant effect on underlying mail volume trends and are likely to continue to adversely affect the

Postal Service *even as the cyclical effects of the Great Recession are over*." JA__(*Id.*) (emphasis added).

To the extent these fundamental, long-run changes were "triggered by the Great Recession," it is "obviously [] correct to include such volume as having been lost due to the Great Recession." JA__(*Id.*). USPS's econometric models employed "intervention variables" to account for the effect of this foundational shift. *See* JA__(Order_47-49).[7] Consistent with the Commission's instructions in Order 864, that analysis was based on the Postal Service's standard "volume forecasting methodology." JA__(Order_864_at_50).

Even though USPS did *precisely* what was required by Order 864, the Commission arbitrarily discarded certain intervention variables and thereby failed to account for the full measure of the recession's effect on mail volumes. Specifically, the Commission ignored a subset of "linear" intervention variables that were "intended to capture changes to long-run mail trends which are attributable to the Great Recession." JA__(POIR_7_Q.14). The Commission jettisoned those variables from its analysis on the ground that "the Great Recession is a *cyclical event*," not a "[l]ong term trend." JA__(Order_82) (emphasis added).

[7] Intervention variables measure changes in the level of mail volume beginning at a particular time. JA__(*Id.*_n.32); *see* JA__(POIR_4_Q.8).

There are two fundamental flaws in the Commission's disregard of the linear intervention variables. At the outset, the Commission had already recognized in its previous orders that the Great Recession was not just a cyclical economic downturn, but an event whose impact on the Postal Service was "*unique in kind and severity*." Order No. 547 at 50 (emphasis added). Indeed, according to the Commission, the Great Recession produced a new economic reality—a "new normal"—for mail volume. Those conclusions alone should have justified the use of linear intervention variables to capture changes in long-run trends due to the recession.

In all events, the Commission was flatly wrong to suggest that there was no evidence showing that "changes in long run trends … are due to the Great Recession." JA__(Order_81). USPS submitted an abundance of record evidence on that exact point. Mr. Thress *repeatedly* emphasized that "the impact of the Great Recession on mail volumes (and many other things) is neither 'short-term' nor is it a 'cycle,'" and that "one impact of the Great Recession was to *change long-term trends in mail volumes*." JA__(Thress_Reply_9-11) (emphasis added); *see* JA__(POIR_1_Q.9) (Great Recession "affected not only the cyclical demand for goods and services but [] also had a significant impact on long-run macro-economic trends"); JA__(POIR_3_Q.1) (Great Recession "appears to have affected the growth rate of the economy well after the Great Recession ended.");

JA__(POIR 3_Q.2) (explaining relationship between recession and linear trend variables).

The Commission failed even to acknowledge this evidence, much less refute it. Vice-Chairman Taub, in contrast, correctly recognized that "the Great Recession had a starkly atypical effect on mail volume," and was "neither 'short term' nor a 'cycle.'" JA__(Dissent_5). He emphasized that "one impact of the Great Recession was to change long-run trends in mail volumes," and that the Postal Service's models were exactly "what is required by Order No. 864." JA__(*Id.*). The majority improperly "moved the goal posts" about the evidentiary showing required for a rate adjustment when it "dismiss[ed] critical aspects of the Postal Service's data that are based on expert analysis and estimation methodologies." JA__(Dissent_3-4).

In sum, both the Commission's inexplicable statement that the Great Recession was "a cyclical event," JA__(Order_82), and its plain disregard for substantial evidence supporting the use of linear intervention variables are arbitrary and capricious. Again, the Court need not quantify the precise impact of those errors to grant the petition for review, but it is significant. Considering only First-Class Mail in the three years before the supposed "new normal" took hold, the Commission's exclusion of the linear intervention variables reduced the calculation of volume losses by 22 billion pieces of mail and reduced contribution losses by nearly $6 billion.

CONCLUSION

The Court should grant the petition for review and remand for further proceedings.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH TYPE-VOLUME LIMITATION

I hereby certify that:

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(N) and the briefing order issued on March 19, 2014 because it contains 9,991 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii) and Circuit Rule 32(a)(1).

2. This Brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the typestyle requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in 14-point font.

Dated: April 15, 2014

s/Barbara A. Smith
Barbara A. Smith

CERTIFICATE OF SERVICE

I hereby certify that on April 15, 2014, I electronically filed the foregoing Page-Proof Opening Brief for Petitioner United States Postal Service with the Clerk of Court for the United States Court of Appeals for the District of Columbia Circuit by using the appellate CM/ECF system, thereby serving all persons required to be served.

s/Paul D. Clement
Paul D. Clement

Addendum

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Postal Accountability and Enhancement Act of 2006
39 U.S.C. § 3622

Modern Rate Regulation

(a) AUTHORITY GENERALLY.–The Postal Regulatory Commission shall, within 18 months after the date of enactment of this section, by regulation establish (and may from time to time thereafter by regulation revise) a modern system for regulating rates and classes for market-dominant products.

(b) OBJECTIVES.–Such system shall be designed to achieve the following objectives, each of which shall be applied in conjunction with the others:

(1) To maximize incentives to reduce costs and increase efficiency.
(2) To create predictability and stability in rates.
(3) To maintain high quality service standards established under section 3691.
(4) To allow the Postal Service pricing flexibility.
(5) To assure adequate revenues, including retained earnings, to maintain financial stability.
(6) To reduce the administrative burden and increase the transparency of the ratemaking process.
(7) To enhance mail security and deter terrorism.
(8) To establish and maintain a just and reasonable schedule for rates and classifications, however the objective under this paragraph shall not be construed to prohibit the Postal Service from making changes of unequal magnitude within, between, or among classes of mail.
(9) To allocate the total institutional costs of the Postal Service appropriately between market-dominant and competitive products.

(c) FACTORS.–In establishing or revising such system, the Postal Regulatory Commission shall take into account–

(1) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;
(2) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to each class or type of mail service through reliably identified causal relationships plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;
(3) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;
(4) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

(5) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;
(6) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;
(7) the importance of pricing flexibility to encourage increased mail volume and operational efficiency;
(8) the relative value to the people of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;
(9) the importance of providing classifications with extremely high degrees of reliability and speed of delivery and of providing those that do not require high degrees of reliability and speed of delivery;
(10) the desirability of special classifications for both postal users and the Postal Service in accordance with the policies of this title, including agreements between the Postal Service and postal users, when available on public and reasonable terms to similarly situated mailers, that–

(A) either–

(i) improve the net financial position of the Postal Service through reducing Postal Service costs or increasing the overall contribution to the institutional costs of the Postal Service; or
(ii) enhance the performance of mail preparation, processing, transportation, or other functions; and

(B) do not cause unreasonable harm to the marketplace.

(11) the educational, cultural, scientific, and informational value to the recipient of mail matter;
(12) the need for the Postal Service to increase its efficiency and reduce its costs, including infrastructure costs, to help maintain high quality, affordable postal services;
(13) the value to the Postal Service and postal users of promoting intelligent mail and of secure, sender-identified mail; and
(14) the policies of this title as well as such other factors as the Commission determines appropriate.

(d) REQUIREMENTS.–

(1) IN GENERAL.–The system for regulating rates and classes for market-dominant products shall–

(A) include an annual limitation on the percentage changes in rates to be set by the Postal Regulatory Commission that will be equal to the change in the Consumer Price Index for All Urban Consumers unadjusted for seasonal variation over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates;

(B) establish a schedule whereby rates, when necessary and appropriate, would change at regular intervals by predictable amounts;

(C) not later than 45 days before the implementation of any adjustment in rates under this section, including adjustments made under subsection (c)(10)–

(i) require the Postal Service to provide public notice of the adjustment;

(ii) provide an opportunity for review by the Postal Regulatory Commission;

(iii) provide for the Postal Regulatory Commission to notify the Postal Service of any noncompliance of the adjustment with the limitation under subparagraph (A); and

(iv) require the Postal Service to respond to the notice provided under clause (iii) and describe the actions to be taken to comply with the limitation under subparagraph (A);

(D) establish procedures whereby the Postal Service may adjust rates not in excess of the annual limitations under subparagraph (A); and

(E) notwithstanding any limitation set under subparagraphs (A) and (C), and provided there is not sufficient unused rate authority under paragraph (2)(C), establish procedures whereby rates may be adjusted on an expedited basis due to either extraordinary or exceptional circumstances, provided that the Commission determines, after notice and opportunity for a public hearing and comment, and within 90 days after any request by the Postal Service, that such adjustment is reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economical management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States.

(2) LIMITATIONS.–

(A) Classes of mail.–Except as provided under subparagraph (C), the annual limitations under paragraph (1)(A) shall apply to a class of mail, as defined in the Domestic Mail Classification Schedule as in effect on the date of enactment of the Postal Accountability and Enhancement Act.

(B) Rounding of rates and fees.–Nothing in this subsection shall preclude the Postal Service from rounding rates and fees to the nearest whole integer, if the effect of such rounding does not cause the overall rate increase for any class to exceed the Consumer Price Index for All Urban Consumers.

(C) Use of unused rate authority.–

(i) Definition.–In this subparagraph, the term "unused rate adjustment authority" means the difference between–

(I) the maximum amount of a rate adjustment that the Postal Service is authorized to make in any year subject to the annual limitation under paragraph (1); and
(II) the amount of the rate adjustment the Postal Service actually makes in that year.
(ii) Authority.–Subject to clause (iii), the Postal Service may use any unused rate adjustment authority for any of the 5 years following the year such authority occurred.
(iii) Limitations.–In exercising the authority under clause (ii) in any year, the Postal Service–
(I) may use unused rate adjustment authority from more than 1 year;
(II) may use any part of the unused rate adjustment authority from any year;
(III) shall use the unused rate adjustment authority from the earliest year such authority first occurred and then each following year; and
(IV) for any class or service, may not exceed the annual limitation under paragraph (1) by more than 2 percentage points.
(3) REVIEW.–Ten years after the date of enactment of the Postal Accountability and Enhancement Act and as appropriate thereafter, the Commission shall review the system for regulating rates and classes for market-dominant products established under this section to determine if the system is achieving the objectives in subsection (b), taking into account the factors in subsection (c). If the Commission determines, after notice and opportunity for public comment, that the system is not achieving the objectives in subsection (b), taking into account the factors in subsection (c), the Commission may, by regulation, make such modification or adopt such alternative system for regulating rates and classes for market-dominant products as necessary to achieve the objectives.

(e) WORKSHARE DISCOUNTS.–
(1) DEFINITION.–In this subsection, the term "workshare discount" refers to rate discounts provided to mailers for the presorting, prebarcoding, handling, or transportation of mail, as further defined by the Postal Regulatory Commission under subsection (a).
(2) SCOPE.–The Postal Regulatory Commission shall ensure that such discounts do not exceed the cost that the Postal Service avoids as a result of workshare activity, unless–
(A) the discount is–
(i) associated with a new postal service, a change to an existing postal service, or with a new work share initiative related to an existing postal service; and

(ii) necessary to induce mailer behavior that furthers the economically efficient operation of the Postal Service and the portion of the discount in excess of the cost that the Postal Service avoids as a result of the workshare activity will be phased out over a limited period of time;

(B) the amount of the discount above costs avoided–

(i) is necessary to mitigate rate shock; and

(ii) will be phased out over time;

(C) the discount is provided in connection with subclasses of mail consisting exclusively of mail matter of educational, cultural, scientific, or informational value; or

(D) reduction or elimination of the discount would impede the efficient operation of the Postal Service.

(3) LIMITATION.–Nothing in this subsection shall require that a work share discount be reduced or eliminated if the reduction or elimination of the discount would–

(A) lead to a loss of volume in the affected category or subclass of mail and reduce the aggregate contribution to the institutional costs of the Postal Service from the category or subclass subject to the discount below what it otherwise would have been if the discount had not been reduced or eliminated; or

(B) result in a further increase in the rates paid by mailers not able to take advantage of the discount.

(4) REPORT.–Whenever the Postal Service establishes a workshare discount rate, the Postal Service shall, at the time it publishes the workshare discount rate, submit to the Postal Regulatory Commission a detailed report that–

(A) explains the Postal Service's reasons for establishing the rate;

(B) sets forth the data, economic analyses, and other information relied on by the Postal Service to justify the rate; and

(C) certifies that the discount will not adversely affect rates or services provided to users of postal services who do not take advantage of the discount rate.

(f) TRANSITION RULE.–For the 1-year period beginning on the date of enactment of this section, rates and classes for market-dominant products shall remain subject to modification in accordance with the provisions of this chapter and section 407, as such provisions were last in effect before the date of enactment of this section. Proceedings initiated to consider a request for a recommended decision filed by the Postal Service during that 1-year period shall be completed in accordance with subchapter II of chapter 36 of this title and implementing regulations, as in effect before the date of enactment of this section.