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

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| NOTICE OF MARKET-DOMINANT PRICE ADJUSTMENT | Docket No. R2015-4 |

**COMMENTS OF THE**
**NATIONAL POSTAL POLICY COUNCIL**
(February 4, 2015)

The National Postal Policy Council[1] hereby respectfully submits its comments on the indexed rate increases filed by the Postal Service in this docket.[2]

Notwithstanding the relatively modest (1.966 percent) general price inflation on which the increases are based, the increases in First-Class Mail almost exclusively target business mailers. The proposal to raise First-Class Presort rates by an average of more than 2.6 percent – about 32 percent greater than the rate of inflation --[3] and the vitally important Automation 5-Digit rate

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, insurance, and mail services industries. Comprised of 39 of the largest customers of the Postal Service with aggregated mailings of nearly 30 billion pieces and pivotal suppliers, NPPC supports a robust postal system as a key to its members' business success and to the health of the economy generally.

2 *United States Postal Service Notice of Market-Dominant Price Adjustment*, Docket No. R2015-3 (Jan. 15, 2015) ("*USPS Notice*"). The Commission gave notice of these adjustments in Order No. 2327, 80 *Fed. Reg.* 3995 (Jan. 26, 2015).

3 *USPS-LR-R2015-1*, CAPCALC-FCM.xls, Tab Presort Ltrs & Cards, Cell J17.

increasing by 2.7 percent,[4] while leaving the Single-Piece one-ounce price untouched without explanation (while the Metered Mail rate used by businesses), is striking. To NPPC members, this is yet another indication of either complacency about, or a loss of interest in, retaining Presort mail on the part of the Postal Service. Whether either is true, or there is some other reason(s) animating this approach by the Service, the result is an ever-widening and discriminatory gap in pricing.

What's worse, the instant proposals come against the backdrop of a history of astonishingly high cost coverages for Presort mail (including an eye-popping 320.16 percent reported in the FY2014 Annual Compliance Report[5]), which these proposals do nothing to moderate.[6] The large increases for Presort Letters and Cards, as well as increases in the 4.5 to 4.9 percent range for Automation Flats, evidence scant regard for a product that generates nearly a quarter of the Postal Service's total revenue and more than $10.4 billion in institutional cost contribution (about 46 percent of the total institutional cost contribution from market-dominant products).[7]

The history of Presort pricing and the currently announced rates appear incompatible with any serious effort to keep Presort mail in the system. Rather, it

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[4] *Id*, Cell J13.

[5] *United States Postal Service FY 2014 Annual Compliance Report* at 7, Table 1 (Dec. 29, 2014).

[6] On the contrary, above-average increases for products that already pay above-average cost coverages can only aggravate the unfairness of the rate schedule.

[7] *See United States Postal Service ACR2014* Public_FY14CRA.xls.

appears to display an expectation that Presort will steadily diminish, and is not worth an effort to retain. That would be a self-fulfilling prophecy.

Regardless of whether the noticed rates reflect a policy decision to let First-Class business mail wither away, they nevertheless must comply with the Postal Accountability and Enhancements Act ("PAEA"). NPPC submits that:

- The Postal Service's decision to place almost the entire burden of the First-Class increase on Presort Letters and Cards through upward changes that substantially exceed inflation – while making minimal adjustments in Single-Piece – has reached a point at which it is unreasonably discriminatory in violation of Section 403(c)(3) of the PAEA, and contrary to the Section 3622(b)(8) objective of a just and reasonable rate schedule;
- The 2.7 percent increase for Automation 5-Digit Letters – the single largest rate category in the class and by far the most important to business mailers – and the failure to ameliorate it by passing though 100 percent of the estimated costs avoided, must be rejected as violating the Section 3622(b)(1) objective to maximize incentives to reduce costs and increase efficiency; and
- The pass-through for the Automation 5-Digit Flats discount is necessary to avoid the rate shock that would result from an increase of some 14.7 percent if the discount were set at the avoided costs estimated in the FY2014 Annual Compliance Report.

## I. THE NOTICED INCREASE FOR FIRST-CLASS PRESORT MAIL IS UNREASONABLY DISCRIMINATORY AND AGGRAVATES AN UNJUST AND UNREASONABLE RATE SCHEDULE

As shown by this table drawn from NPPC's comments in Docket No. ACR2014, First-Class Presort mail has had an extremely high relative cost coverage every year since the PAEA was enacted, especially compared to the system average:

**First-Class Presort Letters and Cards**

| | Attributable Cost (cents) | Average Price (cents) | Unit Contribution (cents) | Cost Coverage (%) | System Cost Coverage (%) |
|---|---|---|---|---|---|
| FY2014 | 11.8 | 37.8 | 26.0 | 320.16 | 184.31[8] |
| FY2013[9] | 11.67 | 36.30 | 24.63 | 311.1 | 165.7 |
| FY2012[10] | 12.15 | 35.64 | 23.49 | 293.3 | 160.8 |
| FY2011[11] | 11.65 | 34.982 | 23.332 | 300.3 | 159.1 |
| FY2010[12] | 11.679 | 34.739 | 23.060 | 297.4 | 161.1 |
| FY2009[13] | 11.704 | 34.152 | 22.448 | 291.8 | 164.5 |
| FY2008[14] | 11.023 | 33.023 | 22.000 | 299.6 | 164.0 |

*See Comments of National Postal Policy Council*, Docket No. ACR2014 at 3 (Feb. 2, 2015). Not only has the cost coverage of Presort mail invariably been much greater than the system average, but Presort mail also routinely has paid the *highest cost coverage* and *highest unit contribution* of any significant

8 Market-dominant products only. USPS-LR14-1 (Public FY14CRS.xls).

9 PRC, *Financial Analysis 2013: Analysis of United States Postal Service Financial Results and 10-K Statement for Fiscal Year 2013*, at 43-44 App. A (revised Apr. 20, 2014). The cost coverage of Single-Piece Letters and Cards was 170.7 percent. *Id*.

10 PRC, *Annual Compliance Determination Fiscal Year 2012*, at Tables VII-1 & D-1 (Mar. 28, 2013). The cost coverage of Single-Piece Letters and Cards was 166.8 percent. *Id*.

11 PRC, *Annual Compliance Determination, Fiscal Year 2011,* at 96 Table VII-1 (Mar. 28, 2012). The cost coverage of Single-Piece Letters and Cards was 162.1 percent. *Id*.

12 PRC *Annual Compliance Determination, Fiscal Year 2010,* at 84 Table VII-1 (Mar. 29, 2011, as corrected Apr. 8, 2011). The cost coverage of Single-Piece Letters and Cards was 164.8 percent. *Id*.

13 PRC, *Annual Compliance Determination, Fiscal Year 2009,* at Tables IV-5 & B-1 (Mar. 29, 2010). The cost coverage of Single-Piece Letters and Cards was 165.7 percent. *Id*.

14 PRC, *Annual Compliance Determination, Fiscal Year 2008,* at Table III-2 (Mar. 30, 2009) ("*FY08 ACD*").

product.[15] This is no accident; the Postal Service year after year has hit Presort with price increases that are not only the biggest in First-Class mail, but routinely substantially exceed inflation and the systemwide average increase. Unsurprisingly, Presort volumes have fallen steadily, year after year.

In *this* proceeding, the Postal Service once again has placed the burden of the First-Class increase on Presort Letters and Cards. In particular, it proposes to increase Presort First-Class Letters and Cards rates by an average 2.417 percent. *Id*., at 17, Table 5. Automation 5-Digit Presort Letters, the single largest rate category in the entire class, face an increase of 2.7 percent.[16] Both figures are well above the 1.966 percent cumulative inflation upon which this case is based. *USPS Notice* at 4, Table 2.

In addition to the 5-Digit increase, the rate for 3-Digit/AADC Letters – the second largest and most profitable Automation category – are set to increase by 2.6 percent. This means that the Postal Service is proposing increases for the two largest categories in Presort letters – accounting for more than 32 billion pieces[17] -- that both well exceed inflation. In comparison, the 12 billion Single-Piece rated basic one-ounce letters will see *no* price change. Even the small 0.623 percent increase noticed for Single-Piece is achieved mostly by increasing the Metered Mail and extra ounce prices also typically used by businesses.[18]

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15 In FY2014, the cost coverage of Single-Piece Letters and Cards was 174.81 percent. *FY2014 ACR* at 7.

16 *USPS-LR-R2015-1*, CAPCALC-FCM.xls, Tab Presort Ltrs & Cards, Cell J13.

17 *USPS-LR-R2015-1*, CAPCALC-FCM.xls, Tab Presort, Cells D10, D11, and D12.

18 For example, *see* Docket No. ACR2014, USPS-FY14-14 at 2-3, for an illustration of how the Postal Service assumes metered mail is business mail.

Taking into account also the above-inflation increases for Automation Flats, it is clear that the Postal Service has placed almost the entire First-Class mail increase on business mailers in one way or another.

Section 403(c) of the PAEA prohibits unreasonable discrimination in rates. Section 3622(b)(8) calls for a just and reasonable rate schedule. There comes a point when repeated discrimination in rates against a particular category of mail, or product of mail, can no longer be tolerated as reasonable, nor as part of a "just and reasonable" rate structure. That time has come, and the Commission should reject the noticed increases for First-Class Presort mail for violating both 39 U.S.C. §403(c) and 39 U.S.C. §3622(b)(8).

### A. The Noticed Rate Increases For First-Class Presort Letters Are Unreasonably Discriminatory In Violation of Section 403(c)

Section 403(c) of the Act prohibits the Postal Service from making:

> any undue or unreasonable discrimination among users of the mails, nor shall it grant any undue or unreasonable preferences to any such user.

39 U.S.C. §403(c). The Postal Service's noticed rates for Presort Letters violate Section 403(c) by unreasonably discriminating against business mailers (Presort) (which works to the benefit of Single-Piece mailers, especially those that do not use the Metered Mail rate used by businesses), at a time at which Presort mail already pays by far the highest cost coverage in the class and in the system overall and has for many years. Even the 0.5 cent increase in the Single-Piece Metered Mail rate would have the effect of *increasing all* Presort Automation Letter rates as well, because it is the starting benchmark for Automation prices. *Notice* at 18.

The Commission reviewed the elements of a Section 403(c) undue discrimination claim in the *Gamefly* complaint proceeding. These are:

- That the complaining party has been offered less favorable rates or terms and conditions than one or more other mailers;
- That it is similarly situated to the other mailer or mailers who have been offered more favorable rates or terms and conditions of service; and
- That there is no rational or legitimate basis for the Postal Service to deny it the more favorable rates or terms offered to others.

*Complaint of GameFly, Inc.*, Docket No. C2009-1, Order No. 718 at 28 (April 20, 2011).

There can be no dispute that First-Class business mailers generally, and Presort mailers in particular, have received above-average price increases and paid above-average cost coverages not only in this proceeding, but also consistently over the years. For example, in Docket No. R2012-3, the Postal Service increased the 5-Digit Presort Automation letter rate by 2.9 percent, more than 40 percent greater than the class cap increase. In Docket No. R2013-1, the Postal Service again increased the 5-Digit rate by 2.9 percent, again well above average. In Docket No. R2013-10, the Postal Service yet again gave the largest percentage increase to Presort Letters, particularly on the Automation Mixed AADC Letter Rate, but still raising the 5-Digit rate by slightly more than the system average.[19] The cumulative effect of these increases, each compounded on the inflated base created by the previous increases, is evident from the excessive cost coverages reported in the Annual Compliance Report.

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[19] *USPS-LR-R2013-10/1*, CAPCALC-FCM-R2013-10xls (Tab Percent Change Summary).

Second, although Presort mail differs from Single-Piece in significant ways, they are similarly situated. Both products are part of First-Class mail. They are the largest two products in that class, accounting for substantial postal revenue. Both have experienced declining volumes in recent years. Both are vulnerable to electronic diversion.

As for the third element, the Postal Service has offered no rational basis for yet another above-inflation and above-average increase in Presort mail rates while not adjusting the Single-Piece one-ounce rate by as little as a penny. In the *Notice*, the Postal Service says, in reference to the Single-Piece rate, only:

> The instant price change will keep the same per-piece price differential between letters and flats. The price differential between single-piece letters and single-piece flats of 47 cents maintains the simplicity of the rate structure since the gap is equivalent to the price of a single-piece first-ounce stamp.

*USPS Notice* at 18. NPPC respectfully submits that this is no rationale at all. Holding the Single-Piece one-ounce price unchanged in order to maintain an arbitrary rate differential between letters and flats within that product does not provide a reasoned basis for discriminating against Presort mail.

Nor can the disparate treatment of Single-Piece and Presort mail be justified on grounds of demand elasticities. The Postal Service's most recent update of its demand forecast model presents an own-price elasticity for Presort mail of -0.305.[20] *Econometric Demand Equation Tables for Market Dominant Products as of January 2015, at* Econometric Demand Equation for First-Class

[20] NPPC is skeptical of the accuracy of the Postal Service's price elasticity estimates, which is why it last year participated in the petition that launched the Docket No. RM2014-5 review of price elasticities.

Workshared Letters, Cards, & Flats (filed Jan. 20, 2015). By comparison, the own-price elasticity of Single-Piece is indicated as -0.140. *Id., at* Econometric Demand Equation for First-Class Single-Piece Letters, Cards, & Flats.

That means that by the Postal Service's own calculations, Presort mail is more price elastic (or less price-inelastic) than Single-Piece mail. Under that circumstance, economically rational and efficient pricing – that is, pricing that raises the most revenue while reducing volume the least – would be an increase in Single-Piece rates.

The absence of a rational justification for discriminatory treatment is, by definition, unreasonable. Here, the Postal Service has offered no rationale that would justify the discriminatory treatment of Presort mail over a period of many years, culminating in the rates noticed in this docket.

### B. The Noticed Rates Will Produce A Rate Schedule That Is Not Just And Reasonable

Section 3622(b)(8) of the PAEA establishes as an objective of the system for regulating market-dominant products the establishment and maintenance of "a just and reasonable schedule for rates." NPPC submits that where a rate schedule has caused one product -- First-Class Presort Letters and Cards – to have a cost coverage that persistently and repeatedly greatly exceeds the system-wide average over a period of many years, a *new* rate increase that disproportionately targets only that product is not just and reasonable. Accordingly, it should not be allowed to take effect.

Here, Presort Letters and Cards begin with the highest cost coverage, and will receive nearly all of the rate increase. That will simply make matters worse, because the inevitable result will be even higher cost coverages for Presort Letters and Cards. If the noticed changes take effect, there can be little doubt that the Postal Service's Annual Compliance Report for FY2015 will show still-higher cost coverages. This case poses the matter clearly. There is no need for the Commission to wade into a murky analysis to compare the increases between Single-Piece and Presort and speculate as to the effects, because the lion's share of the increase falls on one side only.

NPPC recognizes that unequal rate changes, by themselves, do not violate subsection (b)(8). That provision was enacted specifically to permit the Postal Service some flexibility on rates within classes. But allowing unequal rate changes in a limited sense does not mean that they can, or should, be permitted to be repeated to the point that they become an annual pattern to the detriment of the same mail product.

## II. THE COMMISSION SHOULD AMELIORATE PRESORT PRICES BY REQUIRING 100 PERCENT PASS-THROUGH OF THE AUTOMATION 5-DIGIT LETTER DISCOUNT

The Automation 5-Digit category is the largest in First-Class Presort Letters, accounting for half of the volume in the product, and is the most important rate for business mailers. It also is noticed to receive the highest increase (2.7 percent) of any First-Class letter, *and* is the only Automation Letters or Cards discount (excluding the apparently obsolete 3-Digit category) for which the Postal Service does not propose to passthrough 100 percent of the estimated avoided costs. Instead, the Postal Service notices a First-Class Mail Automation 5-Digit Letter discount of 0.023 cents, equating to a pass-through of only 74.2

percent of the 0.031 cents in costs avoided measured in the FY2014 Annual Compliance Report. *USPS-LR-R2015-4-1,* CAPCALC-FCM.xls, Tab Cost Avoidances.

Commission rule 3010.14(b)(6) requires the Postal Service to explain discounts that are set "substantially" below 100 percent of avoided costs. Ignoring this requirement, the Postal Service offers no explanation for its limited passthrough of this discount. Perhaps this is because it does not regard a 25.8 percent shortfall as "substantial," or believe that it needs to explain why it is proposing the largest rate increase (2.7 percent) for the largest volume rate category. However, mailers believe that even a seemingly small 0.008 cent price difference is substantial when applied to a major rate category containing billions of pieces, as is the case with the Automation 5-Digit Letter discount. Accordingly, the Commission should find the noticed pass-through a violation of its rules.

To remedy this violation, the Commission should order a 100 percent pass-through of the Automation 5-Digit Letter discount in First-Class Mail. Such action would not only help to moderate the excessive Presort rate increase, but it also would promote the statutory objective of "maximizing incentives to reduce costs and increase efficiency." 39 U.S.C. §3622(b)(1). The efficiency benefits would be most pronounced in the case of the 5-Digit category because of its significant volume.

Accordingly, the Commission should find that the Postal Service's failure to address the 74.2 percent pass-through violates its rules, and direct the Postal

Service either to increase this discount to 100 percent of the FY2014 avoided costs as a way to ameliorate the excessive rate increases noticed for Presort Letters, or to provide a compelling justification for failing to do so.

## III. THE COMMISSION SHOULD LEAVE THE AUTOMATION 5-DIGIT FLATS DISCOUNT UNCHANGED

The Postal Service proposes a discount for First-Class Automation 5-Digit Flats of 19.2 cents, a pass-through of 126.3 percent of the 15.2 cents avoided cost estimated in the FY2014 Annual Compliance Report. *USPS-LR-R2015-4-1* CPACALC-FCM.xls, Tab Passthrus FCM Auto Flats. The Commission should allow this discount to take effect.

The *USPS Notice* justifies this discount pursuant to Section 3622(e)(2)(B), which allows a discount to exceed 100 percent of estimated avoided costs in order to prevent rate shock, conditioned on the "excess" being phased out over time. The Postal Service also stated that it would reduce the discount in future price changes, taking into due consideration other business and operational needs.[21]

The current rate for a one-ounce Automation 5-Digit Flat is 41.9 cents. The noticed rate is 43.8 cents, a 4.5 percent increase.[22] Were the discount limited to 100 percent of the costs avoided, the rate would rise by 5.9 cents to 47.8 cents – a 14 percent increase.

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[21] The Postal Service also relied on Section 3622(e)(2)(B) in its FY2014 Annual Compliance Report, in which the discount was 18.3 cents. *FY2014 ACR* at 14.

[22] That is the lowest percentage increase for Automation 5-Digit Flats. Increases at higher weight increments are up to 4.9 percent.

NPPC believes that the cost estimates provide no basis on which the Commission can conclude that the discount will exceed the worksharing cost savings going forward. Even if the estimates could support such a conclusion, however, the discount should be allowed to avoid rate shock.

As for the cost estimates, the *USPS Notice* recites (at 44-45) that the estimated avoided costs associated with this discount have bounced from 17.4 cents in FY2010 to 18.8 cents in FY2011, then suddenly down to 14.3 cents in FY2012 and 14.1 cents in FY2013. The latest estimate, for FY2014, increases the avoided costs to 15.2 cents. These estimates must be viewed with skepticism. It is difficult to believe that the *actual* costs avoided by preparing flats to the Automation 5-Digit level have varied to the same extent as the estimates in the Annual Compliance Reviews.[23]

Clearly, however, there is *no* evidence regarding FY2015 costs, nor any sound basis for making assumptions. The costs avoided in a past fiscal year will almost always be different from the costs avoided by the same worksharing activity in the current year, to which the history of this discount attests. Accordingly, the Commission should place little weight on the cost avoided estimate reported in the FY2014 ACR.

The Postal Service has cited the need to avoid rate shock as a justification for the pass-through in both this proceeding and in the ACR. *ACR* at 14 & *USPS Notice* at 45. In this instance, setting the discount equal to 100 percent of the

[23] These variations in the estimated costs avoided for this comparatively lightly used category (137,176,000 pieces in FY2014, compared to 270,600,000 3-Digit flats) may be due to small volumes.

costs avoided would require raising the 5-Digit Automation Flats rate by 3.1 cents *on top of* the more than 1.9 cents (or 4.5 percent) increase for Automation 5-Digit Flats already noticed. *See USPS-LR-R2015-4-1*, CAPCALC-FCM.xls, Tab FCM Bulk Flats Price Comparison. That would amount to a total increase of 5.9 cents, or 14 percent higher than the current rate.

Furthermore, because of how the presort tree works, this nearly 14 percent increase would tend to push up every other Automation Flats rate as well, causing very substantial and unexpected price increases through the sector of the mailing industry that uses First-Class Automation Flats. Although NPPC has not calculated the consequences of such increases, it is certain that no mailers have budgeted for increases of that size, given that inflation has remained steadily below 2 percent, and especially now that the Docket No. R2015-4 noticed rates are known. Increases of that magnitude would severely injure mailers. The Postal Service's reliance on Section 3622(e)(2)(B) should be approved.

The noticed 19.2 cent discount in this proceeding is larger than the current discount of 18.3 cents. Chairman's Information Request No. 2, Question 1 (Jan. 27, 2015), asked whether Section 3622(e)(2)(B) can justify increasing a discount that already exceeds estimated avoided costs. Nothing in Section 3622(e)(2)(B) prohibits a discount from being increased in a given year if necessary to avoid rate shock. The only conditions are that the excess of the discount "is necessary to mitigate rate shock" and will be phased out over time. Here, the rate shock is evident, and the only remaining condition is that the Postal Service will phase the excess out over time, which it has already pledged to do.

For these reasons, the Automation 5-Digit Flats discount should be approved.

## IV. CONCLUSION

For the foregoing reasons, the National Postal Policy Council respectfully urges the Commission to find that the noticed increases for First-Class Presort mail violate Sections 403(c) and 3622(b)(8) of the PAEA and therefore cannot be implemented, to order an increase in the Automation 5-Digit Letter discount, and to allow the Automation 5-Digit Flats discount to take effect as noticed. NPPC urges the Postal Service and Commission to work towards prices that provide the proper incentives for First-Class Letter/Postcards mailers to use, and increase their usage of, the Postal Service's most profitable products.

Respectfully submitted,

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