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

NOTICE OF MARKET-DOMINANT PRICE ADJUSTMENT	Docket No. R2013-10

COMMENTS OF THE NATIONAL POSTAL POLICY COUNCIL,
THE MAJOR MAILERS ASSOCIATION,
THE NATIONAL ASSOCIATION OF PRESORT MAILERS, AND
THE ASSOCIATION FOR MAIL ELECTRONIC ENHANCEMENT
(October 16, 2013)

The National Postal Policy Council, the Major Mailers Association, the National Association of Presort Mailers, and the Association for Mail Electronic Enhancement ("Joint Commenters") hereby respectfully submit these comments on the Postal Service's notice of rate adjustments for market-dominant products.[1] The Joint Commenters' general view is that the Postal Service's filing, while broadly adhering to the cap applicable to this case, is something of a mixed bag on closer examination.

In particular:

– The Postal Service's price increases appear to violate the cap because they do not properly adjust for the mandatory implementation of Full Service IMb;

– Joint Commenters support the new rate for Single Piece Metered Letters and its use as the benchmark for Automation discounts;

– The Postal Service's latest attempt to revise the rate for residual Single Piece-rated pieces in First Class Mail violates several provisions of the law and cannot be approved;

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1 *United States Postal Service Notice of Market-Dominant Price Adjustment*, Docket No. R2013-1 (September 26, 2013) ("*USPS Notice*").

- The Postal Service should in the future make greater use of more complete pass-throughs in Presort Letters to help keep the overall average increase below systemwide and inflation levels;

- The announced price increases for Postcards are already double the rate of inflation and should not be increased further by reducing discounts;

- The Postal Service's proposed workshare discounts for Automation cards and Automation Flats should be approved;

- The Postal Service is to be commended for presenting its planned promotional discounts for calendar year 2014 in this filing. However, the Postal Service should ensure that mail service providers are eligible to participate in all promotions. In addition, the Joint Commenters reiterate their continuing concern that "baking" promotions into current prices may enable the Postal Service to exceed the rate cap.

I. THE POSTAL SERVICE'S NEW PRICES FOR FIRST CLASS MAIL MAY EXCEED THE CAP BECAUSE THEY DO NOT PROPERLY ACCOUNT MAIL FOR THE JANUARY IMPLEMENTATION OF MANDATORY INTELLIGENT MAIL BARCODE

As the Commission knows, the Postal Service has long announced that it will require all mailers of First-Class Automation Letters to include an Intelligent Mail Barcode on each mailpiece, beginning with the effective date of the noticed increases, currently January 26, 2014. Mailpieces that do not have the mandatory IMb will no longer be eligible for Automation prices, but instead would be charged, presumably, Presort rates. This classification change has implications for the proper calculation of the price cap, and it does not appear that the Postal Service has taken the effects of mandatory IMb implementation into account in its cap calculations.

Commission rule 3010.23 provides:

> The volumes for each rate cell shall be obtained from the most recent available 12 months of Postal Service

> billing determinants. The Postal Service shall make reasonable adjustments to the billing determinants to account for the effect of classification changes such as the introduction, deletion, or redefinition of rate cells. Adjustments shall be based on known mail characteristics or historic volume data, as opposed to forecasts of mailer behavior. The Postal Service shall identify and explain all adjustments.[2]

Currently, approximately 34.7 percent of Presort First Class letters do not use Full-Service IMb. *See* USPS-LR-R2013-10/1 - First-Class Mail Workpapers CAPCAL-FCM-R2013-10.xls, Tab "Presort." Assuming no change in mailer behavior – that is, that those pieces do not add a Full-Service IMb – those letters would be charged at least Presort prices. That would constitute an increase ranging from 3.6 to 8.1 cents (going from current Automation to new Presort rates) on approximately 14 billion letters that could cause the noticed rates to exceed the cap.

The Postal Service clearly assumes that those mailers will change their mailing behavior by adding the mandatory Full-Service IMb to remain eligible for Automation prices, because it has made no adjustment to the Automation letter billing determinants in anticipation of the mandatory IMb requirement.[3] It does not explain why it assumes that all current Presort pieces would adopt Full-Service IMb, and there is no analysis that would indicate the anticipated rate of Full-Service IMb adoption.

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[2] The Commission's revised regulations governing adjustments to rates for market-dominant products took effect on September 25, 2013. *Price Cap Rules For Certain Postal Rate Adjustments*, Docket No. RM2013-2, Order No. 1786, 78 Fed. Reg. 52694, 52695 (Aug. 26, 2013). Those regulations apply to the Postal Service's proposed cap adjustments for market-dominant rates in the *USPS Notice*, which were filed the next day.

[3] In contrast, the Postal Service did adjust historical billing determinants in connection with its introduction of new rate categories for the Flats Sequencing System. *USPS Notice* at 27.

Thus, the Postal Service's cap compliance showing assumes that all Automation letter mailers will convert to Full-Service IMb by January 26. In other words, the Postal Service's cap calculation can be correct ONLY if ALL of the 34.7 percent of current Automation mailers that do not use Full-Service IMbs convert to doing so by January 26.

That the Postal Service may not assume. As noted above, the Commission's price cap rules do not permit adjustments to historical billing determinants based on forecasts of anticipated mailer behavior. But the Postal Service has done precisely that, forecasting that every Automation piece not currently compliant with Full-Service IMb will change their mailing behavior by January 26, 2014.

Not only is that assumption impermissible under the Commission's rules, but it also is unlikely to prove correct. Full-Service IMb imposes additional costs to mailers, especially in converting systems.[4] To the extent any of the 34.7 percent of current Automation mailers do not convert to Full-Service IMb, whether because of the cost or other reasons, they presumably would instead pay Presort, or in rare instances Single Piece, prices if they remain in the mail. To the extent that they do, those conversions would exert upward pressure on the cap compliance showing.

Just how many mailers would have to shift to Presort or other rates for the new prices to exceed the cap is unclear, because the *USPS Notice* does not

[4] The Postal Service acknowledged this in its Technology Credit proposal. Although that credit never took effect, the Joint Commenters appreciate the Postal Service 's responsiveness to industry concerns about the importance of maintaining this discount, which has assisted and will continue to assist mailers in the conversion .

spread the 34.7 percent of Automation volume across the different price tiers. To address this, the Public Representative has asked the Commission to issue an Information Request. *See Public Representative Motion for Issuance of Information Request* (Sept. 30, 2013) (Proposed Questions 1-2). That Request, which the Commission should issue, should produce the information needed to calculate the effect of mandatory Full-Service implementation on the cap applicable to First-Class Mail. Using historical data to "map" past Automation letter non-Full-Service IMb volumes to Presort rates would be a proper adjustment, as it would not depend upon forecasts of mailer activity.

A price cap system does not work properly if the regulated entity can impose costs or raise prices by restricting eligibility to certain rates. The implementation of mandatory Full-Service IMB as a condition for Automation rate eligibility constitutes a mail classification eligibility change that directly affects more than one-third of the current Automation letter mailstream.[5]

And that classification change constitutes a rate increase to current Automation mailers that do not use Full-Service IMb, and that increase must be included in the cap calculations. For this reason, the Commission must determine whether the Postal Service has accurately calculated the cap increase for First-Class Mail, based on historical billing data and taking into account the implementation of Full-Service IMb.

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[5] The Commission has already recognized that service quality reductions could be tantamount to rate increases. *Advisory Opinion on Mail Processing Network Rationalization Service Changes*, Docket No. N2012-1 at 151-155 (Sept. 28, 2012). Same, too, can be the effect of eligibility changes that deny mailers access to a price which they previously have used.

II. THE NEW FIRST-CLASS SINGLE PIECE METERED MAIL PRICE IS A MATERIAL IMPROVEMENT IN THE RATE DESIGN

The Joint Commenters support the introduction of a new Metered Letters price for Single Piece metered letters. *USPS Notice* at 18. This is a welcome recognition of the utility of metered mail to smaller businesses and the benefits accruing to the Postal Service for mail prepared in that manner. In addition, as the Commission decided in Order No. 1320, metered mail is the appropriate base group for calculating the costs avoided by Presort First-Class letters. *Consideration of Technical Methods To Be Applied In Workshare Discount Design*, Docket No. RM2010-13, Order No. 1320 at 11 (April 20, 2012).

Accordingly, establishing a new Metered Mail price category is a commendable use of the Postal Service's pricing flexibility.

III. THE POSTAL SERVICE'S LATEST ATTEMPT TO LIMIT ELIGIBILITY FOR THE "BLENDED" PRICE PAID BY RESIDUAL FIRST-CLASS LETTERS CANNOT BE APPROVED

In Docket No. R2013-1, the Postal Service introduced a new "Single-Piece Residual Machinable Letters" price which gave relief to residual 2-ounce First-Class letters from Automation mailings that otherwise would have had to pay much-higher Single Piece first postage. That price was a "blended" rate, higher than the one-ounce rate.

Unfortunately, as the Commission is aware, after the new residual category was approved, the Postal Service tried to restrict the availability of the residual rate by belatedly adding a footnote to the MCS that would make the blended rate unavailable to residual 2-ounce pieces from a mixed 1- and 2-oz mailing. The Commission properly rejected that attempt. *Modification of Mail*

Classification Schedule Regarding First-Class Mail Single-Piece Residual Price Table, Docket No. MC2013-30, Order No. 1661 (Feb. 15, 2013),

In this proceeding, the Postal Service seeks yet again to limit the availability of the residual rates. However, its latest attempt appears to violate Section 3642 and potentially may violate the price cap.

A. The Postal Service's Proposal

In its narrative, the Postal Service describes the new residual single-piece rate structure as:

> Residuals from uniform 1-ounce presort letter mailings will pay the 1-ounce Metered letter rate of 46 cents. Residuals from uniform 2-ounce presort letter mailings will pay the 2-ounce Metered letter rate of 66 cents; and residuals from mixed mailings of 1-ounce and 2-ounce letters will pay the Residual rate of 48 cents.

USPS Notice at 21. Several aspects of this warrant attention.

First, the Residual rate would remain unchanged at today's 48 cents under the index price adjustment.

Second, 1-ounce residual letters would be charged the new Metered Letter rate rather than the current Machinable Letter rate.

Third, the Postal Service's current proposal differs from the current rate structure in that residual 2-ounce letters from "uniform" 2-ounce mailings would pay the higher extra ounce rate rather than the blended residual rate.[6]

[6] This is the reverse of the rate design rejected in Order No. 1661, which would have charged the extra ounce price to 2-ounce residual pieces from mixed mailings, but not those from pure 2-ounce mailings.

B. The Commission, Not The Postal Service, Has Authority Over Classification Changes

Section 3642 requires the Commission to approve changes to the Mail Classification Schedule. To exclude certain 2-ounce pieces from a residual rate to which they qualify today is a classification change. However, the Postal Service has not requested Commission approval of any such change.

Although the narrative in the *USPS Notice* describes the Postal Service's intention to exclude 2-ounce pieces from uniform mailings from the residual rate, the proposed new MCS language is difficult to square with the narrative:

Single-Piece Residual Machinable Letters

Maximum Weight (ounces)	**Residual Machinable Letters ($)**
1	0.48
2	0.48
3	0.86
3.5	1.06

USPS Notice, Attachment A at 4. This Table presents a price of 48 cents for a 2-ounce residual letter, not the 66 cent price that the narrative says would apply to 2-ounce residual pieces from uniform two-ounce mailings. Although the Postal Service may intend for this "Residual" Table to apply only to residual pieces from mixed mailings, no MCS language or footnote prohibits 2-ounce residual letters from uniform 2-ounce mailings.

It is conceivable that the Postal Service may seek to restrict the availability of the Machinable 2-ounce rate through language in the Domestic Mail Manual. But the DMM must conform to the MCS, and the MCS language gives the Postal Service no authority to do so.[7]

The Postal Service has offered no new classification to approve or reject – only text in a narrative that has no basis in the accompanying MCS language. While the Postal Service has a significant pricing flexibility, it may not make classification changes in the absence of approved MCS changes. The Commission should make clear that nothing in the MCS language confers the Postal Service with authority to restrict the eligibility of residual 2-ounce letters from the residual rate.

C. The Postal Service Has Not Accounted For Its Treatment Of Two-Ounce Residual Pieces In Its Cap Calculation

Under the Postal Service's residual rate proposal, some 2-ounce residual pieces would experience a rate increase from 48 cents (current) to the 2-ounce Metered Mail rate of 66 cents. *USPS Notice* at 21. The Postal Service appears not to have accounted for this increase in its cap compliance calculation.

The Postal Service's cap compliance calculation shows no change for revenues from the residual rate. *See* USPS-LR-R2013-10/1 - First-Class Mail Workpapers CAPCAL-FCM-R2013-10.xls, Tab "Single-Piece." However, the current volumes presumably include 2-ounce pieces, because the Postal Service wants to prohibit them from using that rate. And although the Percent Change

[7] This differs from other provisions in the MCS which authorizes the Postal Service to

Single-Piece Tab includes a note that in 2014 the residual rate is limited to mixed mailings, there is no indication whether, or to where, those current 2-ounce pieces have been moved for the cap calculation. Thus, it appears that some volume of 2-ounce pieces may have simply disappeared from the calculations.

How many 2-ounce pieces are unaccounted for in the cap calculation is not clear. The Postal Service has provided no data separating the residual letters by weight.

However, according to the billing determinants, fewer than 118,000,000 letters claim the residual rate, generating revenue of $56 million. *See* USPS-LR-R2013-10/1 - First-Class Mail Workpapers CAPCAL-FCM-R2013-10.xls, Tab "Single-Piece." Even under the unrealistic assumption that every one of those 118,000,000 pieces were 2-ounce letters from uniform 2-ounce mailings, the additional postage from raising the rate to 66 cents would barely exceed $21,000,000. The actual total is likely less.

Although the amount of revenue at stake is unclear, it is evidently comparatively minor to the Postal Service, but it can be significant to a mailer. The Joint Commenters understand that the Postal Service may fear that residual uniform 2-ounce pieces predominate in the residual category, and thus that it loses substantial revenue when they pay the blended residual rate. Even if that were true – which is not shown on this record – the amount of postage it seeks to gain seems *de minimis* and not worth the effort.

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For the foregoing reasons, the Commission should not approve the Postal Service's latest attempt at residual letter rate design.

IV. THE COMMISSION SHOULD NOT IMPOSE HIGHER RATES ON MAILERS BY REDUCING WORKSHARING DISCOUNTS

Passthroughs of worksharing cost savings present issues in every annual index adjustment. Part of the problem is reluctance on the part of the Postal Service to encourage mail volume growth by passing through the full cost savings from worksharing to its largest and most profitable mail – First-Class 5-Digit Automation letters.

A second aspect of the problem is the mismatch between forward-looking prices that will take effect on January 26, 2014, and estimates of avoided costs that are based on costs incurred between October 1, 2011, and September 30, 2012, the period covered in the most recent Annual Compliance Determination. Experience teaches that there is little reason to believe that FY2012 costs will prove to be precisely accurate in calendar year 2014, and certainly not to the precision of tenths of cents with which pass-throughs are measured. Quite literally, there is no basis for concluding that the announced discounts will exceed avoided costs in 2014, because those costs are genuinely unknown.

Both issues bear on the First-Class Mail discounts. These are discussed in turn.

A. The Pass-Throughs In First-Class Automation Letters Should Be Increased

It is unfortunate that, in the first opportunity to use the new benchmark adopted in Docket No. RM201206, the Postal Service once again chose not to passthrough the full cost savings from at the 5-Digit Presort letter level. Instead, the Postal Service has passed through only 81 percent of the costs avoided (USPS-LR-R2013-10/1 - First-Class Mail Workpapers CAPCAL-FCM-R2013-10.xls, Tab “Cost Avoidances”), thereby missing an opportunity to reduce the price charged its largest and most important category of mail, and increase its competitiveness to alternatives to the mail.

The Postal Service should in the future make greater use of more complete pass-throughs in Presort Letters to help keep the overall average increase below systemwide and inflation levels.

B. The Increase In The Price For First-Class Presort Postcards And Automation Flats Is Already Excessive

Chairman’s Information Request No. 2 sought information about three Presort discounts – Mixed AADC Automation Cards, AADC Automation Cards, and 5-Digit Automation Flats -- whose pass-throughs exceed 100 percent of the costs avoided according to the estimates in last year’s Annual Compliance Determination. The Postal Service has provided sufficient justification for each such discount, and they should be approved.

As the Postal Service states, the pass-through of 136.4 percent for Mixed AADC Automation Cards already results in a 3.1 percent price increase despite the discount’s being one-third smaller than it is currently. *USPS Notice* at 40. That is essentially double the inflation rate and the system average. And the Postal Service also correctly notes that raising the price at the Mixed AADC level would produce still greater increases at the finer presortation categories. A similar justification supports the AADC Automation Cards pass-through of 130.0

percent, which is a first-time matter because the benchmark was changed in Docket No. RM2013-6.

In addition to the justifications cited by the Postal Service *(USPS Notice* at 40), these percentage pass-throughs illustrate the difficulties in using costs from FY2012 to evaluate prices for FY2014. The actual difference between the discount and the avoided costs estimated in the ACD for FY2012 is merely 0.4 cents in the case of Mixed AADC Cards, and 0.3 cents in the case of AADC Cards. Not only does the mismatch between costs and discounts demand caution by regulators when reviewing the prices, but it also means that no FY2014 costs avoided data (or even estimates) exists on this record.

Furthermore, the Mixed AADC and AADC tiers are the two smallest within Presort Postcards, accounting for less than 20 percent of Presort Postcard volume. The comparatively small volumes at those tiers mean that a modestly excessive discount will not lead to significant uneconomic presortation activity by Postcard mailers.

Finally, the announced discounts for ADC and 5-Digit Automation Flats are substantially smaller than the current discounts, yet exceed 100 percent because the estimates of the avoided costs in FY2012 were well below those of FY2011. For 5-Digit Automation flats, estimated avoided costs in FY2012 dropped from 18.8 cents in FY2011 to 15.4 cents. There is no evidence of what the costs avoided will be in 2014. Here, the difference between the estimated FY2012 costs and the discount is only 1 cent, yet that still yields a price increase of 3.2 percent. Any larger increase would pose a substantial risk of rate shock to Flats mailers.

V. THE JOINT COMMENTERS CONTINUE TO OPPOSE THE POSTAL SERVICE'S PRACTICE OF BAKING PROMOTIONAL DISCOUNTS INTO THE PRICES PAID BY OTHER MAILERS

The *USPS Notice* presents a full calendar year of promotions, extending a full quarter beyond the postal year. First Class mailers benefit from as much notice as possible of the Postal Service's promotions in order to determine how best they can make use of those opportunities. The Joint Commenters have encouraged the Postal Service to provide notice well in advance of its promotions, and commends it for doing so in the case.

The Joint Commenters also encourage the Postal Service to develop promotional incentive programs in a way that fully leverages the support and participation of mail services providers. MSPs play a vital role in the postal ecosystem and should not be excluded from any promotions that are available to mailers themselves.

However, one negative consequence of the Postal Service's presenting a yearly schedule of promotions in a market-dominant index cap adjustment is that it gives the Postal Service an opportunity to attempt to recover revenue "leakage" from the promotions through higher prices elsewhere in the filing or through banked future cap authority. And the nature of the annual notices makes it impossible to identify what categories of mail will be charged more in postage to offset the revenue leakage of the promotions.

As the Commission well knows, the question whether the Postal Service should be allowed to offset promotional discounts with higher rates, or with additional cap space, is contentious and has arisen in several separate dockets in 2013 alone.

Until October 2012, the settled treatment of temporary promotions in the price cap regime was that such promotions did not create new cap space.[8] For purposes of calculating cap compliance, volumes mailed at promotional prices were treated as though they had paid full prices. This approach had the virtue of being simple and understandable. The Commission changed its practice in Docket No. R2013-1, in which it allowed the Postal Service to offset promotions with higher rates elsewhere. However, the Commission's brief discussion of the matter focused only on the Postal Service's forecast of discounted volumes. It did not acknowledge or discuss that it was treating promotional discounts in a new way.[9]

The issue arose again in Docket No. R2013-6, when the Postal Service asked to offset its proposed Technology Credit with additional cap space. It surfaced yet again in Docket No. RM2013-2, when the Commission adopted its current price cap procedural regulations but did not resolve the issue.

The established practice, honored in all cases except Docket No. R2013-1, was that promotions are not to be offset by cap space, because doing so

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[8] *See , e.g., Reply Comments of the National Postal Policy Council*, Docket No. RM2013-2 at 2-6 (May 31, 2013). *See, e.g.*, Order No. 606, Docket No. R2011-1 at 18-19 (Dec.10, 2010) (disallowing cap space to offset Reply Rides Free and a Saturation/High Density Mail incentive).

[9] *See* Order No. 1541 at 16-17.

would compel non-participating mailers to pay for promotional discounts, and shift the risk of failed discounts or overestimations of discount usage. Here, the Postal Service has only negative cap authority for First-Class and Standard Mail, and the Commission should not allow the Postal Service to use any revenue leakage from its promotions to affect the levels of its banked cap authority.

VI. CONCLUSION

For the foregoing reasons, the Joint Commenters respectfully urge the Commission and Postal Service to take these comments into consideration and work towards prices that provide the proper incentives for First-Class mailers to use, and increase their usage of, the Postal Service's most profitable products.

Respectfully submitted,

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