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

MARKET-DOMINANT PRICE CHANGE	Docket No. R2020-1

COMMENTS OF THE
NATIONAL POSTAL POLICY COUNCIL
(October 29, 2019)

The National Postal Policy Council hereby respectfully submits these comments on the Postal Service's notice of market-dominant price adjustments.[1] The Postal Service has failed to justify the proposed price levels and workshare discount passthroughs for First-Class Presort Mail. Accordingly, the Commission cannot, consistent with the Postal Accountability and Enhancement Act and the Administrative Procedure Act, approve the proposed rates identified below but, instead, must reject them and direct the Postal Service to refile changes that are consistent with law.

I. INTRODUCTION

The National Postal Policy Council is an association of large business users of letter mail, primarily First-Class Mail using the Automation rate category, with member companies from the telecommunications, banking and financial services, insurance, and mail services industries. NPPC members account for a

1 *United States Postal Service Notice of Market-Dominant Price Change*, Docket No. R2020-1 (Oct. 9, 2019) ("*USPS Notice*"). The Commission issued public notice in Order No. 5273, issued the next day. *Notice and Order on Price Adjustments and Classification Changes for Market Dominant Products*, Docket No. R2020-1 (Oct. 10, 2019).

large majority of the Presort Letters and Card (hereinafter "Presort Mail") in the postal system and work closely with the Postal Service on worksharing and many other efforts to make their mail as efficient and low cost as possible. Both price levels and discount passthroughs in Presort Letters are vital considerations in NPPC members' mailing decisions.

NPPC supports some of the noticed rates. In particular, NPPC supports the Postal Service's proposed promotions for the upcoming year. Many NPPC members have used promotions to retain or increase volume or to test innovative mail designs and initiatives. Such promotions are consistent with the statutory objectives of pricing flexibility and assuring adequate revenues (by retaining and encouraging volume), as well as Factors 7 and 13. The Commission should approve them. NPPC also appreciates the stable rate for Metered Mail and the below-average increase for 5-Digit letters in Marketing Mail.

But NPPC has profound concerns about the proposals for Presort mail, in particular:

- The cost coverage for Presort Letters, which is unjust and unreasonable;
- The above-inflation price increases for the most important Automation Letter rates, which renders those rates even more unjust and unreasonable; and the
- Workshare discount passthroughs for Nonautomation Presort Letters, Automation Mixed AADC Letters, AADC Letters, and 5-Digit Automation Letters, which set inefficient price signals, do not maximize cost reduction, and will lose the Postal Service money.

In Docket No. R2019-1, the Postal Service used a pricing strategy of below-inflation rate increases for Presort Mail and moved discount passthroughs closer to 100 percent of avoided costs. The Commission has approved that pricing as consistent with the PAEA, stating that the "modest increase for Presorted Letters/Postcards, sent by business mail users, reflects the Postal Service's need to retain and encourage volume for this highly profitable but price-sensitive product." Order No. 5285, at 53 (Oct. 24, 2019).[2] Now, the Postal Service is proposing new rates that completely reversed that approach without either acknowledging that reversal or offering any explanation for it.

Together, the proposed Automation rate levels and passthroughs will drive profitable mail from the postal system, promote inefficiency, and harm the Postal Service's financial stability – all contrary to the PAEA. Presort Mail already pays the highest cost coverage and unit contribution, and the Postal Service's above-inflation increases will exacerbate the unreasonableness of these rates. Setting worksharing discounts further away from the 100 percent passthroughs required by Efficient Component Pricing will not maximize cost efficiency, also violating several provisions of Section 3622.

Furthermore, the Postal Service's complete reversal of pricing strategies used last year and approved by the Commission as consistent with the PAEA is entirely unexplained. Accordingly, there is no basis in the record on which the Commission may reasonably approve them consistent with the Administrative Procedure Act.

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2 The Commission said this repeatedly. *See, e.g.*, Order No. 5285, at 43-44 (stating that applying "relatively smaller than average increases to mailpieces that are less costly for the Postal Service to collect, process, and deliver (such as Metered Letters and Presorted Letters/Cards) is consistent with a strategy of incentivizing the entry of volume that would reduce the costs of the Postal Service and increase contribution to institutional costs thereby improving the Postal Service's financial position).

II. THE COMMISSION MUST REASONABLY ADDRESS CRITICISMS OF THE PROPOSED FIRST-CLASS PRESORT MAIL RATES

The Postal Service devoted substantial pages of its *Notice* to an effort to minimize the Commission's review of its proposed rates. Citing the language in 39 U.S.C. §404(b), the Service argues that the Governors, when developing proposed rates that must be "reasonable and equitable," consider matters such as "the mailing habits, available market alternatives, price sensitivities, and preferences of disparate customer groups." *USPS Notice* at 10. It argues further that the Section 3622(b) objectives and 3622(c) factors do not apply to individual rates. *Id*. at 11. Indeed, it argues that Commission rule 3010.12(b)(7) – which requires the Postal Service to discuss how the proposed adjustments "are designed to further" the Section 3622 objectives and factors -- "cannot" require justification of "specific rate adjustments at the class, product, price-category, or price-cell level, but only of the overall rate design." *Id*. After thus minimizing the materiality of the statutory objectives and factors to the proposed new First-Class Mail rates, the Postal Service essentially asserts that the Commission must submit to the black box of the "Governors' business judgment" (*id*. at 11) but with little if any explanation of how the Governors actually exercised that judgment.

The Postal Service's "trust us" approach overstates its case.[3] To be sure, Section 404(b) bestows the Governors with authority to propose rate adjustments for market-dominant products, but as the Service barely acknowledges, that discretion must be exercised within statutory constraints. In particular, the Postal

[3] This portion of the *USPS Notice* reads mostly as a criticism of the Court of Appeals' reasoning in *Carlson v. Postal Regulatory Commission*, 938 F.3d 337 (D.C. Cir. 2019), *petition for rehearing filed* (Oct. 28, 2019).

Service Governors' power to set market-dominant rates is constrained by the ratemaking system established pursuant to Section 3622 to achieve the objectives and take into account the factors.

Those objectives and facts are not incidental considerations; they are central to the ratemaking system established by Congress. The Commission's role is to ensure that the Governors' discretion is exercised in a manner consistent with the PAEA. That is why under the PAEA it is the Commission, not the Governors, that has the final say over market-dominant product rates.[4]

The *Carlson* decision stands for the unremarkable proposition that the Administrative Procedure Act requires the Commission, when administering the PAEA, to consider seriously and address arguments that particular proposed market-dominant rates are not consistent with the statutory considerations – quantitative and qualitative -- that Congress directed the ratesetting system to achieve.

In light of the *Carlson* decision, the Commission should not focus primarily on quantitative issues during this pre-implementation review, as it has in past index cases. *Carlson* holds that reasoned decisionmaking requires consideration of qualitative issues as well. Indeed, the Commission has acknowledged that "[a]pplying the objectives and factors to price adjustments is necessarily fact-specific, situation-specific, and generally qualitative in nature." Order No. 4285, Docket No. R2019-1, at 24 (Oct. 24, 2019). While not all objectives and factors

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[4] Under the prior law, the Commission "recommended" rates and the Governors had the ultimate power to modify those recommendations, although that power was limited and rarely exercised. The PAEA reversed this by giving the Commission the final say, although in practice it usually has accepted the Governors' proposed rates.

necessarily apply to every particular rate cell or change, the Postal Service's argument that the Section 3622 Objectives and Factors do not apply at all at the class, product, category, or cell level (*USPS Notice* at 13) is simply inconsistent with the *Carlson* decision of the Court of Appeals and past Commission practice.[5]

Finally, the Postal Service's assertion that adjusting rates to achieve desired relationships is a multiyear strategy, appears to be an attempt to discourage challenges to its proposals in a given year. NPPC understands that altering rate design can take more than one year. However, in doing so, the objectives and factors must be applied consistently, or a reasoned explanation provided if they are applied differently. *See, e.g, FCC v. Fox Television Stations,* 556 U.S. 502, 515-16 (2009) (agency changing standards must provide a reasoned explanation for disregarding facts and circumstances that underlay the previous action); *California v. Environmental Protection Agency*, No. 18-1114, Slip Op. at 17 (D.C. Cir. (Oct. 25, 2019). That means that any pricing justifications that the Postal Service invokes and the Commission approves should be applied consistently within each annual filing and across the multiyear period, and where a justification is applied inconsistent from year to year it must be noted and explained.[6] To do otherwise would be to drain the rationales of any

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5 *See, e.g., Annual Compliance Determination Report for Fiscal Year 2010* at 16-20 (Mar. 29, 2011) (addressing below-cost pricing Marketing Mail Flats), *aff'd sub nom. United States Postal Service v. Postal Regulatory Commission*, 676 F.3d 1105, 1107 (D.C. Cir. 2012) (stating that the PAEA "provides the Commission with fourteen factors to consider when reviewing Postal Service rates for market-dominant products"); *accord* Order No. 5285, Docket No. R2019-1 (Oct. 24, 2019) (applying Objectives and Factors).

6 For example, in Docket No. R2019-1, the Postal Service set the additional ounce First-Class Flats price to match the additional ounce Letters price, lowering both to 15 cents. United States Postal Service Notice of Market-Dominant Price Change, Docket No. R2019-1, at 8 (Oct. 10, 2018). In this case, the Postal Service has abandoned that equality without any explanation.

substantive or determinative content, making them meaningless words and rendering arbitrary and capricious the rates which they purport to justify. Reasoned ratesetting requires better.[7]

III. THE POSTAL SERVICE'S UNEXPLAINED INCREASES TO ALREADY EXCESSIVELY HIGH PRESORT AND AUTOMATION RATES ARE UNJUST, UNREASONABLE, AND ARBITRARY

First-Class Presort Mail currently bears by far the greatest institutional cost coverage burden not only within First-Class Mail, but also throughout the entire market-dominant product rate schedule. NPPC believes that even the current rates are excessive by any pertinent measure and thus are not just and reasonable. The Postal Service's proposed increases above these already excessive rates, particularly for Mixed AADC and 5-Digit Letters, would increase that burden and conflict with Objectives 1, 5, and 8 as well as Factors 1, 3, 5, 6, 7, 12, 13, and 14.[8] Increasing that burden directly conflicts with the Postal Service's pricing strategy announced only last year of incentivizing "the entry of mailpieces that would reduce the costs of the Postal Service." Order No. 5285, at 36. The Postal Service makes no effort to explain its reversal of position or its increasing of the institutional cost burden on these mail categories. That failure requires the Commission to find those increases to be arbitrary and unreasonable as well as in violation of the PAEA.

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[7] Indeed, in this very docket the Postal Service recently criticized the Commission for asking a question based on a theory that "would conflict directly with the Commission's precedent one year ago in Docket No. R2019-1." *Response of the United States Postal Service To Chairman's Information Request No. 3*, Question 1(a-c) at 2 (Oct. 23, 2019).

[8] The proposed rates do not appear to raise particular issues under Objectives 3, 4, 6, 7, and 9. Objective 2 is addressed *infra* at 21 & 24.

A. First-Class Presort Mail Pays Excessive Institutional Costs

First-Class Presort Mail already pays the overwhelmingly largest share of institutional costs – whether measured by cost coverage, markup index or unit contribution. The Commission itself reported this in Order No. 4257, where it published a Table comparing the cost coverages from FY2008 through FY2016 (the latest year then available) for the largest volume market-dominant products. *See* Order No. 4257, Table II-5. That Table II-5 is reproduced here:

Cost Coverage and Price Elasticity (By Class and Selected Products)										
	2008	2009	2010	2011	2012	2013	2014	2015	2016	FY 2016 Elasticity
First Class Mail	**200.42%**	**199.57%**	**199.27%**	**198.98%**	**202.91%**	**210.40%**	**220.28%**	**225.80%**	**223.17%**	**(0.169)**
Single-Piece Letters and Cards	**167.07%**	**165.67%**	**164.82%**	**162.06%**	**166.80%**	**170.69%**	**176.97%**	**187.49%**	**176.80%**	**(0.116)**
Presort Letters and Cards	297.98%	291.79%	297.44%	300.27%	293.34%	311.14%	320.63%	320.07%	337.98%	(0.193)
Flats	157.75%	164.35%	145.38%	144.84%	149.25%	149.46%	159.58%	151.53%	144.15%	(0.216)
Parcels	103.79%	101.81%	100.12%	110.01%	98.54%	99.47%	109.26%	112.17%	121.10%	(0.648)
Standard Mail	**156.39%**	**142.66%**	**146.64%**	**147.59%**	**149.00%**	**159.92%**	**166.10%**	**159.84%**	**158.30%**	**(0.538)**
High Density and Saturation Letters	229.05%	216.02%	212.76%	221.24%	222.17%	236.83%	239.01%	219.23%	219.22%	(0.802)
High Density and Saturation Flats and Parcels	255.56%	239.56%	224.43%	213.57%	217.28%	229.48%	226.92%	173.49%	168.87%	(0.823)
Carrier Route	150.52%	144.56%	142.98%	135.68%	130.76%	133.69%	137.22%	131.08%	137.55%	(0.816)
Letters	192.64%	174.12%	181.28%	184.88%	178.92%	189.65%	201.23%	203.99%	202.32%	(0.403)
Flats	94.15%	82.40%	81.79%	79.53%	80.88%	85.05%	83.24%	80.25%	79.76%	(0.450)
Periodicals	**83.99%**	**76.05%**	**75.46%**	**74.94%**	**72.10%**	**76.10%**	**76.16%**	**75.64%**	**73.96%**	**(0.202)**
In County	96.05%	87.85%	75.44%	78.39%	70.51%	75.90%	78.47%	75.35%	70.94%	(0.040)
Outside County	83.56%	75.57%	75.46%	74.81%	72.16%	76.10%	76.06%	75.65%	74.09%	(0.219)
Packages	**100.95%**	**96.77%**	**89.29%**	**94.29%**	**97.69%**	**101.62%**	**112.54%**	**104.88%**	**102.29%**	**(0.467)**
Bound Printed Matter Flats	166.23%	174.68%	147.91%	163.58%	135.13%	142.67%	151.07%	140.96%	160.56%	(0.444)
Bound Printed Matter Parcels	107.70%	98.05%	92.35%	98.75%	109.07%	104.83%	108.90%	119.09%	104.63%	(0.499)
Media and Library Mail	87.49%	84.33%	80.55%	77.16%	85.26%	85.01%	93.98%	76.44%	75.23%	(0.443)

PRC-LR-RM2017-3-1, Table II-5. From FY2008 through FY2016, Presort Letters and Cards have never paid a cost coverage of less than 293 percent, and have paid as much as 338 percent. Their cost coverage remained over 300 percent in FY2017 and FY2018 as well, as shown by the following table (a version of which, with citations, is attached hereto as Attachment A), which also updates the Commission's Table II-5 by showing the attributable cost, average price, unit contribution, and cost coverage of First-Class Presort Letters and Cards since 2008, compared to the average market-dominant cost coverage:

First-Class Presort Letters and Cards

	Attributable Cost (cents)	Average Price (cents)	Unit Contribution (cents)	Cost Coverage (%)	M-D Avg. Cost Coverage (%)	Markup Index[9]
FY2008	11.023	33.023	22.000	299.6	170.8	1.75
FY2009	11.704	34.152	22.448	291.8	164.5	1.77
FY2010	11.679	34.739	23.060	297.4	165.2	1.80
FY2011	11.65	34.982	23.332	300.3	159.1	1.89
FY2012	12.15	35.64	23.49	293.3	166.6	1.76
FY2013	11.67	36.30	24.63	311.1	176.1	1.77
FY2014	11.8	37.848	26.04	320.6	184.3	1.74
FY2015	12.14	38.85	26.71	320.1	183.4	1.75
FY2016	11.46	38.73	27.27	332.8	181.3	1.84
FY2017	11.78	37.64	25.86	319.9	169.5	1.89
FY2018	12.24	37.90	25.66	309.8	166.6	1.86

See Attachment A. A cost coverage hovering around 300 percent means that the rates charged First-Class Presort Mail throughout the PAEA era have been triple their attributable costs.

No other market-dominant product has borne a cost coverage burden anywhere close to the burden borne by Presort Mail. When the Commission prepared Table II-5, the product with the next highest cost coverage was High Density and Saturation Flats in what is now called Marketing Mail, the cost coverage of which ranged from a high of 256 percent in FY2008 to a low of 169

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9 Under the former law, the markup index (or cost coverage index) was calculated across all products. In Order No. 4257, the Commission chose to calculate the markup index by dividing the cost coverage of a class or product by the cost coverage of all market-dominant classes or products. Order No. 4257 at n.223. NPPC uses that methodology here.

percent in FY2015. *Id*. Its cost coverage has since declined further to 145.2 percent in FY2018.[10] And while the cost coverage of Single-Piece crept up briefly during the years that the exigent surcharge was in place, by FY2018 it had returned to its FY2008 level. In FY2018, the cost coverage of Single Piece mail was only 160.7, almost precisely equal to the average coverage for the entire system.[11]

That First-Class Presort Letters and Cards also bear an excessive institutional cost burden is shown by its cost coverage index, which has risen materially since FY2008 (when the Postal Service assumed primary pricing authority pursuant to the PAEA). Two years ago, the Commission presented market-dominant coverage indices by class and selected products from FY2008 through FY2016 (the then-latest year available). *See* Order No. 4257, Table II-4. That showed that the coverage index for First-Class Presort Mail had risen from 2008 to 2016 by more than that of any other product on the list, and that in FY2016 it (at 1.88) far exceeded any other product (1.22 for High Density and Saturation Letters is the only other product whose coverage index exceeded 1.00), and that it exceeded the average by more than twice the standard deviation. Since then, the coverage index for Presort Mail has risen even higher to 1.93.

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10 *See* Postal Regulatory Commission, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2018*, Appendix A, at 73 (Apr. 19, 2019) (including High Density and Saturation parcels as well).

11 *Id*.

The exceptionally high cost coverage of Presort Mail has cost mailers billions of dollars. In FY2018, First-Class Presort Mail paid $9,720,175,000 in contribution to the institutional costs of the Postal Service, at a cost coverage of 309.8 percent. *Id*. The Presort Mail product alone accounted for more than half of the total contribution to institutional costs ($17,441,457,000) paid by market-dominant mail that year. No other product paid even half that amount.[12] The same has been true for many years.[13]

The same conclusion -- that Presort Mail today pays, and for years has paid -- far more than other market-dominant products also is true when compared on a unit basis or by markup index. The unit contribution of Presort Mail, which is by far the largest for any non-package item, has risen from 22 to 25.6 cents over the past ten years, nearly 20 percent. First-Class Automation Letters have significantly lower attributable costs than other mail even before taking worksharing into account. This large unit contribution occurs because Presort Mail has many low-cost characteristics – *e.g.*, "cleanliness," local entry, traying and facing, legible addressing, entry near the destination, lower cost sales channel – and these cost-saving characteristics are ignored by the narrow calculations that underlie the discounts. In contrast, the unit contribution of

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12 *Id*. The next highest total contribution was paid by Marketing Mail Letters ($4,714,943,000), the Marketing Mail category most used by NPPC members. Single Piece Letters and Cards paid the third largest amount ($3,288,900,000). No other product paid even as much as $1,000,000,000.

13 For example, in FY2017, Presort Letters and Cards paid $10,033,472,000 in institutional cost contribution. Marketing Mail Letters paid the next highest amount ($4,687,524,000) and Single Piece the third highest ($3,488,464,000). No other product paid close to $1,000,000,000. Postal Regulatory Commission*, Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2017*, Appendix A (Apr. 5, 2018).

Single Piece Letters and Cards (which are much less "clean") was 18.8 cents, and of Marketing Mail High Density and Saturation Flats was 5.46 cents.[14]

As the Commission knows, the uniquely and persistently high cost coverage of Presort Mail began with the introduction of worksharing in pre-PAEA ratemaking and has persisted due to the omission of many cost reducing features of presorted mail from the discount methodology. In those days, of course, First-Class Mail was the largest volume product in the postal system and did not face electronic alternatives.

Since then, sweeping changes in the mailing industry and the emergence of the Internet and mobile technologies have spurred widespread use of electronic alternatives and led to substantial volume declines in First-Class Mail. Despite these dramatic changes, the cost coverage for this mail has remained persistently high for years, as Table II-5 and Attachment A attest. This has cost business mailers billions of dollars and understandably given them powerful incentives to divert mail from the postal system to faster and less costly alternatives. *Accord* Order No. 5285, at 55 (urging, under Factor 4, the Postal Service to "consider the prospect that price increases higher than the rate of inflation may accelerate the efforts of business mailers to convert mail recipients to electronic delivery").

The PAEA's introduction of more pricing flexibility gave the Postal Service an opportunity to reduce this burden. Unfortunately, since enactment of the PAEA, the Postal Service has not adjusted its pricing structure to a more

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[14] *See Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2018*, Appendix A, at 73 (Apr. 19, 2019).

reasonable balance. And it is unsurprising that, in response, First-Class Mail volume has fallen drastically to the financial detriment of the Postal Service.

The Commission over the years routinely has allowed the Postal Service to continue to charge these high cost coverages as “pricing flexibility.” The Docket No. 2019-1 adjustments were a rare exception, when the Postal Service gave Presort Mail a below-average increase in a deliberate pricing strategy to encourage the retention of less costly mail, and the Commission endorsed that approach both last year and again only last week.

Unfortunately, in this case the Postal Service has reverted to its former practice of raising the cost coverage of Presort Mail. *See* CAPCALC-FCM-R2020-1 Tab Percent Change Summary. The increase for the product exceeds inflation. *USPS Notice* at 3 & 7. These above-CPI increase will only exacerbate the excessive and inefficient cost coverage of that mail, further enhancing the attractiveness of electronic alternatives, and putting Postal Service volumes and revenues further at risk.

B. The Proposed Rates For Presort Letters Are Unjust And Unreasonable In Today’s Mailing Environment

The Postal Service’s proposal violates the PAEA by conflicting with Objectives 1 (maximizing cost reduction), 5 (financial stability), and 8 (just and reasonable rate structure). It also conflicts with Factors 3(effect of rate increases on mailers), 5 (degree of preparation), 7 (using pricing flexibility to encourage volume and efficiency), and 12 (increase efficiency/reduce costs). The Commission should not approve them.

1. The new rates conflict with Objective 1

Under Objective 1, the ratesetting system should result in rates that "maximize incentives to reduce costs and increase efficiency." 39 U.S.C. §3622(b)(1). The proposed rates for Presort Letters violate this Objective and also fail to take properly into account Factors 3 (the effect of rate increases of users), 4 (the availability of alternatives), 5 (the degree of preparation), and 12 (the need for the Postal Service to increase its efficiency and reduce its costs).

In Docket No. R2019-1, the Commission twice approved below-inflation rate increases for Presort Mail as consistent with Objective 1 "by encouraging the entry of First-Class Mali pieces that are less costly to the Postal Service to process." Order No. 5285, at 36. The Commission specifically found that a below-average price increase for less costly Presort Mail reflected "a proper incentive" to encourage entry of mailpieces that would reduce Postal Service costs. *Id*. It further found that doing so would reduce the Postal Service's mail processing costs per piece. *Id*.

The Postal Service's proposal in this docket is the reverse. It is imposing the largest price increases on the most efficient product in First-Class Mail. That is not just contrary to Objective 1, but also fails to take into account the related Factors 3, 4, 5, and 12. The record gives the Commission no reason to approve this proposal, which is directly contrary to the application of Objective 1 that it approved in Docket No. R2019-1 and reaffirmed one week ago.

2. The proposed rates are inconsistent with Objective 5

Objective 5 seeks to assure the Postal Service's financial stability through adequate revenues. Although rate increases would seem to promote the Postal Service's financial stability, not all increases have the same effect. Raising prices on the most profitable products can kill the golden goose.

In this proceeding, the Postal Service has chosen to impose the largest First-Class letter mail increases on the product that, according to its own most recent estimates, are comparatively price elastic (Presort Letters: -0.376)[15] while giving a decrease to less elastic (-0.143) Single-Piece mail. *See* Postal Service, *Narrative Explanation of Econometric Demand Equations for Market Dominant Products Filed with Postal Regulatory Commission on January 28, 2019* at 23 and 32.[16] That means that Presort Letters/Cards are more likely to leave the postal system than Single-Piece mail. Presort Mail volumes have fallen substantially over the past decade to the Postal Service's financial detriment. Targeting the largest increases in this product on Automation Mixed AADC and 5-Digit Letters, the latter of which is by far the largest volume category in First-

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[15] NPPC has long believed, based on its members' business choices, that the price elasticity of Presort has been underestimated, and must be reexamined from the ground up. *See Petition To Improve Econometric Demand Equations For Market-Dominant Products and Related Estimates of Price Elasticities and Internet Diversion*, Docket No. RM2014-5 (May 2, 2014). The inexorable erosion year by year of Presort volume, long after the recession and the big wave of communications realignment to digital, is a direct indicator that in the current environment price does really matter. *See infra* at 12-13.

[16] The Postal Service does not say why it did not mention this recent price elasticity estimate in its *Notice*; instead, it cites (*USPS Notice* at 16) an older estimate from FY2016 of Presort Letter price elasticity of -0.193. Prices for 2020 should reflect current conditions, not those of several years ago.

Class Mail, will only encourage more of it to leave the system, harming the Postal Service's financial stability contrary to Objective 5 and Factor 7.

In Docket No. R2019-1, the Postal Service stated that a below-average increase on Presort Letters would "retain[] volume in a category of mail that provides higher unit contribution and slows electronic diversion." *See USPS R2019-1 Notice*, at 7-8, n.12, *quoted at* Order No. 5285, at 43. The Commission approved that strategy, noting that "retaining and encouraging volume for Presorted Letters/Postcards, which provide a greater unit contribution than Single-Piece Letters/Postcards, would improve the financial position of the Postal Service. Order No. 5285, at 54. The Commission even noted how that "illustrates how the price adjustments are consistent with Objective 5." Order No. 5285, at 44.

It follows that an above-average increase on Mixed AADC and 5-Digit Automation Letters, and Presort Letters overall, can be expected to have the opposite effect.[17] The proposed rates will only accelerate volume losses to the detriment of its financial position.

3. The proposed rates are inconsistent with Objective 8

The Postal Service's proposed new rates for Presort Letters and Cards violate Section 3622(b)(8), under which the ratesetting system must produce a just and reasonable rate schedule. And while Objective 8 specifically allows unequal rate changes within a class, it does not authorize perpetually and

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[17] NPPC is pleased, however, that the Postal Service is not changing the Metered Mail rate, which will be helpful to smaller and midsize commercial mailers.

persistently placing the lion's share of the institutional cost burden on one particular product over a multiyear period.

In Order No. 4257, the Commission ruled that whether rates are "just" or not is defined by whether the rates are "excessive to the mailer," which is "highly fact-specific and situation-specific." *Id*. at 116; *accord* Order No. 5285, at 47. In Order No. 4257, the Commission applied several analytical tools to evaluate the justness of rates. First, the Commission examined the changes in cost coverages by class. *Id*. at 124. Second, it reviewed cost coverage indices. It also compared changes in cost coverage to estimates of demand elasticity. *Id*. at 127-130 & Table II-5.

The proposed Presort Letter rates are unjust by these measures. First, under the new rates the cost coverage of Presort Letters and Cards would remain far higher than for any other market-dominant product. They unquestionably would increase Presort Mail's cost coverage and unit contributions, because they comprise the majority of the increase within the class. At the same time, cost coverages for other products within the class, which are already at or below average, would decline.

Second, this increase is not merely in cost coverage, but as noted above Presort Mail's cost coverage markup has been increasing despite its falling volumes. And the noticed rate increases will perpetuate this trend. Of the approximately $500 million rate increase on First-Class Mail, the Presort Letters product alone would pay more than half. That will translate directly into a higher cost coverage.

But even the overall average masks the unreasonableness of the proposed increases at the rate category level. Within Presort (domestic) Letters, the largest percentage increases are being imposed on Mixed AADC Automation Letters (2.570 percent) and 5-Digit Automation Letters (2.089 percent).[18] The latter rate category is by far the largest volume product in First-Class Mail (alone more than twice the volume of Single-Piece Letters), and therefore the above-average increases would affect the most volume.

The Postal Service has recognized the need to lower the cost coverages of other high markup products. For example, the Postal Service has dramatically reduced the cost coverage of Standard Mail High Density and Saturation Flats and Parcels, the product with the next highest cost coverage in FY2008, from 255.56 percent in FY2008 to 168.97 percent in FY2016. That reduction has continued in the years since, to a low of 145.2 percent in FY2018, and the newly noticed rates will maintain that trend.

And in this very proceeding, the Postal Service is proposing to *reduce* the rate for Tracking for Marketing Mail Parcels by *50 percent*, stating that the fee "is more than double its attributable costs, so a 50 percent reduction allows the service to continue to cover costs."[19] As the Presort Letters and Cards now pay *triple* their cost, a similar 50 percent reduction would improve the attractiveness of that product, attract lost volume, and still easily cover attributable costs.

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[18] In contrast, the revenue change for Single-Piece Letters and Cards is a *decrease*. *See* CAPCALC-FCM-R2020-1 Tab Percent Change Summary.

[19] *USPS Notice*, at 33.

A rate schedule that repeatedly singles out one large product for uniquely high rate markups while reducing the markups on all other products with high markups cannot be called just and reasonable. The Postal Service cannot continue to impose an aberrant, anachronistic, and vastly disproportionate set of markups without explaining their appropriateness to today's mailing environment. In Order No. 5285 (at 48), the Commission found that a relatively smaller increase for high contribution mail to retain volume was rational and consistent with Objective 8. The time has come for the Commission to conclude that increasing the cost coverage of the highest markup mail in First-Class results in a rate schedule is not just and reasonable.[20]

C. The Postal Service Has Offered No Valid Explanation Or Justification For The Presort Mail Increase

In Docket No. R2019-1, the Postal Service mentioned that it might apply larger than average increases in future years to rate categories that received smaller increases in that docket. *USPS Notice R2019-1* at 8. The Postal Service may not simply rely on that non-binding statement[21] in this proceeding. On the contrary, the Commission has correctly observed that "each situation would require specific analysis when it is presented." Order No. 5285, at 40-41.

In this case, the Postal Service has completely failed to provide a "specific analysis" of the rates. Instead, it devotes merely one paragraph to explain how

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[20] NPPC is not unmindful of the difficult circumstances that tempt the Postal Service to go back to the First-Class well repeatedly, and the historical reliance on First Class revenues inherited from bygone eras. While we sympathize with the predicament, it does not diminish the imperative to treat First Class Presort rates in accordance with what the law requires today.

[21] The Commission has specifically noted the nonbinding nature of that statement. Order No. 5285 at 40, n.64.

the Presort Letters and Cards pricing comports with the objectives and factors. *See USPS Notice* at 16-17. But nothing in that paragraph explains the rates.

The Postal Service begins by observing (correctly) that Presort mail has a higher price elasticity and unit contribution than Single-Piece mail. However, that is the end of that particular discussion. It offers absolutely no explanation of how those facts support the new rates (not that it could, as those facts would support lower, not higher, rates).

The Postal Service's next sentence notes that Presort Mail by definition improves operational efficiency. *USPS Notice* at 17. NPPC agrees that Presort Mail promotes operational efficiency consistent with Objective 1 and Factor 7. Yet the Postal Service does not explain how above-average increases for Automation Letters will advance those considerations. Instead, it simply asserts that the increases on Presort mail are a reasonable exercise of its pricing flexibility. *Id*. at 17.

It next recites that the new rates are designed to assure adequate revenues while balancing the effects on users. Yet the same words could be used in support of practically any rate change that complies with the price cap. Nothing about them explains the particular rates proposed in this docket.

Finally, the Service's assertion that it balances the effect of rate increases on the general public and business mail users over time. *Id*. But that does not excuse the Service from (1) applying the Objectives and Factors consistently over the same time period or (2) its obligation to provide a "specific analysis"[22]

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[22] Order No. 5285, at 41.

justifying the rate changes under *current circumstances*. The Postal Service has not explained how it has taken recent trends in price elasticity and diversion into account in these rates. It has made no effort to explain why raising Presort rates, instead of others, in this case results in a just rate schedule appropriate for today's mailing environment. As a minimum, a practice of whipsawing mailers between large and small adjustments from year to year does not comport with the objective of predictability and stability in rates. 39 U.S.C §3622(b)(2).

Second, not only does the Postal Service not justify the proposed Presort rate increases, but it also fails to acknowledge – much less try to explain – its complete reversal of the pricing strategy it employed only last year and that the Commission found was entirely consistent with the Objectives and Factors. That unexplained reversal of position cannot be approved.

Third, regardless of whether high markups on Presort mail may have been appropriate in a much different time and era, they are now an anachronism that must be reevaluated under the current changed circumstances. The failure of the Postal Service to adapt to these sweeping changes in the mailing industry by reducing the coverage markup on Presort Mail is arbitrary and capricious. See *Alon Refining Krotz Springs, Inc., v. Environmental Protection Agency*, 936 F.3d 628, 643 (D.C. Cir. 2019); *Van Hollen, Jr. v. Federal Election Commission*, 811 F.3d 486, 496 (D.C. Cir. 2016).

IV. THE UNEXPLAINED FIRST-CLASS MAIL AUTOMATION DISCOUNT PASSTHROUGHS ARE ARBITRARY AND INCONSISTENT MAXIMIZING INCENTIVES TO INCREASE EFFICIENCY

The proposed new Presort Letter discount passthroughs are:

Rate Category	Costs Avoided	Passthrough
Nonautomation machinable letters	$0.075	53.3%
Mixed AADC	$0.067	91.0%
AADC Automation	$0.024	83.3%
5-Digit Automation	$0.034	82.4%

Source: USPS CAPCALC-FCM-R2020-1 Tab FCM Worksharing. The Postal Service's *Notice* (at 18) says only that they are less than 100 percent. It devotes not a single word to justifying any of these passthroughs.

The Commission should not approve them for several reasons:

- The passthroughs of less than 100 percent fail to achieve the Objective 1 goal of maximizing cost reductions and efficiency and Factors 5 and 12, as well as the Commission's repeated exhortations to move discount passthroughs to efficient levels.
- The Postal Service has not complied with Commission Rule 3010.12(b)(6), which requires it to "identify and explain discounts that are set substantially below avoided costs."
- By passing through less than 100 percent of the costs avoided, the Postal Service is, in fact, pricing its sortation services below cost, which is both uneconomic on its face, loses the Postal Service money, and is harmful to private sector presort services that can presort the mail more efficiently than the Postal Service.

A. The Postal Service Has Not Justified Its Failure To Maximize The Incentives For Cost Reduction And Efficiency

Both Objective 1 and Factor 5 require the Postal Service to maximize the price incentives to reduce costs and increase efficiency. The Commission has long recognized that passthroughs of 100 percent best advance these goals, consistent with the concept of Efficient Component Pricing. *See* Order No. 5285, at 37 ("prices are most efficient when workshare discounts are set equal to avoided costs").[23] The Commission's recent proposal to require greater use of Efficient Component Pricing, which calls for full passthroughs of avoided costs, reflects that understanding.[24]

Passthroughs of less than 100 percent by definition do not maximize the incentives for efficiency.[25] Here, the relevant passthroughs range from a high of 91 percent to a low of 53 percent. That these would convey inefficient pricing signals is self-evident.

Objective 1 says that rates should "maximize" the incentives – it does not say to "take reasonable steps" towards doing so. And Factor 12 reiterates the Postal Service's need to "increase its efficiency and reduce its costs." Discount passthroughs that move away from ECP levels are inconsistent with these statutory considerations.

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[23] This is a longstanding concern of the Commission's. *See Annual Compliance Determination*, Docket No. ACR2015 at 17 (Mar. 28, 2016) (stating "Although § 3622(e) does not prohibit the Postal Service from offering workshare discounts with passthroughs that are less than 100 percent, other statutory requirements and objectives focus on sending efficient pricing signals to mailers. This concept is relevant to all passthroughs"); *Annual Compliance Determination, Docket No. ACR2009* at 53: "While the PAEA does not impose a minimum passthrough of avoided costs for worksharing discounts, parts of the law (including § 3622(b)(1) on incentives to increase efficiency and § 3622(c)(5) on reflecting the degree of mail preparation) do provide a rationale for promoting efficient mailing choices by mailers, which 100 percent passthroughs of avoided costs does help to achieve."

[24] *See* Order No. 4258, Docket No. RM2017-3, at 93 (Dec.1, 2017). NPPC supported that proposal in that proceeding and urged that it be even stronger. *Comments of the National Postal Policy Council, The Major Mailers Association, and the National Association of Presort Mailers*, Docket No. RM2017-3, at 41 (Mar. 1, 2018).

[25] The Commission has previously found that the current ratemaking system has not maximized the incentives for efficiency. *See* Order No. 4257 at 224-226 & 248.

In Docket No. R2019-1, the Service moved several discounts closer to ECP but, as in this case, moved the Automation 5-Digit discount away from ECP. Although the Commission tolerated that departure, it nonetheless urged the Postal Service "to strive to set discounts that increase (rather than decrease) pricing efficiency." Order No. 5285, at 38. The Postal Service's proposal to move the 5-Digit discount still further away from ECP should not be approved this time.

It should be noted that predictability and stability in rates are not advanced by fluctuating passthroughs from year to year. While mailers already must deal with some uncertainty arising from the changing estimates of costs avoided from year to year, inconsistency in the passthroughs adds a second major source of unpredictability that is inconsistent with Section 3622. Such fluctuations can also impair the simplicity of the rate structure and of the relationships between rate categories, thus conflicting with Factor 6.[26] And the Commission has noted that adhering "to ECP has a positive effect on business mail users' participation in worksharing." Order No. 5285, at 54.

NPPC recognizes that there may be practical issues in rate design that require modest departures from full passthroughs, but it is the responsibility of the Postal Service to identify and explain those issues. Here, the Postal Service has made no attempt to do so. Because the Postal Service has not justified its

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[26] The Postal Service's mantra of "pricing flexibility" can be honored through its treatment of non-worksharing relationships and by structuring the rate design (such as its combining of the AADC and 3-Digit tiers several years ago).

failure to satisfy Objective 1, the proposed rates must be disapproved as arbitrary.

B. The Postal Service Has Ignored Its Obligation To Identify And Explain Passthroughs Substantially Below 100 Percent

Commission Rule 3010.12(b)(6) requires the Postal Service to identify and explain worksharing passthroughs that are substantially below 100 percent. The *USPS Notice* does not specifically mention, much less justify, any of the Presort/Automation passthroughs listed above.

It may be arguable that the Postal Service "identified" the passthroughs below 100 percent by listing them without comment in Attachment B to the *Notice* and in its supporting workpapers in Library Reference USPS-LR-R2020-1/1. But it is inarguable that the Postal Service has not explained why any discount is set substantially below 100 percent.

A passthrough of 53 percent must be considered "substantially" below 100 percent by any measure, but the USPS Notice offers no explanation for it. The Commission should not approve this violation of its rules.

The Commission has not ruled whether an 82.4 percent passthrough at the 5-Digit Automation Letter category is "substantially" below 100 percent. When the Commission adopted rule 3012(b)(6), it chose not to define "substantially," stating that the Postal Service "would not be required to explain reasonable passthroughs of less than 100 percent that were due to rounding, or other similar rate design goals." Order No. 43, Docket No. RM2007-1, at 41 (Oct. 29, 2007).

A decade later, in an effort to improve efficient pricing, the Commission proposed a presumptively valid "band" of passthroughs for First-Class and Marketing Mail ranging from 85 to 115 percent. Order No. 4258, Docket No. RM2017-3, at 93 (Dec. 1, 2017). That proposal suggests that the Commission views departures of more than 15 percent from 100 percent as substantial. NPPC has commented in that proceeding that the proposed band is too wide; nonetheless, the proposed passthroughs for Nonautomation Machinable Letters, AADC Automation Letters, and 5-Digit Letters fall outside even that generous band.

It is difficult to imagine that the Postal Service does not regard a 17.6 percent shortfall in the discount for its largest volume rate category as "substantial." The financial effects surely are -- even a seemingly small 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.

Nor has the Postal Service asserted that rounding necessitated the reduced passthrough.

Furthermore, the Postal Service in this case is *reducing* the passthrough from the 90.6 percent used in Docket No. R2019-1. The Postal Service is also reducing the discount in absolute terms from $0.029 to $0.028, while the avoided costs have increased from $0.032 to $0.034 cents. Moreover, this is the second consecutive year in which the 5-Digit discount has been shrunk. These moves away from the statutory and economically desirable direction demand explanation, but the Service offers none.

Given the importance of the 5-Digit Automation Letter category and the fact that the Postal Service is reducing both the percentage and the value of the discount while avoided costs are rising, the new 5-Digit passthrough should be considered "substantially" below 100 percent. The Postal Service's failure to explain that passthrough is a violation of the Commission's rules and fails to provide the Commission with any reasoned basis for approving the rate.

C. By Passing Through Less Than 100 Percent Of Avoided Costs, The Postal Service Is Losing Money By Pricing Its Sortation Service Below Cost

A discount of less than 100 percent of avoided costs is also a form of exclusionary below-cost pricing. When the Postal Service passes through less than 100 percent of the avoided costs, it sells its own mail processing services below its cost (in this instance, the processing of mail from the AADC level to the 5-digit level). That could both exclude a more efficient provider of sortation services (either a mailer or a mail services provider ("MSP")) and cause the Postal Service to lose money.

Here, the Postal Service is proposing a discount of $0.028 cents for presorting to the 5-Digit level instead of the AADC level, an operation that would cost the Postal Service $0.034 to do itself. The conventional way of looking at the pricing is to say that the Postal Service is offering the mailer a discount of 2.8 cents per piece to do work that costs the Service 3.4 cents to do. It is equally true that the discount is the price that the Postal Service would charge to process mail to the discount tier. Either the mailer prepares the mail to the 5-Digit level and accepts the discount, or the Postal Service does so and the mailer pays it the undiscounted amount.

For example, consider a mailer deciding whether to prepare a large mailing to the AADC or the 5-Digit level. The decision whether to accept the discount depends upon a comparison of the mailer's (or mailing services provider's) cost to prepare the mailing to the 5-Digit level (instead of the AADC level) to the $0.028 discount. There are three scenarios to consider.

Mailer/MSP	Mailer's cost to sort to 5-Digit	USPS costs avoided	USPS proposed 5-Digit discount	Mailer's Rational Choice	USPS lose $	Efficient outcome?
A	$0.026	$0.034	$0.028	Accept discount (save $0.002)	No	Yes
B	$0.038	$0.034	$0.028	Decline discount (USPS sorts)	Yes	Yes
C	$0.030	$0.034	$0.028	Decline discount (USPS sorts)	Yes	No

The only difference is the cost incurred by the mailer to prepare to the 5-Digit level. Mailer A is more efficient than the Postal Service and should accept the discount. Mailer B is less efficient than the Postal Service, so should pay the Postal Service to process the mail to the 5-Digit level. In this instance, the Postal Service loses $0.006 because it is paid $0.028 to do work that costs $0.034.

Mailer C is more efficient than the Postal Service, but because the Postal Service discount is set inefficiently, the discount is not sufficient to cover its costs. So the mailer's rational decision is to decline the discount and pay the Postal Service to do process the mailing to the 5-Digit level. But in this instance there are two inefficiencies: (1) the Postal Service loses $0.006 per piece (as in the case of Mailer B as well); and (2) the work is performed by the less efficient provider to the detriment of the overall postal system.

In two of these scenarios, the Postal Service loses money. In one of them, the entire system is render less efficient. Neither is an outcome consistent with either Objective 1 or Objective 5. Both are the result of the uneconomic pricing signals sent by passthroughs of less than 100 percent.

This also explains how failing to pass through the full amount of avoided costs is a form of exclusionary pricing. Mailer C is more efficient than the Postal Service, yet the proposed discount would obscure that pricing signal. The effect would be to exclude it from the market for mail preparation services and render the entire postal system less efficient.

For the Postal Service to price below cost conflicts with the objective of financial stability. It also can take work from more efficient private mail preparation firms. The Commission should not approve Postal Service discount passthroughs that fail to passthrough the full costs avoided from worksharing.

V. CONCLUSION

For the foregoing reasons, the National Postal Policy Council requests that the Commission disapprove – as contrary to the PAEA and the requirement for reasoned explanations -- the proposed new rates for First-Class Presort Letters and Cards and the proposed reductions in the Presort Letter worksharing discounts. It is important that the Commission do so at this stage, as 39 U.S.C §3681 would not allow mailers to recover any postage payments later found by a court or the Commission to be unlawful.

Respectfully submitted,

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Attachment A

Attributable cost, average price, unit contribution, and cost coverage of First-Class Presort Letters and Cards since 2008, compared to the average market-dominant cost coverage:

First-Class Presort Letters and Cards

	Attributable Cost (cents)	Average Price (cents)	Unit Contribution (cents)	Cost Coverage (%)	M-D Avg. Cost Coverage (%)	Markup Index[27]
FY2008[28]	11.023	33.023	22.000	299.6	170.8	1.75
FY2009[29]	11.704	34.152	22.448	291.8	164.5	1.77
FY2010[30]	11.679	34.739	23.060	297.4	165.2	1.80
FY2011[31]	11.65	34.982	23.332	300.3	159.1	1.89
FY2012[32]	12.15	35.64	23.49	293.3	166.6	1.76
FY2013[33]	11.67	36.30	24.63	311.1	176.1	1.77
FY2014[34]	11.8	37.848	26.04	320.6	184.3	1.74

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[27] Under the former law, the markup index (or cost coverage index) was calculated across all products. In Order No. 4257, the Commission chose to calculate the markup index by dividing the cost coverage of a class or product by the cost coverage of all market-dominant classes or products. Order No. 4257 at n.223.

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

[29] PRC, *Annual Compliance Determination, Fiscal Year 2009,* at Tables VII-1 & B-1 (Mar. 29, 2010).

[30] PRC *Annual Compliance Determination, Fiscal Year 2010,* at 84 Table VII-1 (Mar. 29, 2011, as corrected Apr. 8, 2011).

[31] PRC, *Annual Compliance Determination, Fiscal Year 2011,* at 96 Table VII-1 (Mar. 28, 2012).

[32] PRC, *Annual Compliance Determination Fiscal Year 2012*, at Tables VII-1 & D-1 (Mar. 28, 2013).

[33] 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).

[34] PRC, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2014*, Appendix A, at 73 (April 1, 2015).

FY2015[35]	12.14	38.85	26.71	320.1	183.4	1.75
FY2016[36]	11.46	38.73	27.27	332.8	181.3	1.84
FY2017[37]	11.78	37.64	25.86	319.9	169.5	1.89
FY2018[38]	12.24	37.90	25.66	309.8	166.6	1.86

35 PRC, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2015*, Appendix A, at 88 (Mar. 29, 2016).

36 PRC, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2016*, Appendix A-2 at 93 (Mar. 31, 2017).

37 PRC, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2017*, Appendix B, at 85 (Apr. 5, 2018).

38 PRC, *Financial Analysis of United States Postal Service Financial Results and 10-K Statement, Fiscal Year 2018*, Appendix A, at 87 (Apr. 4, 2019).