Postal Regulatory Commission
Submitted 3/2/2009 4:27:48 PM
Filing ID: 62468
Accepted 3/2/2009

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

NOTICE OF PRICE ADJUSTMENT	))	Docket No. R2009-2

COMMENTS OF
NATIONAL POSTAL POLICY COUNCIL
(March 2, 2009)

Pursuant to Order No. 180, the National Postal Policy Council ("NPPC") respectfully submits these comments on the price adjustments proposed by the Postal Service in this docket. These comments address the following issues: (1) the rate differentials proposed between Single-Piece and Presort First-Class Mail; (2) the discounts proposed for using the Full Service Intelligent Mail Barcode ("IMb"); (3) the proposed seven-cent per-piece surcharge on Standard Mail for failure to comply with Move Update; and (4) the proposed price $250,000 for a Platinum-level subscription to Confirm when purchased by a mail service provider.

I. RATE DIFFERENTIALS BETWEEN SINGLE-PIECE AND PRESORT FIRST-CLASS MAIL

The Commission should approve the two-cent increase proposed by the Postal Service for the first ounce single-piece First-Class letter rate, and the smaller overall increases proposed for presort letters and cards. *See* USPS Notice of Market-Dominant Price Adjustment (Feb. 10, 2009) at 11-14. For the reasons explained in more detail in NPPC's Reply Comments in Docket No. ACR2008, the Postal Service is correct that the Presort and Single-Piece First-Class Mail are separate products, and the rate differentials between the two products are not limited by the provisions of 39 U.S.C. § 3622(e) regarding "workshare discounts." Response of USPS to Chairman's Information Request No. 1 (Feb. 20, 2009); Docket No. ACR2008, NPPC Reply Comments (Feb. 13, 2009) (analyzing statutory scheme).

Two points bear reemphasis here. First, even single-piece mailers have conceded that the differences between Presort and Single-Piece First-Class Mail go beyond worksharing or costs. As the Greeting Card Association acknowledged in Docket No. ACR2007:

> [O]n a broad level, the nature of the communication and its purposes differ between bulk and single piece letters/postcards, with the former generally used for business applications involving groups such as customers and the latter generally used for individual correspondence or transactions. Thus, from both a cost and a market perspective, bulk letters and postcards are a much different product than are single-piece letters and postcards.

Docket No. ACR2007, *Annual Compliance Report*, Reply Comments of GCA (Feb. 13, 2008) at 4 (quoting with approval PRC Docket No. RM2007-1, USPS Submission of Initial Mail Classification Schedule In Response to Order No. 26 (Sept. 24, 2007) at 12).

Second, analysis of the evidence on cost and demand characteristics in Docket No. ACR2008 indicates that the rate differentials proposed by the Postal Service between Presort and Single-Piece First-Class Mail in the present docket are too small, not too large. Specifically, the evidence submitted by the Postal Service in ACR2008 indicates that the own price elasticities of Single-Piece and Presort First-Class Mail are roughly the same: -0.218 for Single Piece letters and -0.250 for Presort letters.[1] By

[1] USPS, Econometric Demand Equation Tables for Market Dominant Products as of November 2008 (submitted to PRC on January 16, 2009).

contrast, the average percentage *markup* of Single-Piece First-Class letter mail over attributable costs (67.1 percent) is only about *one-third* the corresponding percentage markup over attributable costs generated by Presort First-Class letter mail (198.1 percent).[2] Hence, the Postal Service almost certainly could improve its financial position by substantially reducing Presort First-Class rates (or increasing them at a below-average rate) and using the resulting headroom under the CPI cap for First-Class Mail to raise Single-Piece Class rates.[3]

NPPC is not asking the Commission to impose such a rate rebalancing in this docket. The price changes proposed by the Postal Service, however, are a step in the right direction, and the Commission should allow them to take effect. Forcing the Postal Service to narrow the rate spread between Presort and Single-Piece First-Class Mail would needlessly worsen the Postal Service's already-significant shortfall in contribution to institutional costs at a time when the Postal Service's financial situation has been described as "grave"[4] and a "crisis."[5]

---

[2] *See* USPS FY 2008 Annual Compliance Report (Dec. 29, 2008) at 18, Table 1, "cost coverage" column. The percentage markup is the cost coverage minus 100 percent.

[3] This conclusion is a corollary of the standard economic formula for maximizing the overall profit of a multi-product firm, with or without an overall regulatory constraint on profits. *See* William J. Baumol and David Bradford, "Optimal Departures From Marginal Cost Pricing," 60 *Amer. Econ. Rev.* 265-283 (June 1970); Jean-Jacques Laffont and Jean Tirole, *A Theory of Incentives in Procurement and Regulation* 30-31 (1993).

[4] Statement Of Postmaster General/CEO John E. Potter Before The Subcommittee On Federal Financial Management, Government Information, Federal Services And International Security Of The Committee On Homeland Security And Governmental Affairs United States Senate (January 28, 2009).

[5] Statement of PRC Chairman Dan G. Blair before the Senate Subcommittee on Federal Financial Management, Government Information, Federal Services, and International Security (January 28, 2009).

II. THE 0.3 CENT PER PIECE DISCOUNT PROPOSED FOR FIRST-CLASS MAIL WITH THE FULL SERVICE INTELLIGENT MAIL BARCODE ("IMb").

The Postal Service has proposed to implement on November 29, 2009, a discount of 0.3 cents per piece for First-Class Mail presorted letters and flats entered with the full-service Intelligent Mail barcode ("IMb"). USPS Notice at 14. While a discount for use of the full-service IMb is a welcome development, the proposed amount may not stimulate much additional use of the service. To benefit from the full-service IMb, a mailer must make very large capital investments in computers, other infrastructure and training. NPPC's members believe that, at a discount of 0.3 cents per piece, the anticipated return on these investments is marginal. NPPC hopes that the Postal Service will reconsider the size of the discount.

The proposed IMb discount raises a broader issue that the Postal Service and the Commission is likely to need to confront in the near future: the relationship between the CPI-based rate cap of 39 U.S.C. § 3622(d) and the costly unfunded mandates that the Postal Service is imposing on its business customers. In the past two years, the Postal Service has forced mailers to make an array of costly operational changes without rate discounts or other compensation. Many of these changes have required large investments in computer hardware, software and systems: e.g., the incorporation of delivery point validation ("DPV") requirements in CASS Cycle L; CASS Cycle M; a halving of the Move Update cycle for First-Class Mail; and the extension of Move Update requirements to Standard Mail. Mailers have incurred these costs while absorbing two annual price increases on Market Dominant products and a rate adjustment in January 2009 for Priority Mail, which many large business mailers rely on heavily.

NPPC generally supports the Postal Service's technology initiatives. But the proliferation of uncompensated mandates is increasingly distorting the CPI-based index. The comments filed with the Commission in Docket No. RM2007-1 and ACR2007 reflected a broad consensus among mailers that an adjustment to the index prescribed by 39 U.S.C. § 3622(d) for significant changes in the quality of service (including changes in the level of uncompensated mail preparation and worksharing mandated by the Postal Service) is necessary to carry out its purposes.[6] This consensus is also supported by the scholarly literature. When prices are capped by a benchmark other than the firm's costs of services, it is almost inevitable that the firm will seek to circumvent the price cap by reducing the quality of service, including by forcing the purchaser to furnish complementary goods or services that the regulated company

[6] *See, e.g*., Docket No. RM2007-1, ANM-NAPM-NPPC Comments (April 6, 2007) at 7-9; DMA Comments (April 6, 2007) at 6; Mulford Associates (April 6, 2007) at 3; NNA Comments (April 6, 2007) at 10-12; OCA Comments (April 6, 2007) at 18-20; Pitney Bowes Comments (April 6, 2007) at 9; McGraw-Hill Reply Comments (July 30, 2007) at 6-7; Transcript of Kansas City field hearing (June 22, 2007) at 40 (Randy Stumbo testimony for Meredith Corporation); Transcript of Los Angeles field hearing (June 28, 2007) at 38 (John Carper testimony for Pepperdine University); Transcript of Wilmington field hearing (July 9, 2007) at 19-20 (testimony of Sr. Georgette Lehmuth for National Catholic Development Conference); *id*. at 30 (testimony of Daniel C. Emens for J.P. Morgan Chase); NPPC Comments on Order No. 26 (Sept. 24, 2007) at 7-9; Docket No. ACR2007, NPPC Reply Comments at (Feb. 13, 2008) at 2-3.

previously supplied.[7] Attention to quality of service is particularly important in rate indexing for regulated industries that are not experiencing rapid productivity gains.[8]

The current recession has also heightened the importance of this issue. Many NPPC members are in financial straits as acute as those facing the Postal Service. Much of the private financial sector has faced budget cuts, layoffs, and private sector or government takeover of major divisions or even entire companies. A further proliferation of uncompensated Postal Service mandates will inevitably result in an acceleration of the recent decline in the volume of mail sent by financially strapped companies whose primary business is not mailing.

The Commission, while stating in Docket No. RM2007-1 that it was "sympathetic" to the question of uncompensated mandates, deferred consideration of a quality adjustment until after the promulgation of rules for the collection of data on service performance. Order No. 26 ¶ 2067. In the interim, the Commission stated that it "expects that the Postal Service will operate within both the letter and the spirit of the PAEA." *Id*. ¶ 2068. While the issue is clearly too complex to resolve within the limited

---

[7] Stephen Breyer, *Regulation and Its Reform* 68-69 (1982); Michael A. Crew and Paul R. Kleindorfer, "Pricing, Entry, Service Quality, and Innovation under a Commercialized Postal Service," in J.G. Sidak, ed., *Governing the Postal Service* 164-165 (1994); *accord*, Jean-Jacques Laffont and Jean Tirole, *A Theory of Incentives in Procurement and Regulation* 212, 233 (1993). This basic problem is the reason why Pentagon contract managers tend to "favor performance over cost. They often feel that fixed-price contracts encourage contractors to make 'uneconomic' reliability trade-offs and be reluctant to make design improvements." *Id*. at 233 n. 13.

[8] Michael A. Crew and Paul R. Kleindorfer, "A Critique of the Theory of Incentive Regulation: Implications for the Design of Performance Based Regulation for Postal Service," in Crew and Kleindorfer, eds., *Future Directions in Postal Reform* (2001).

time periods of this docket, the Commission should institute a separate docket to consider these issues in the near future.

III. THE SEVEN-CENT PER-PIECE RATE SURCHARGES ON DISCOUNTED MAIL FOR NON-COMPLIANCE WITH MOVE UPDATE.

The rate changes proposed by the Postal Service in this docket would continue to leave the First-Class rate structure without a fallback rate below the single-piece rate for presort First-Class Mail that does not satisfy the Move Update requirements. Moreover, the Postal Service proposes to adopt for the first time a surcharge of seven cents per piece for Standard Mail that does not comply with Move Update requirements. In light of the many unresolved issues raised by recent changes in Move Update standards and enforcement policies, the Commission should direct the Postal Service to establish a more reasonable fallback rate for First-Class Mail, and should decline to approve the full surcharge proposed for Standard Mail. These rate differentials are disproportionate to the costs imposed on the Postal Service by nonconforming mail, and are therefore unjust and unreasonable within the meaning of 39 U.S.C. §§ 404(b), 3622(b)(8) and 3622(c)(5).[9] Moreover, numerous measurement and process issues need to be resolved before surcharges of this magnitude can be fairly considered.

The Postal Service first imposed Move Update requirements for First-Class Mail in 1997. Until recently, however, enforcement of Move Update has been sporadic at best, and the Postal Service has never issued written guidance on many of the complex interpretive issues that enforcement would raise. The Postal Service's disengagement

[9] The separate comments of the Association for Postal Commerce discuss this issue in greater detail.

from Move Update compliance has left mailers to fend for themselves in interpreting rules that are skeletal, vague and cryptic. Moreover, the Postal Service reporting systems needed for mailers to assess the Move Update compliance of addresses in advance of mailing are incomplete or undeveloped.[10] Given the heightened level of

---

[10] For example, until the recent PBV/MERLIN deployment, mailers have lacked any advance way to evaluate the compliance of their mailings with Move Update.

Obtaining PBV reports in a user-friendly and timely fashion requires logging into PostalOne. Most mailers—even large ones—have not been licensed users of PostalOne. Becoming certified and set up as a PostalOne user is extremely time consuming.

The data captured by MERLIN lack critical details. Obtaining the critical data from other Postal Service sources requires extremely time consuming manual work.

The mailpiece images captured by MERLIN are random, and do not always correspond with the specific pieces that have failed the MERLIN/Move-Update comparison. This omission requires the mailer to make a physical copy of each piece that failed to obtain the details needed to readily investigate the biller source/mailing job that was sampled.

The information captured on the MERLIN/Move Update report lacks details about the product, biller and job captured in the sample. The MERLIN job number and piece count report do not provide adequate information to investigate. While the information can be determined through a manual search, this is an extremely time-consuming process. This is a major issue for mailers that have multiple products, biller applications and production facilities.

All of the Move Update methods approved by the Postal Service have flaws—and error rates that vary significantly. Some mailers have begun using more than one Move Update method out of self-protection.

Business rules that are established for updating have not yet been fully tested with the Postal Service.

Many large mailers co-mingle various jobs together electronically before the physical mail is created. Doing so maximizes address density, thereby minimizing the costs of both the Postal Service and the mailer. The multiplicity of billers and processes in a co-mingled mailing, however, makes investigation of Move Update compliance issues more difficult and time-consuming. The Postal Service does not appear to have developed any process for linking non-compliant pieces to the unique customers represented in a co-mingled mailing. The same issue would need to be resolved for mailings that co-mingle multiple internal jobs generated by multiple offices or divisions within a company.

enforcement recently embarked upon by the Postal Service, the continued absence of reasonable fallback rate for discounted First-Class Mail has become unjust and unreasonable.

The Postal Service has assured mailers that it will protect them by setting an initial tolerance level of 30 percent—i.e., a mailing will be accepted as Move Update-compliant if 70 percent of the addresses tested are found to be compliant. This may appear on first blush to be a comfortably wide tolerance range. In fact, the way that the Postal Service proposes to calculate the error rate of a mailing makes the tolerance range extraordinarily narrow.

The problem is that the Postal Service plans to define the denominator of the compliance ratio as the subset of addresses in the mailing that have updating matches in the Postal Service database—not the total number of addresses in the mailing. The following example illustrates this fact. Suppose that a mailer entered a Standard mailing of one million pieces; the Postal Service drew a sample of 1,000 pieces from the mailing; 25 of the pieces had addresses that showed change-of-address matches on the Postal Service's database; 15 of the 25 pieces had in fact been updated; and 10 had not been. Ten stale addresses in the 1,000-piece sample (or an estimated 10,000 stale addresses in the entire mailing) equates to an error rate of only 1/10 of one percent.

The Postal Service's methodology, however, would find define the error rate of the addresses in the mailing as 40 percent—i.e., the 10 pieces in the sample with stale addresses divided by the 25 pieces in the sample with updated addresses in the Postal Service database. Because a compliance rate of 60 percent is less than the 70 percent tolerance, the entire mailing—all million pieces—would be deemed to out of compliance with Move Update. To the Postal Service, the mailer would be 40 percent out of compliance for a mailing that, to the mailer, was 99.9 percent in compliance. The result, under the Postal Service's rate proposal, would be a $70,000 penalty.

IV. THE $250,000 PRICE PROPOSED FOR A PLATINUM-LEVEL SUBSCRIPTION TO CONFIRM BY A MAIL SERVICE PROVIDER

The Postal Service has proposed in this docket to raise the price of a Platinum-level Confirm subscription from $23,500, the current price for all mailers, to $25,000 for "mail owners" (an increase of 6.38 percent) and $250,000 for "mail agents" (an increase of *963.8 percent*). The latter price is clearly unjust and unreasonable within the meaning of 39 U.S.C. §§ 404(b) and 3622(b)(8) (which require that rates within each class be "equitable," "just and reasonable"), the policy of § 3622(c)(2) that rates bear only a reasonable share of institutional costs, the policy of § 3622(b)(2) favoring rate stability and disfavoring rate shock, and policy of § 3622(c)(3) that requires consideration of "the effect of rate increases upon the general public [and] business mail users."[11]

That the Postal Service wishes to raise Confirm prices at all is baffling. According to the revenue and cost data submitted by the Postal Service in Docket No. ACR2008 and this docket, Confirm service as a whole would have a cost coverage of approximately 200 percent in the coming year even if Confirm prices were unchanged. Moreover, the total revenues that the Postal Service projects from Confirm—under either the existing or proposed rates—are dwarfed by the revenue generated by the

[11] *See also* Comments of the Platinum Coalition, Section II.

major mail products that Confirm supports: Presorted First-Class and Standard Mail. At a time when USPS needs every dollar it can get, reducing the attractiveness of the two biggest contributors to the Postal Service's institutional costs by disrupting the distribution channel of a complementary product that increases the perceived value of Presorted First-Class and Standard Mail is misguided and self-destructive. While the proposed Platinum subscription price of $25,000 for mail owners represents an increase in excess of the CPI, NPPC does not oppose that price. The $25,000 price should be made available to all Platinum subscribers, however, not just mail owners.

CONCLUSION

NPPC respectfully requests that the Commission approve the price changes proposed by the Postal Service, with the exceptions discussed in these comments.

Respectfully submitted,

Arthur B. Sackler
Executive Director
NATIONAL POSTAL POLICY COUNCIL
1156 15th St., NW, Suite 900
Washington DC 20005
(202) 955-0097

David M. Levy
Rita L. Brickman
VENABLE LLP
575 Seventh Street, N.W.
Washington DC 20004
(202) 344-4732

Counsel for National Postal Policy Council

March 2, 2009