

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Notice of Price Adjustment

Docket No. R2009-3

COMMENTS OF THE PUBLIC REPRESENTATIVES

(May 21, 2009)

On May 1, 2009, the Postal Service filed a notice with the Postal Regulatory Commission (Commission) of proposed adjustment in the prices for Standard Mail letters and flats for the period July 1, 2009, through September 30, 2009.¹ The adjustment is referred to as a “Standard Mail Volume Incentive Pricing Program,” more commonly referred to as the “Summer Sale Program” (Program). The Postal Service’s notice was filed pursuant 39 U.S.C. 3622 and 39 CFR Part 3010.

The Commission’s Order No. 209, issued May 4, 2009, designated the undersigned as Public Representatives in this proceeding and designated May 21, 2009, as the deadline for filing initial comments. Pursuant to Order No. 209, the Public Representatives hereby file their initial comments.

I. INTRODUCTION

The Postal Service states in its May 1 Notice that the Summer Sale Program has been proposed as a way “to help its customers increase their use of mail during ... challenging economic times.” Notice at 2-3. The hope is that mailers will generate additional business by increasing their mail volume. Such an increase should also benefit the Postal Service which is itself suffering the adverse consequences of a substantial decline in overall mail volume.²

¹ United States Postal Service Notice of Market-Dominant Price Adjustment, Docket No. R2009-3 (May 1, 2009) (“May 1 Notice” or “Notice”).

² According to the Postal Service’s Form 10-Q for FY2009, the Postal Service suffered a loss of \$1.9 Billion in the Second Quarter. For the first two quarters of FY2009, the combined loss was \$2.3 Billion.

In addition to potential financial advantages from increased volume generated by the Program, the Postal Service also hopes that by implementing this Program it ‘will be able to examine potential improvements to postal data systems, and evaluate its communications with customers ...’ Notice at 3. It is hoped that information gained from the Program “will allow the Postal Service to improve its performance and become more efficient at developing and implementing new programs in the future ... and enhance existing relationships with customers.” Id.

II. PROGRAM SUMMARY

In Part I of the May 1 Notice, the Postal Service provides a discussion of the Summer Sales Program’s key elements. The basic parameters of the Program can be summarized as follows:

- The Program will be in effect from July 1 through September 30, 2009.
- Eligible mailers must: be the owner of a permit imprint advance deposit account; and be able to demonstrate Standard Mail letter and flats volume of at least one million pieces between October 1, 2007, and March 31, 2008, for one or more permit imprint advance deposit account(s), precanceled stamp permit(s), or postage meter permit(s), or able to provide adequate documentation that it was the owner of mail volume that was mailed through an account owned by a mail service provider.
- Mail service providers are to be excluded from the Program.
- Eligible mailers will receive a 30 percent rebate of postage paid on the volume of Standard Mail letters and flats that exceeds mailer-specific thresholds.
- The rebate threshold volume will be calculated in a two

step process: first, a comparison will be made of an Eligible Mailer's mail volume for two periods (Period 1: October 1, 2007 – March 31, 2008; and Period 2: October 1, 2008 – March 31, 2009) to determine the percentage increase or decrease from Period 1 to Period 2; and, second, the percentage of increase or decrease will be applied to the Eligible Mailer's mail volume between July 1, 2008, and September 30, 2008, to arrive at the Eligible Mailer's threshold volume that will be used to calculate the Eligible Mailer's rebates.³

- Mailers whose actual mail volume during the period from July 1, 2009, through September 30, 2009, exceeds their threshold will receive a rebate of 30 percent of the postage paid on the volume that exceeds the threshold.
- To prevent previously planned mailings from being shifted from October, 2009, into the sales period, each mailer's October, 2009 volume will be compared to the trend calculated above. Any October, 2009 shortfall from the trend will be deducted from the rebate-eligible total.

Administratively, the Program will operate in the following manner:

- Each potential Program participant will be contacted by the Postal Service and will be provided with the Standard Mail letter and flats threshold volume that it must exceed in order to begin earning a rebate.
- The mailers interested in participating in the Program are to indicate their interest on the Postal Service's website and to state whether they agree or disagree with their threshold volume as calculated by the Postal Service. A procedure is prescribed for resolving any disagreements over a mailer's volume.
- Mailers who are not contacted by the Postal Service, but wish to participate, are instructed to contact the Postal Service

³ Page 4 of the May 1 Notice provides two examples of the threshold calculation. In the first example, the hypothetical mailer's Period 2 volume increases by 10 percent over the Period 1 volume. That results in a threshold which is 110 percent of the mailer's July 1, 2008 to September 30, 2008 actual volume. In the second example, the mailer's Period 2 volume decreases by 10 percent from the Period 1 volume. In that example, the mailer's threshold is 90 percent of the mailer's July 1, 2008 to September 30, 2008 actual volume.

to obtain an eligibility determination.

- At the end of the Summer Sale period, the Postal Service will calculate rebates using volume and revenue data from PostalOne! and CBCIS. Each mailer (or responsible agent) will be required to certify the data used to calculate the rebate. Rebates will be credited to the mailer's permit account.

The Postal Service projects an incremental revenue increase from the Program of between \$38 and \$95 million net of rebates. Administrative costs are estimated to be approximately \$997,000.⁴ Additional volume is estimated to produce enough contribution to ensure adequate Standard Mail cost coverage.

III. COMMENTS

The Public Representative agrees that during these tumultuous times innovative programs should be implemented in an effort to benefit both the Postal Service and its customers. The Summer Sale Program is intended to be such a program. If it functions as intended, mailers will be able to increase mailings at a lower cost and the Postal Service will generate additional revenues during the summer period utilizing what the Postal Service maintains is "excess capacity." The concept of a "sale" is of course not at all unusual in most typical retail environments.

The information gained from the Summer Sale may also lead to the implementation of future programs that address the needs of mailers and foster increases in mail volumes. In that regard, the Public Representatives would note that comments have already been filed in this proceeding by mailers who have applauded the Postal Service's decision to propose the Summer Sale Program and have urged the Postal Service to propose further innovative programs in the future.⁵ In supporting the Postal Service, at least one mailer points out that the rebates offered under the Program would enable it to contact additional business "prospects and marginal segments of ...

⁴ This projection consists of program support by dedicated Postal Service personnel (\$550,000); analytical support by contractors (\$400,000); registration website creation (\$7,000); and production of customer print communications (\$20,000).

⁵ Letter dated May 19, 2009, from L.L. Bean; and Letter dated May 19, 2009, from Boston Apparel Group.

[its] own mailing list” who might not otherwise be included in that mailer’s advertising campaigns.⁶

A. Period Covered by the Program

As its name implies, the Summer Sale Program is to be in effect from July 1, 2009 through September 30, 2009.⁷ The decision to offer the Summer Sale Program is motivated by several factors, including the fact that excess capacity has historically available during these months and by the fact that the severe economic downturn has greatly exacerbated that magnitude of that excess capacity.

B. Program Eligibility

In designing the Program, the Postal Service has imposed a number of eligibility limitations, as well as restrictions on mail volumes eligible for rebates. As proposed, the Program will be open to customers who mailed more than 1 million pieces between October 1, 2007 and March 31, 2008. This could amount to as many as 3,200 customers. This will leave more than 300,000 customers ineligible to participate. In defending its limitation on mailer eligibility, the Postal Service notes that its administrative costs would rise rapidly were it to expand eligibility. In addition, at some point, small mailers simply would not save enough to make participation worthwhile.⁸

Mail Service Providers MSP’s utilizing their own permits would also be excluded from the Program to ensure that the Program’s benefits inure to the originators of the mail by protecting the Postal Service from MSP participants combining volumes from multiple mail owners permits onto MSP’s permits in order to optimize discount-

⁶ See Letter dated May 18, 2009 Letter from Cuddledown, Inc. (“Cuddledown Letter”)

⁷ The fact that the program period coincides with the Fourth Quarter of the Postal Service’s fiscal year will hopefully result in the collection of information and data that is susceptible to meaningful comparisons and analyses and be even more useful in evaluating the Program.

⁸ Hopefully, lessons learned from this summer’s Summer Sale will enable the Postal Service to expand eligibility in the future to a larger number of mailers.

qualifying volumes thus merely shifting existing volume around in order to receive a discount.⁹

C. Migration

The objective in designing a program such as the Summer Sale is to entice incremental volumes and limit, or avoid altogether, volume shifting and migration from other mail classes. The eligibility limitations proposed by the Postal Service should accomplish these ends. The adjustment made in October volume will tend to mitigate volume shifts from future period into the program period. While there is no such adjustment to prevent shifting of volumes from June to July and hence into the Program, it is the Postal Service's position that the short time horizon in implementing the Program will discourage this type of behavior. This practical limitation would appear to prevent such migration.

Another potentially more serious form of volume migration appear to be possible, namely, volume migration from First Class to Standard Mail. First Class presorted mail used by some advertisers is not eligible for the Program as it has been proposed. There are, however, some mailers who can utilize both First Class (presort) and Standard Mail for their advertising. From the Program's perspective, volume migration from First Class to Standard would be undesirable in that it is not incremental volume and would be quite unprofitable due to the fact that First Class currently provides a much higher level of contribution than Standard Mail (particularly when discounted 30 percent).¹⁰

⁹While MSP's are excluded from the Program, it would appear that they should nevertheless benefit indirectly from any increased volume entered by their mailer customers. The exclusion of MSP's from direct participation in the Program would not appear to prohibit other forms of mailer aggregation that seek to insure reasonable access to the Program. For example, the Postal Service states in its response to Question No. 1 of the May 8, 2009 Chairman's Information Request that the Summer Sale Program is being offered "to 'Parent' organizations ... [with] ... [m]ailing activity for subsidiary organizations ... [being] rolled up under the parent." This form of "enterprise aggregation" has the potential for increasing Program availability while at the same time limiting the Program's benefits to mailers who increase their mail volumes.

¹⁰ One way to mitigate such potential migration would have been to include First Class advertising mail in the Summer Program. Giving First Class mailers a 30 percent volume-related discount would have maintained the differential between First Class and Standard Mail which provides a disincentive to outright migration to Standard Mail. However, the Postal Service in a response to a

The Postal Service dismisses the possibility that First Class Mail might migrate to Standard Mail by arguing that the limited lead time available to First Class mailers will prevent migration and that “[a] substantial price difference already exists between the two services ... [and that it] ... believes that most customers who would shift to Standard Mail for price reasons alone have made the shift already and that the Summer Sale Program will have little impact on that decision.” Response to CHIR Question 2.a. For that reason, the Postal Service has no specific plans to attempt measurement of volume migration. Id.

The Postal Service may be correct in claiming that the limited lead time available to prepare for participation in the Program will, as a practical matter, preclude some migration from First Class to Standard Mail. However, its assertion that the existing price differential between First Class and Standard Mail would have already induced a migration from First Class to Standard is untested. That assertion assumes that substantial rebates for Standard Mail would not elicit further interest by First Class mailers in migrating to Standard Mail. Accordingly, the Public Representatives submit that prudence dictates that the Postal Service should attempt to monitor any such migration. Moreover, in the event of a longer lead time should the Program be offered next year, an even greater threat of migration from First Class to Standard Mail might be presented. It is therefore important for the Postal Service to begin looking at the threat of migration now, not next year.

D. Excess Capacity

The economics of the Summer Sale Program are driven by the existence of excess capacity. The existence of excess capacity, the Postal Service asserts, results in ‘the resulting short-run marginal costs for a firm will be lower than its long-term marginal cost or even zero’ Response to CHIR Question No.4. The existence of excess capacity is demonstrated in several ways and it is demonstrated that, to some extent, it has always has occurred in Quarter 4, the Summer Sale months. The existence of

Chairman’s Information Request indicates that there is no reliable way to discern what is advertising mail in a First Class mailing. Response of the United States Postal Service to Chairman’s Information Request No.1 (May 15, 2009) (Response to CHIR) Question No. 5.c.

excess capacity is not the same for all functions. For example, work hours have fallen more rapidly in mail processing than for delivery, which according to the Postal Service “suggests that there is a material temporary excess capacity in delivery.” Response to CHIR Question No. 3. High Density and Saturation products will be most affected by the existence of excess capacity in that these products incur over half their attributable costs in delivery. Flats which incur only a quarter of their costs in delivery have a smaller percentage reduction in cost from excess capacity.

In the Postal Service’s calculations, the existence of excess capacity results in the estimated cost coverages on the incremental Standard Mail products generated by the Summer Sale being considerably higher than for base volumes, despite a 30 percent discount.¹¹ While the Postal Service has made a showing of excess capacity in a variety of activities, it is not clear as to whether the excess capacity is geographically dispersed or concentrated in certain areas and whether this could affect the Postal Service’s ability to utilize the excess as intended. Despite this latter uncertainty, there is no current evidence that demonstrates that the Postal Service will not have adequate excess capacity to achieve the Program’s objectives.

E. Volume Thresholds and Magnitude of Rebates

The volume threshold methodology while perhaps cumbersome is necessary in light of the rapid declines occurring in the economy and in mail volumes. Without an adjustment to base period volumes, customers would tend to be discouraged from participating in the Program because they would find it less advantageous financially. Even with the base period adjustment, some customers will be unable to breach the threshold and will therefore be unable to participate.¹² Notwithstanding its ineligibility, at least one mailer has enthusiastically supported the Program and has urged the Postal Service to pursue further such initiatives as a means of fostering increased mail volume.¹³

¹¹ See Table 3 in the Postal Service’s Response to CHIR Question No. 4 Cf. ACD Table VI-6 at 59.

¹² See Cuddledown Letter, *supra*, note 7.

¹³ *Id.*

The Program as proposed incorporates a 30 percent discount. It is unclear how the Postal Service decided this discount level or whether the Postal Service considered any lower level of discount. A lower discount level might generate more contribution for the Postal Service despite potentially lower volumes being mailed. Given the fact that this is the Postal Service's first attempt to implement a program of this nature and in light of the apparent likelihood that product cost coverages will not be impaired by rebates of this magnitude, see *infra*, the Public Representatives believe the 30 percent discount to be at a reasonable inducement to increase mail volumes.

F. Interaction with Other Programs

It remains unclear how the Summer Sale will interact with the already existing Saturation Mail Incentive Program. Some saturation mailers could simultaneously qualify for both programs. While these programs are similar in nature there are differences between them. The two programs have different time frames. The Summer Sale is for a 3-month period as versus an annual period for the Saturation Mail Incentive Program. The programs do not cover identical products. Standard Letters and Flats as well as high density and saturation letters are eligible for the Summer Sale Program while only Saturation mail is eligible for the Saturation mail incentive program. Finally, these programs have different volume thresholds. The Summer Sale uses an adjusted comparison of the Same Period Last Year (SPLY) while the Saturation Mail Incentive Program uses an unadjusted SPLY basis, which in a period of steadily declining volumes, creates a higher volume threshold, thus in effect creating a second tier discount at least during the time period that both programs are in effect. The Saturation Mail Incentive Program has apparently not seen a lot of activity to date. On its face, having two types of discount programs is not necessarily bad. This is particularly true in the example of a mailer whose actual volume has risen over the base period. In this instance this mailer might not be eligible for the Summer Sale, but could qualify for the Saturation Mail Incentive program. However, some coordination is necessary to maximize the benefits of the combined programs. In addition, the existence of two or

more programs could even further complicate any evaluation of the program costs and benefits.

G. The Requirements of Rule 3014.14

Rule 3010.14 (b)(1) through (4) generally requires that a notice of rate adjustment be accompanied by calculations of cap and price changes. In its Notice, the Postal Service relies upon the temporary nature of the Program and the uncertainty over the amount of new volume that will be generated to propose that for purposes of price cap compliance it treat the Program in a manner that is mathematically analogous to negotiated service agreements as provided in rule 3010.24. The Postal Service therefore intends to ignore the effect on the price cap that results from the price decrease produced by Program rebates. For the reasons given by the Postal Service, the Public Representatives do not oppose this approach.

In its May 1 Notice the Postal Service includes a discussion of why it believes that the proposed rate adjustment satisfies the requirements of rules 3010.14(b)(5) through (8). That discussion addresses how the proposal is designed to help achieve the objectives of 39 U.S.C. 3622(b); how the proposal takes into account the factors of 39 U.S.C. 3822(c); and how the planned prices are consistent with 39 U.S.C. 3626. Notice at 8-13.

With respect to the objectives of section 3622(b), the Postal Service asserts that the Summer Sale Program “does not substantially alter the degree to which Standard Mail prices already address these objectives, or they are addressed by the design of the system itself (Objectives 1,2,3,6,7,8, and 9).” Notice at 9. In addition, the Postal Service states that Objective 4 (allowing the Postal Service pricing flexibility) would be furthered by approving the Summer Sale rates; and that Objective 5 (ensuring adequate revenues to maintain financial stability) would also be furthered by the Program’s incentive to increase mail volumes and its support for a key customer segment. The Public Representatives do not take issue with these assertions.

With respect to the factors of section 3622(c), the Postal Service alleges that the Program “does not substantially alter the degree to which Standard Mail prices address

... Factors 1, 4, 5, 6, 8, 9, 10, 11, 12, 13, and 14....” With respect to the remaining factors, the Postal Service claims: that the Program addresses Factor 7 by using pricing flexibility to encourage increased mail volume during a period of low-volume months; and that the Program addresses Factor 3 by providing assistance to a key customer segment during the severe economic downturn. Again, the Public Representatives do not dispute these assertions.

There is, however, one area of concern, namely, the attributable cost coverage for Standard Mail Flats. This is not a new problem unique to the Summer Sale Program. In its FY2008 Annual Compliance Determination (ACD), the Commission noted that the cost coverage for all Standard Mail Flats was only 94 percent, a loss of 2.2 cents per piece. ACD at 60-61.¹⁴

In its Response to CHIR Question No. 6, the Postal Service notes that “Flats mailers are among the hardest hit by the [economic] downturn,” and that by including Flats mailers in the Program, they will be given a base for future growth that will, in turn, assist in improving profitability of the product. Moreover, the Postal Service argues that with respect to Factor 2, “the program will not imperil the ability of Standard Mail to cover its attributable costs...”; that “incremental prices generated as a result of the program are expected to cover their additional attributable costs...”; that Standard Mail as a whole will continue to make a contribution to institutional costs; and that even if a loss were experienced on incremental pieces generated by the Program, it is “highly unlikely” that the ability of the class as a whole to cover its costs would be jeopardized. Notice at 12-13.

After reviewing the information provided in the Notice and the Postal Service Response to CHIR Question No. 4, in particular Table 3 showing the projected cost coverages under the Program, the Public Representatives have concluded that the Postal Service has made an adequate demonstration that Factor 2 has been satisfied.

¹⁴ Commercial Flats coverage was 102 percent. Non-profit Flats coverage was 58 percent. ACD at 60-61.

H. Effects on Worksharing Discounts

The Postal Service has also addressed the potential effect on workshare discounts and the preferred rates for non-profit mailers. Notice at 13. With respect to workshare discounts, the Postal Service asserts, and there appears to be no obvious basis for disputing, that “[t]o the extent that the Program affects these [workshare] discounts, it will shrink them.” Id. Finally, since non-profit letters and flats are eligible for the same Summer Sale rebates, the 60 percent ratio between the prices will remain unchanged.

I. Evaluation of the Program

The Postal Service plans to evaluate the Program at its conclusion. It indicates that measuring incremental revenues and volume growth will be its primary measures of the Program’s success. The Postal Service also needs to verify that its costs behave in the manner in which they suggest, as this is obviously such a powerful element of the Program. Certain elements of the Program may need to be adjusted if the Program is to be revived next summer as well in particular volume eligibility thresholds. Also, as noted above, the Public Representatives submit that the possible migration of First Class Mail volumes to Standard Mail could be an even more significant concern in the future if mailers have more lead time to react to a new program. It is therefore important that steps be taken under the current Program to analyze such migration and to include such analyses in future programs and the Commission should require that such an analysis be attempted under the current Summer Sale Program.

The Summer Sale Program has been presented as an experiment in promotional pricing. Response to CHIR Question No. 1. As such, the Postal Service “expects to learn a great deal through the administrative execution of the program.”¹⁵ Notice at 3. Information from and experience with the Program are expected to “help the Postal

¹⁵ Among other things, the Postal Service hopes to acquire information regarding: potential improvements to its data systems; communications with its customers; and to gauge customer satisfaction with the Summer Sale concept and implementation of the Program.

Service fine-tune future offerings and enhance existing relationships with customers.”
Id.

The Summer Sale Program also provides the Commission with its first opportunity to learn about the type of promotional pricing embodied by the Summer Sale concept. If, as the Postal Service has suggested, the Summer Sale Program leads to new programs in the future, it will be important for the Commission to have the benefit of the Postal Service’s experience with the Program. Accordingly, the Public Representatives recommend that at the conclusion of the Program, the Postal Service be required to submit a report to the Commission on the results of the Program. Such a report should include, at a minimum, the following: (1) incremental volumes generated by the Program (in total and by participant); (2) rebates under the Program (in total and by participant);(3) the effect of any overlap of the Summer Sale Program and the Saturation Mail incentive program; (4) an estimate of any migration of mail to the Summer Sale Program from the period prior to July 1, 2009; (5) an estimate of any migration to the Summer Sale Program from First Class mailers; (6) an identification of any significant changes to the projected cost coverages and an explanation of the reasons for any such changes; (7) a narrative discussion of any problems experienced with implementation of the Program; (8) identification of any necessary or desirable improvements to Postal Service data systems identified as a result of implementing the Program; (9) a summary of customer expressions of satisfaction or dissatisfaction with the Program; (10) a discussion of any generic weaknesses with, or strengths inherent in, the Summer Sale concept; and an identification or discussion of any other information gained from the Program which the Postal Service deems to be relevant or pertinent.

The submission of such a report should not be an undue burden inasmuch as the information identified is, in a number of cases, information that the Postal Service has expressly identified as information that it expects to obtain and analyze. The purpose of the recommendation is simply to ensure that the Postal Service shares its Program experience with the Commission. This will provide a foundation not only for the formulation of future programs by the Postal Service, but for Commission evaluation of

future such programs. Moreover, the production of this information is entirely consistent with the PAEA's emphasis on increased transparency.

IV. CONCLUSION

In conclusion, for the reasons stated above, we the Public Representatives believe the Standard Mail Volume Incentive Pricing Program is an innovative use of the Pricing flexibility granted by the PAEA and, with the administrative and operational experience gained, could pave the way for additional equally innovative plans in the future involving yet more customers and, if deemed appropriate, additional products. While the Postal Service must continue to rationalize its network to match workhours with volumes, the instant Program, which will benefit both the Postal Service and its mailers, should be approved by the Commission with the refinements noted herein.

Respectfully submitted,

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