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

ANNUAL COMPLIANCE REPORT, 2010	Docket No. ACR2010

COMMENTS OF THE
NATIONAL POSTAL POLICY COUNCIL
ON ANNUAL COMPLIANCE REVIEW
(February 2. 2011)

The National Postal Policy Council[1] hereby respectfully submits its comments on the Postal Service's Annual Compliance Review for Fiscal Year 2010 ("ACR"). NPPC submits that:

- Rates for First-Class commercial Automation and Presort letter mail were in compliance with all applicable legal standards;
- The Commission should consider using its powers to adjust cost coverages downward for products whose volume is declining; and
- The Commission should commence a rulemaking to examine the Postal Service's continuing imposition of uncompensated costs, particularly those associated with mail preparation tasks, and the effects of accounting for such costs in the Annual Compliance Review process and on the proper calculation of the rate cap.

[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 approximately 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.

I. ALTHOUGH RATES FOR FIRST-CLASS COMMERCIAL AUTOMATION AND PRESORT LETTERS WERE IN COMPLIANCE WITH SECTION 3622, THERE ARE WORRISOME TRENDS

The Postal Service's ACR provides ample reason for the Commission to conclude that the rates for First-Class Automation and Presort letters fully complied with all applicable legal standards.

The Postal Service did not institute a rate cap adjustment in Fiscal Year 2010, and the Commission rejected the Postal Service's request for debilitating rate increases pursuant to the "extraordinary or exceptional circumstances" exception to the rate cap. 39 U.S.C. §3622(d)(1)(E) & *Order No. 547*, Docket No. R2010-4 (September 30, 2010). As a result, the Automation and Presort letter rates did not experience any increase in FY2010.

A. Three Troubling Trends Are Emerging

The ACR provides information relevant to three trends that, while each troubling on its own, in combination raise material concern. First, First-Class commercial bulk letters continue to pay an extraordinarily large cost coverage – 295 in FY2010. *USPS Cost and Revenue Analysis FY2010*. This is the highest cost coverage of any major postal product. In fact, the cost coverage increased in FY2010 despite rates not increasing. *Postal Regulatory Commission, Annual Compliance Determination 2009* at Table IV-5 (cost coverage of 291.8). The cost coverage is likely to rise yet again in 2011 because the Postal Service recently announced its intention to raise rates for commercial First-Class letters by more than the rate of inflation.

In unit terms, an average piece of First-Class commercial bulk letter mail pays 22.9 cents in contribution alone, while imposing only 11.7 costs in attributable costs. In other words, only 1/3 of the rate paid by Automation and Presort letter mailers recovers attributable costs (11.7 cents). Two-thirds of the rate (22.9 cents) consists of overhead contribution. This is 5.5 cents more per piece in contribution than Single-Piece mail. By comparison, Single-Piece mail has far higher attributable costs (an average of 27.2 cents per piece) and pays 17.4 cents in overhead contribution for a cost coverage of 164. *ACR* at 18.

The second troubling trend is that volumes of First-Class commercial bulk letters are declining. The ACR reports that the volume of commercial letters fell by 3.5 percent in FY2010. This loss follows a drop in volume in FY2009 of 3.8 billion pieces, a 7.4 percent decline. *2009 ACD* at 33.

A cost coverage of 295 is not "reasonable" for a highly profitable product that is suffering from electronic diversion and whose mailers are actively striving to reduce their mailing budgets. In the exigency case last summer, a declaration submitted by the NPPC Executive Director noted that nearly a dozen of the largest letter mailers in the nation were planning to reduce their volume in 2011 by converting some of their mail to electronic delivery. *Declaration of Arthur B. Sackler*, Docket No. R2010-4 (August 17, 2010). This trend has not abated.

The persistently excessive cost coverage for First-Class commercial bulk letters may explain, at least in part, the third concern, which is that large mailers are the grouping that expressed the least satisfaction with First-Class Mail. Page 15 of the ACR reports the level of satisfaction experienced by customers of market-dominant products. Within First-Class Mail, 93.7 percent of residential customers were very/mostly satisfied with their mail service, only 90.2 percent of large businesses are very/mostly satisfied with their mail service. *ACR* at 15.

The Postal Service does not suggest an explanation for this comparatively poor rating by large mailers. However, that it received the lowest approval rating from its most profitable customers should concern it greatly. High rates and concerns about uncompensated costs discussed below may account for this comparative rating. The trends identified in these comments may help explain why large First-Class commercial mailers continue to explore electronic diversion.

B. The Commission Should Consider Exercising Its Authority To Ensure That Rates Are Just And Reasonable

There will be a point at which a persistently high cost coverage for commercial bulk First-Class letters can no longer be "just and reasonable" under Section 3622(b)(8) of the Postal Accountability and Enhancements Act. That time may be at hand where the volume of the product facing the exorbitant cost coverage are declining year after year.

At noted above, commercial bulk First-Class letters bear the highest cost coverage in the system. This high markup (as noted, double the attributable costs of the product) contributes to the decline in volume of this product. While historically the Postal Service has maintained high cost coverages for commercial First-Class letters, such a strategy is increasingly unsustainable in an age where less costly electronic alternatives are readily available.

It almost appears that the Postal Service believes that it will be unable to retain this mail in the years to come, and will content itself with trying to extract the maximum possible revenue from those pieces that must remain in the system. However, the purpose of market-dominant product rate regulation is precisely to protect mailers from exploitation of this nature.

The Commission has authority under the Act to prevent the Postal Service from charging an unjust and unreasonable cost coverage. NPPC respectfully urges the Commission to consider using this power, especially when volume in the affected product are declining year after year.

II. FIRST-CLASS AUTOMATION AND PRESORT LETTER DISCOUNTS COMPLIED WITH SECTION 3622(e)

Section 3622(e) requires, with certain exceptions not applicable here, that worksharing discounts should not exceed 100 percent of the estimated costs avoided. That statutory provision was met by the rates for First-Class Automation and Presort letters.

As the Postal Service states in the ACR (at 51), in Order No. 536 the Commission "determined that a worksharing relationship existed between single-piece mail and presorted mail, but also determined that the former single-piece benchmark, Bulk Metered Mail, was obsolete and should no longer be used." *Order No. 536* at 3-4 & 63.[2] Order No. 536 also held that, pending selection of a more appropriate benchmark (currently the subject of Docket No. RM2010-13),

2 NPPC's position is that the Commission's ruling that a worksharing relationship exists between Single-Piece mail and Automation and Presorted mail is incorrect. That issue is currently under review in the U.S. Court of Appeals for the District of Columbia Circuit. *United States Postal Service v. Postal Regulatory Commission*, Docket No. 10-1324).

Automation and Presorted rates need not be adjusted as there is currently no benchmark. *Id.* at 4. The Postal Service's ACR (at 53) properly reflects those determinations.

Accordingly, the only cost avoidance pass-throughs relevant to First-Class commercial bulk letters in this Annual Compliance Determination are those between Mixed AADC and AADC letters, AADC letters and 3-digit letters, and 3-digit letters and 5-digit letters. None of these discounts exceed 100 percent. *USPS-LR10.3 Workshare Discounts Table FY2010 FCM Bulk Letters/Cards.* Therefore, the Commission should find that First-Class Automation and Presort workshare discounts fully complied with Section 3622(e).

III. THE COMMISSION SHOULD INITIATE A RULEMAKING TO EXAMINE UNCOMPENSATED COSTS

Mailers incur a number of costs in preparing mail for entry. In some cases (*e.g*. barcodes), mailers receive a discount in exchange for their mail preparation activities. But mailers receive no compensation for many additional costs that are imposed by changes in Postal Service mailing regulations. And, in recent years, the Postal Service has increasingly imposed substantial additional pre-mailing costs on mailers.

These costs can be substantial. In effect, they constitute "shadow" rate increases, because they add to a mailer's costs just as directly as a rate increase. These costs are seldom, if ever, offset by rate reductions. The result is that the Postal Service effectively raises the cost of mailing by imposing uncompensated compliance costs on mailers, seemingly without any regard for their impact on mailers.

One example involves Move Update using NCOALink, announced by the Postal Service last fall. To meet the new requirements, NPPC members must invest tens of millions of dollars in modifying their information technology systems. This process is neither simple nor inexpensive. Nor do the Postal Service's deadlines take into account the mailers' product cycles, their difficulties and costs in modifying or changing systems, or the costs of these changes. Furthermore, the necessary changes are not limited to mailing software; some changes must be made to customer-facing front end systems to obtain information not demanded by the Postal Service previously. As mentioned, these costs can range in the multi-millions of dollars.

As another example, the Postal Service has in some instances reduced the acceptance windows for bulk mailings, which increases mailers costs as they adjust their production processes to meet the narrowed entry window. Even submitting a mailing statement has become more difficult, which the Postal Service attributes to Sarbanes-Oxley requirements. Regardless of the justification, the effect on mailers nonetheless of such changes is more time, effort and expenditure for which there is no compensation.

These mail preparation systems and processes may help to reduce the Postal Service's costs. However, every time the Postal Service tweaks the regulations governing these services, the effect is to impose new and uncompensated mailer costs in both money and time. With one exception, mailers receive no offsetting compensation for these “shadow” rate increases.

Even in the one instance in which the Postal Service offers rate recognition – full-service Intelligent Mail Barcode – the rate differential is commonly far less than the mailer’s costs. The IMb rate differential is 0.003 cents per piece. Compare that to mailers’ costs of complying with IMb requirements, which can run into seven or even eight figures. Such sums simply cannot be recouped at 0.003 cents per piece. The net result is an uncompensated cost imposed on the mailer, which equates to a shadow rate increase.

To NPPC’s knowledge, the Postal Service performs no cost-benefit analysis before announcing changes in preparation or entry requirements. And, because they are suffered by the mailers, not by the Postal Service, these shadow rate increases are not reported or otherwise accounted for in the Annual Compliance Review process.[3] Since this phenomenon is neither evaluated nor reported, it goes unchecked.

It makes no sense for the Postal Service to impose $10 worth of additional costs on mailers in order to reduce its operating costs by $1. The net result is higher costs and frustrations for mailers. Mailers respond by continuing to drive their mail out of the system as it becomes more costly and difficult to meet the Postal Service’ ever-changing, and complex, mailing requirements, which

[3] To the extent these new costs imposed on mailers succeed in reducing the Postal Service’s costs, they would appear in an Annual Compliance Report as a higher cost coverage.

requires modifications to systems already installed at substantial cost to meet previous postal requirements.

Under a rate cap regime, there is a well-understood temptation for the regulated entity to shift costs to the customer. The Commission considered this danger during its rulemaking to adopt rules governing market-dominant rates, but declined at that time to include in the price cap an "adjustment for service degradation or for costs associated with mail preparation and other activities." *Regulations Establishing a System of Ratemaking*, Docket No. RM2007-1 at 45 (Oct. 29, 2007) (Order No. 43). However, the Commission stated that "if experience shows that additional regulations are needed to achieve the objectives of the legislation" it would develop appropriate regulations or recommend a legislative change. *Id*. at 46.

NPPC respectfully believes that the time has come for the Commission to review these shadow costs afresh. The Commission should commence a rulemaking aimed at improving the current situation in two ways.

First, the Commission should require the Postal Service to conduct a cost-benefit analysis when it contemplates a compliance change to identify and calculate the uncompensated "shadow" costs incurred when it changes mailing regulations or entry requirements. This should include not only direct costs, but indirect costs and burdens to mailers from the timing of change or otherwise. Examples would include any assessments or payments of higher postage because the mailer was in information technology "lockdown" at the end of the year, requiring it to postpone implementing the new rules, or had to defer or forego discounts because its information technology resources could not be diverted from the needs of its primary business.

A proper cost-benefit analysis could, in fact, help the Postal Service by identifying potential mailer concerns *before* new regulations and requirements are announced, not after-the-fact. This would improve the current situation, in which the Postal Service often makes pronouncements only to backtrack after mailer protests.

Second, the Commission should require the Postal Service to include in the ACR an estimate of the uncompensated costs it imposed during the year that effectively resulted in shadow rate increases. A thorough analysis also should include a review and discussion of the aggregate financial and other effects, over time, not only from changes in the past year but from other changes in previous years that may affect the same mailers.

This would provide an opportunity to review both the frequency of such changes and how rapidly they take effect. It also would provide the Commission with information that may enable it to determine whether the rate cap should be adjusted to reflect the hidden shift of costs to mailers, resulting in shadow rate increases.

IV. CONCLUSION

For the foregoing reasons, the National Postal Policy Council respectfully urges the Commission to find that postal rates for First-Class bulk commercial (Automation and Presort) letters were in compliance with all applicable rate requirements. In addition, NPPC asks the Commission to initiate a rulemaking to consider the problem of "shadow" rate increases in the form of uncompensated costs.

Respectfully submitted,

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