

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, D.C. 20268-0001

NOTICE OF MARKET-DOMINANT PRICE ADJUSTMENT

Docket No. R2012-3

**COMMENTS OF THE
NATIONAL POSTAL POLICY COUNCIL**
(November 7, 2011)

The National Postal Policy Council¹ respectfully submits these comments in response to the Commission's Order 921 noticing the Postal Service's planned rate adjustments for market-dominant products, to take effect January 22, 2012.² NPPC will address the second-ounce proposal, the worksharing discounts in Presort First-Class Mail, and the 10 percent increase in the 5-digit postcard rate.

I. THE NEW SECOND-OUNCE RATE FOR PRESORT FIRST-CLASS LETTERS OFFERS CONSIDERABLE POTENTIAL BENEFIT TO THE POSTAL SERVICE

NPPC has long encouraged the Postal Service to use the flexibility provided under the Postal Accountability and Enhancement Act to design rates and products to spur innovative uses of First-Class Mail. NPPC is gratified that the Postal Service has taken this opportunity to enhance the value of First-Class

¹ The National Postal Policy Council is an association of large business users of letter mail, primarily Bulk First-Class Mail using the Automation rate category, with member companies from the telecommunications, banking and financial services, utilities, insurance, and mail services industries. Composed of more than 30 of the largest customers of the Postal Service with aggregated mailings of more than 30 billion pieces, NPPC supports a robust postal system as a key to its members' business success and to the health of the economy generally.

² See *Notice and Order on Planned Rate Adjustments and Classification Changes for Market Dominant Postal Products*, Order No. 921 (Oct. 21, 2011).

Mail by modifying its rate schedule to eliminate the hefty additional charge for the second-ounce of Presort First-Class Mail.³ This change offers a welcome incentive for commercial mailers to continue to use, and conceivably to increase the use of, the Postal Service's most profitable product -- First-Class Presort Mail. The Postal Service deserves credit, and the Commission's approval, for taking an important step toward creating pricing conditions to the mutual benefit of the Service and its customers.

The second-ounce proposal replaces, and improves upon, the earlier and to-be-discontinued "Reply Rides Free" initiative. Reply Rides Free was a step in the right direction, but offered only limited utility to mailers because of certain counterproductive eligibility conditions. The fewer strings associated with the new second-ounce adjustment will allow mailers to explore a full range of innovative uses of their mailings. As just one example, mailers of account statements will now have materially more room in their envelopes for additional matter, in a way that is simply not cost-justifiable under the current rate schedule. The possible uses are many, including but not limited to reply envelopes and advertising materials. In contrast, the current second-ounce charge is effectively

³ Nonetheless, a lack of clarity exists in the Postal Service's filing concerning the reasons for the higher-than-inflation and higher-than-class average increases in several Presort categories and in postcards. It is simply not clear if these higher rates are intended to recoup some of the revenue leakage from providing the second ounce without charge. If that were indeed the case, in effect creating a "blended" rate, then that would raise a concern. The second-ounce-free will encourage more volume through an innovative and long overdue pricing signal. To the extent, however, that the Postal Service has tried to "blend" it with a higher first-ounce rate, the benefit will be offset and drained. Here, the above-average increases for 1-ounce 5-digit and 3-digit Presort letters provide confused signals that may discourage as much or more mail than will be gained from the "free" second ounce, an unexpected and counterproductive impact.

punitive and actually discourages highly cost-conscious Presort mailers from exploring innovative uses of First-Class Mail.

For these reasons, the second-ounce-free adjustment will give mailers a serious incentive to consider keeping more of their customer account mail and other correspondence in the postal system instead of in electronic alternatives. It also conceivably could encourage new volume. Given that the Postal Service handles and processes two-ounce First-Class letters no differently than one-ounce letters, so that the costs are essentially similar, and that the current high markups make both one- and two-ounce letters highly profitable to the Postal Service, the second-ounce proposal is readily justifiable.

II. THE POSTAL SERVICE COULD AND SHOULD HAVE GIVEN SMALLER INCREASES TO ONE-OUNCE PRESORT RATES

Although the announced First-Class Presort letter rates appear to comply with the price cap limitations, NPPC regrets that when discussing the announced worksharing discounts for First-Class Presort letters, the Postal Service continues to cite to the admittedly “obsolete” Bulk Metered Mail benchmark which the Commission no longer believes valid.⁴ Instead, the Postal Service would have better served its long-term interests by seizing the opportunity to price Presort letters using a more realistic benchmark, such as “Metered Mail.”⁵

⁴ Order No. 536, at 8 (September 14, 2010).

⁵ See *Joint Comments of the American Bankers Association, the Bank of America Corporation, the Direct Marketing Association, Discover Financial Services, the Major Mailers Association, the National Association of Presort Mailers, and the National Postal Policy Council*, Docket No. RM2010-13 (Feb. 18, 2011); *Reply Comments of the American Bankers Association, the Bank of America Corporation, the Direct Marketing Association, Discover Financial Services, the Major Mailers Association, the National Association of Presort Mailers, and the National Postal Policy Council*, Docket No. RM2010-13 (April 4, 2011).

Indeed, with the recent dismissal on ripeness grounds of the Postal Service's petition for review of Order No. 536,⁶ there was no reason for the Service not to do so.

A. The Failure To Passthrough The Full Costs Avoided By 5-Digit Letters Results In Excessive Rates For The Largest And Most Efficient Presort Letters

The Postal Service's failure to use a more accurate and modern benchmark for the Mixed AADC Automation rate means that the Presort letter discounts are uniformly too small, resulting in rates that are too high throughout all of the Presort letter tiers. As a result, once again the Postal Service is punishing its largest and most profitable First-Class mail category – 5-digit Automation – with an above-average increase (this time, 2.9 percent, 40 percent greater than the 2.133 percent index) that on its face exceeds the increases for almost all other Presort mail.

Although the major cause of the excessive increase in the 5-digit rate is the Postal Service's inexplicable apparent adherence to the BMM benchmark, another contributing cause is the Postal Service's decision to passthrough less than 100 percent of the avoided costs in the 5-digit discount. Although the Postal Service presents the passthrough as one of 92.3 percent (*USPS Notice of Market-Dominant Price Adjustment* at 35-36 (Oct. 18, 2011)), from a mailer's

⁶ *United States Postal Service v. Postal Regulatory Commission*, No. 10-1324 (D.C. Cir. Oct. 21, 2011).

perspective the relevant passthrough is measured from the AADC rate, and on that basis the passthrough is about 85 percent.⁷

The Postal Service explains this only by observing that the current difference between the 5-digit and single-piece letter rates will remain unchanged. *USPS Notice of Market-Dominant Price Adjustment* at 35-36. That, however, is not a statutory factor, and masks that the result is an increase that is about 40 percent larger than the rate of inflation on 5-digit Automation letters, the most-highly presorted, efficient, and profitable mail in the system.

Had the Postal Service instead chosen to passthrough the full amount of avoided costs between the 3-digit and 5-digit levels, so that the 5-digit rate would be \$0.346 (assuming no other changes), the increase would have been only 2.35 percent, much closer to, but still above, the class average. A passthrough of the full amount of avoided costs between the AADC and 5-digit levels would have resulted in an even more moderate rate increase for the Postal Service's most profitable mail. And as noted above, had the Postal Service used Metered Mail as the starting point for the Presort discounts, the 5-digit rate would have been still more reasonable.

Perpetuating excessively high rates and markups for the most numerous and cost-efficient First-Class Presort 5-digit letters will only continue to impede the Postal Service's efforts to stem the erosion of its most profitable product.

Although the new second-ounce rate announced by the Postal Service will offset

⁷ See *USPS Notice of Market-Dominant Price Adjustment*, Attachment B, Page 3 of 16 (showing avoided costs between the new "combined" AADC / 3-Digit Automation Letters rate and the 5-Digit Automation Letters rate of 2.8 cents; the effective discount between these rates is only 2.4 cents).

these excessive rates for some mailers, it will do nothing to ameliorate the excessive rates paid by mailers of one-ounce letters, which constitute the vast majority of the current Presort mailstream.

B. The New AADC Discount Should Not Be Reduced, But The 3-Digit Discount Should Be Modified To Reflect Cost Differences

The Postal Service's planned rate for AADC Automation letters exceeds the costs avoided from the Mixed AADC level, with a passthrough of 143 percent. Also, the Postal Service has chosen not to passthrough any of the cost difference between AADC and 3-digit presorted mail.

The Postal Service offers two explanations for this design. First, it explains that it wants to encourage the preparation of AADC/3-digit presorted mail to improve operational efficiency because it currently has excess capacity in incoming mail processing. *USPS Notice of Market-Dominant Price Adjustment* at 35. In addition, the Postal Service states that it wants to preserve the AADC/3-digit presortation options as it considers restructuring sortation levels as part of the network realignment process.

NPPC is concerned insofar as the passthroughs used to develop these and other Presort letter rates depart from the normal practice of setting rates to optimize efficient levels of worksharing, a concept undergirding Section 3622(e) of the PAEA. In particular, pricing to excess capacity is self-defeating and sets a troubling precedent that runs counter to decades of established ratesetting policy. The Postal Service must reduce excess capacity rather than structuring discounts to encourage mail to absorb that capacity.

NPPC recognizes the imperative that the Postal Service restructure and rescale its size to match the reduced volumes that it is currently experiencing and is likely to experience in the future. NPPC also recognizes that it is difficult to anticipate all of the issues that may arise as the network optimization initiative tries to minimize operational steps and reduce costs while still meeting service commitments.

While NPPC recognizes that there will be temporary dislocations in staffing levels as restructuring proceeds, pricing to excess capacity will, paradoxically, not serve the Postal Service's long-term interest. Nor is it consistent with the strategy of encouraging more First Class mail as exemplified by second-ounce-free. "Pricing to capacity" here increases 3-digit letter rates, and has contributed to the 40 percent above-average increase for 5-digit Automation letters discussed above. These increases do not create incentives for mailers to prepare mail to a more expensive and less presorted level, as the Postal Service apparently imagines. Instead, they create disincentives to mail, flatly counterproductive to what the Postal Service seeks to achieve with the second-ounce-free. Failing to passthrough the full costs avoided by 3-digit and 5-digit mail will mean not only fewer pieces when the Postal Service is trying to retain (or increase) what it has, but also less business for that excess capacity.

Separately, the Postal Service justifies the announced passthrough of 143 percent for AADC discount as intended to "preserve existing sortation options for customers in 2012" while it continues evaluating what future sortation will be most appropriate for mail currently entered as AADC or 3-digit mail. *USPS*

Notice of Market-Dominant Price Adjustment at 14. It acknowledges that the AADC Automation Letters discount is subject to review under section 3622(e)(2)(A), and justifies the proposed discount as necessary to enhance the operational efficiency of the Postal Service. See 39 U.S.C. §3622(e)(2)(D).

NPPC supports the announced discount for AADC letters, as it will encourage Mixed AADC mail to migrate to AADC presortation, and urges its approval. Also, NPPC notes that it is urgently important that the Commission recognize that any reduction of the AADC discount from the announced level to a lesser passthrough would increase not only the AADC rate, but also have the effect of raising the rates for more finely presorted tiers.

Reducing the AADC discount would also threaten to exceed the rate cap unless other adjustments were made within Presort letters to reduce the impact on more efficiently, finely-presorted letters. In any case, it is imperative that the Commission, if it does not approve the AADC discount, ensure that any modification of that rate not impose even more severe increases on the Presort letters that are already receiving above-average increases under the announced rates. NPPC has already identified above certain appropriate changes that would rectify the excessive announced 5-digit Presort rate.

In addition – and independent of the AADC discount -- it is not clear to NPPC why the Postal Service could not still recognize the cost savings of 3-digit presortation while achieving its goals of preserving mailer options and promoting efficient incoming mail processing operations while restructuring. The avoided costs are \$0.002, and reflecting this amount in a discount – instead of the zero

percent passthrough in the new rate – does not conflict with the Postal Service’s stated objectives. Accordingly, the Commission should also consider whether the failure to passthrough any of costs avoided by 3-digit presortation is consistent with Section 3622(e).

C. The 10 Percent Increase In The Rate For 5-Digit Presorted Postcards Is Unexplained And Grossly Unreasonable

The Postal Service is raising the 5-digit Presorted postcard rate from its current level of \$0.208 to \$0.229 – an increase of 10 percent and of more than 2 cents in absolute terms. This increase obviously greatly exceeds the 2.133 percent inflation adjustment for First-Class mail generally.

The Postal Service’s notice of rate adjustments does not attempt to explain or justify this increase. In fact, as far as NPPC has been able to tell, the Postal Service nowhere even mentions it. Indeed, while the Postal Service does mention that the Single Piece postcard rate is rising by 3 cents, it defends that increase by noting that Single Piece Letters and Cards had a relatively small increase in the last cap adjustment while Presort Letters and Cards had comparatively large increases. *USPS Notice of Market-Dominant Price Adjustment* at 12. The Postal Service’s justification for the increased Single Piece postcard rate simply does not hold water if applied to the 5-digit Presort card rate is increasing by 10 percent, and even the Mixed AADC card rate is rising by 8.5 percent.

NPPC members mail millions of 5-digit Presorted postcards, conceivably accounting for the majority of the 1.1 billion 5-digit cards mailed annually. This

unexpected 10 percent rate hike will have a dramatic adverse effect on usage, and will accelerate efforts by those mailers to convert to alternatives. Given that the increase appears entirely unexplained and unjustified by the Postal Service, and that it will drive away badly needed volume, the Commission should find the unsupported increase unreasonable.

III. CONCLUSION

For the foregoing reasons, the National Postal Policy Council supports the new incentive for the second-ounce of Presort First-Class Mail Letters, but has concerns regarding the relative burden imposed on Presort First-Class Mail Letters overall, and certain of the worksharing discounts as described herein.

Respectfully submitted,

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