

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

NOTICE OF CLASSIFICATION AND PRICE
ADJUSTMENTS FOR FIRST-CLASS MAIL
AND STANDARD MAIL INITIATIVES

Docket No. R2011-1

RESPONSES OF THE UNITED STATES POSTAL SERVICE TO
QUESTIONS 1-3 OF CHAIRMAN'S INFORMATION REQUEST NO. 1
(November 16, 2010)

Chairman's Information Request No. 1 was issued on November 10, 2010. Responses were requested by November 16, 2010. Attached are the Postal Service's responses to Questions 1-3. Each request is stated verbatim, and followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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November 16, 2010

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1. Rule 3010.14(b)(1) requires the Postal Service to provide “[t]he amount of the applicable change in CPI-U calculated as required by § 3010.21 or § 3010.22, as appropriate.” Because more than 12 months have passed since the previous notice of Type 1-A or 1-B rate adjustment for First-Class Mail and Standard Mail, rule 3010.21 (Calculation of annual limitation) applies. Please provide the information required by rule 3010.14(b)(1), including the calculation of the annual limitation as defined in rule 3010.21, and revise the Notice as appropriate.

RESPONSE:

As Andrew German noted in his October 6 letter to the Commission, there is some confusion about the price cap and how the calculated numbers should be applied to each other in order to determine the price cap for each class of mail.¹ Commission General Counsel Stephen Sharfman responded to this letter on October 12, 2010, but this response was challenged in a 28-page filing by the Affordable Mail Alliance.² At the Commission’s public meeting on November 3, 2010, General Counsel Sharfman noted that his October 12 letter did not legally bind the Commission. The United States Postal Service later filed a Petition for Rulemaking regarding the calculation of unused rate adjustment authority, on November 10, 2010, in an attempt to bring clarity to this matter.³ Until this matter gets resolved, the Postal Service is uncertain how the rules defining the price cap should be applied.

When the Postal Service filed its notice of market dominant price adjustment in Docket No. R2011-1, the Postal Service provided sufficient information to calculate the

¹ Letter from R. Andrew German to Shoshana Grove Regarding Available CPI-U Authority (October 6, 2010).

² See Letter in Response to Andrew German (October 12, 2010), and Response of the Affordable Mail Alliance to October 6 Letter - Petition of the United States Postal Service and October 12 Letter - Ruling of the Office of General Counsel (October 13, 2010).

³ Petition for Rulemaking Regarding the Calculation of Unused Rate Adjustment Authority, Docket No. RM2011-2 (November 10, 2011).

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change in the price cap as a result of this request. Since there was ambiguity about the price cap at the time the request was filed, and since, because the net effect of the changes was an average price decrease (or an increase the Postal Service's banked authority) in both First-Class Mail and Standard Mail, the approach used balanced the uncertainty with the need to move forward with these proposals in an expeditious manner. The Postal Service agrees that an adjustment to the banked authority will be necessary as a result of this docket. The Postal Service moreover believes that the Commission can apply the information about how much the cap authority for each class has changed to either of the methodologies under discussion in Docket No. RM2011-2. The Postal Service still believes clarification of the rules is needed, but will nevertheless attempt to respond to the questions in this Chairman's information request, as follows.

The Postal Service filed the proposed price adjustments on November 2, 2010. Therefore the annual limitation calculation would be based on the September 2010 CPI-U, which was released on October 15, 2010. Table 1 below shows the necessary data to calculate the annual limitation on that date.

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Table 1

Annual Limitation Calculation for November 2, 2010 Price Adjustment

Month	CPI	12-month total	12-month total divided by 12	Base Average	12-month moving average
Sep-09	215.969	2565.2	213.7678	214.4628	-0.324%
Oct-09	216.177	2564.8	213.7348	215.0992	-0.634%
Nov-09	216.330	2568.7	214.0603	215.2865	-0.570%
Dec-09	215.949	2574.4	214.5370	215.3025	-0.356%
Jan-10	216.687	2580.0	214.9990	215.3078	-0.143%
Feb-10	216.741	2584.5	215.3780	215.3494	0.013%
Mar-10	217.631	2589.5	215.7882	215.2812	0.236%
Apr-10	218.009	2594.2	216.1856	215.1493	0.482%
May-10	218.178	2598.5	216.5458	214.9179	0.757%
Jun-10	217.965	2600.8	216.7351	214.6578	0.968%
Jul-10	218.011	2603.5	216.9568	214.2733	1.252%
Aug-10	218.312	2606.0	217.1633	214.0023	1.477%
Sep-10	218.439	2608.4	217.3691	213.7678	1.685%

The annual limitation in CPI-U is 1.685% for the 12-month moving average using the September 2010 CPI-U. The specific calculation that results in 1.685% is the “12-month total divided by 12” for Sept-10 (217.3691) divided by the “12-month total divided by 12” for Sept-09 (213.7678), minus 1. Mathematically, this calculation is $((217.3691/213.7678)-1)$ equals 0.01685 or 1.685%. This also is shown on the Commission’s website at <http://www.prc.gov/PRC-DOCS/home/CPI.pdf>.

Given the circumstances described above, the Postal Service does not believe that any revision to its November 2, 2010 Notice in this docket is appropriate

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2. Rule 3010.14(b)(4) requires presentation of “[t]he amount of new unused rate authority, if any, that will be generated by the rate adjustment calculated as required by § 3010.26.” The Postal Service presents what it characterizes as the “Unused Pricing Authority” resulting from the proposed price changes. Notice at 9. The Postal Service’s figures are calculated by subtracting the percentage change in rates for each class from the corresponding current unused rate adjustment authority. Please refer to rule 3010.26, which states that the annual limitation (from rule 3010.21) is to be used to determine the new unused rate authority. Because more than 12 months have passed since the previous notice of Type 1 rate adjustment, the new unused rate authority for each class is equal to the sum of two figures: (1) the difference between the annual limitation (12 month change in CPI-U) and the actual percentage change in rates for the class; and (2) the percentage change in CPI-U that accrued between the filing of the previous notice of rate adjustment and the beginning of the period covered by the annual limitation (see rule 3010.26(c)(2)). Please provide the calculation of new unused rate adjustment authority generated by the proposal as defined by rule 3010.26 and revise the Notice to reflect the corrected figures.

RESPONSE:

As noted in the response to question 1, the application of the price cap in the circumstances of this docket is unclear. The following provides responsive information to question 2.

Table 2 below shows the calculations necessary to determine the annual limitation adjusted by rule 3010.26(c).

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Table 2

12-Month Moving Average Calculation and adjustment for November 2, 2010 Price Adjustment

Month	CPI	12-month total	12-month total divided by 12	Base Average	12-month moving average	3010.26.c Look-back	Price Cap
Dec-08	210.228	2583.6	215.3025	207.3424	3.8%	N/A	3.8%
Jan-09	211.143	2583.7	215.3078	208.0644	3.5%	N/A	3.5%
Feb-09	212.193	2584.2	215.3494	208.7473	3.2%	N/A	3.2%
Mar-09	212.709	2583.4	215.2812	209.4286	2.8%	N/A	2.8%
Apr-09	213.240	2581.8	215.1493	210.1067	2.4%	N/A	2.4%
May-09	213.856	2579.0	214.9179	210.8303	1.9%	N/A	1.9%
Jun-09	215.693	2575.9	214.6578	211.7022	1.4%	N/A	1.4%
Jul-09	215.351	2571.3	214.2733	212.6743	0.8%	N/A	0.8%
Aug-09	215.834	2568.0	214.0023	213.6050	0.2%	N/A	0.2%
Sep-09	215.969	2565.2	213.7678	214.4628	-0.324%	N/A	-0.324%
Oct-09	216.177	2564.8	213.7348	215.0992	-0.634%	N/A	-0.634%
Nov-09	216.330	2568.7	214.0603	215.2865	-0.570%	N/A	-0.570%
Dec-09	215.949	2574.4	214.5370	215.3025	-0.356%	N/A	-0.356%
Jan-10	216.687	2580.0	214.9990	215.3078	-0.143%	0.002%	-0.141%
Feb-10	216.741	2584.5	215.3780	215.3494	0.013%	0.022%	0.035%
Mar-10	217.631	2589.5	215.7882	215.2812	0.236%	-0.010%	0.226%
Apr-10	218.009	2594.2	216.1856	215.1493	0.482%	-0.071%	0.411%
May-10	218.178	2598.5	216.5458	214.9179	0.757%	-0.179%	0.578%
Jun-10	217.965	2600.8	216.7351	214.6578	0.968%	-0.299%	0.669%
Jul-10	218.011	2603.5	216.9568	214.2733	1.252%	-0.478%	0.774%
Aug-10	218.312	2606.0	217.1633	214.0023	1.477%	-0.604%	0.873%
Sep-10	218.439	2608.4	217.3691	213.7678	1.685%	-0.713%	0.972%

The rule 3010.26(c)(2) adjustment becomes necessary to calculate the price cap because more than 12 months have passed since the most recent price adjustment. The CPI-U month used in the most recent price adjustment was December 2008, so rule 3010.26(c)(2) becomes effective starting with the January 2010 CPI-U. The rule requires calculation of an adjustment to the 12-month moving average using the recent average (“12-month total divided by 12”) of the most recent filing and the base average (“12-month total divided by 12”) of the current filing, and subtracting one from the quotient. This results in an adjustment of $((213.7678/215.3025)-1)$ or -0.00713 or -0.713%. The adjustment would reduce the annual limitation of 1.685% to 0.972%.

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But following the approach in General Counsel Sharfman’s letter of October 12, 2010, the adjustment would not apply because the period prior to the last 12 months was a period of deflation, and the Postal Service has filed a Type 1-B filing.

It also is unclear as to whether the subtraction applies to the general price cap itself, or only to the unique unused authority amounts applied to each class itself. Fundamentally, one of the questions at issue in the rulemaking docket is the “ordering” of the application of the various potential pricing authority “components” (12 month CPI moving average, “look-back” authority under rule 3010.26(c), and unused authority by class) available to the Postal Service as of the date of any filing, and whether these components are identified and applied separately (according to an established precedence) or whether they are aggregated with the net result available to the Postal Service as of the date of a filing.

The adjusted annual limitation amount of either 1.685% or 0.972% is then added to the current unused authorities of 0.044% for First-Class Mail and 0.103% for Standard Mail to provide the price cap available at the time for those two mail classes. Table 3 shows the unused authority for these two classes at the time of the price adjustment, applying the rule 3010.26(c)(2) adjustment, while Table 4 shows the price cap without the rule 3010.26(c)(2) adjustment

Table 3

Class	Annual Limitation (%)	3010.26.c.2 Adjustment (%)	General Price Cap (%)	Unused Authority (%)	Class Price Cap Authority (%)
First-Class Mail	1.685	-0.713	0.972	0.044	1.016
Standard Mail	1.685	-0.713	0.972	0.103	1.075

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Table 4

Class	Annual Limitation (%)	General Price Cap (%)	Unused Authority⁴ (%)	Class Price Cap Authority (%)
First-Class Mail	1.685	1.685	0.044	1.729
Standard Mail	1.685	1.685	0.103	1.788

Tables 5 and 6 show the Class Price Cap Authority with the changes provided in the November 2, 2010 filing, with and without the rule 3010.26(c)(2) adjustment, respectively.

Table 5

Class	Unused Authority (%)	Class Price Cap Authority (%)	Price Change (%)	New Class Cap Authority (%)
First-Class Mail	0.044	1.016	-0.0010	1.026
Standard Mail	0.103	1.075	-0.0024	1.099

Table 6

Class	Unused Authority (%)	Class Price Cap Authority (%)	Price Change (%)	New Class Cap Authority (%)
First-Class Mail	0.044	1.729	-0.0010	1.739
Standard Mail	0.103	1.788	-0.0024	1.812

Given the circumstances described above and in the response to question 1, the Postal Service does not believe that any revision to its November 2, 2010 Notice in this docket is appropriate.

⁴ In this alternative approach, the rule 3010.26(c)(2) adjustment applies only to unused authority when the authority for the price change relies on adding the unused authority to the general price cap.

3. In Docket No. R2009-4, Postal Service expressed the view that:

Thus, while the Commission must apply the price cap structure of section 3622(d) to price adjustments that include increases to prices (i.e., either a price adjustment that consists solely of price increases, or a price adjustment that includes increases to some prices, and decreases to others), it is not required to do so with respect to a price adjustment consisting solely of a decrease in prices.⁵

Is it still the Postal Service view that had it requested only rate decreases in this docket, the cap would not have to be recomputed, but because the Postal Service is also requesting an increase of the Move Update Assessment Charge threshold, the price cap recomputation is required?

RESPONSE:

In both this docket and Docket No. R2009-4 the Postal Service is attempting to apply the Commission's Rules in a way that makes the most sense given the need to address the generally unforeseen (at the time of enactment of the PAEA and the creation of the Commission's Rules) circumstance of deflation, combined with the reasonable application of a price cap regulatory structure in the context of an ongoing need to implement proposed pricing and classification changes to respond to business requirements.

The circumstance that arose in Docket No. R2009-4 is not unlike the current situation, where clarity has been requested about the application of the price cap. In this docket, pending clarification of the Commission's rules, the Postal Service did not do a complete price cap recomputation for the reasons described in the responses to Questions 1 and 2.

⁵ Docket No. R2009-4, Response of the United States Postal Service to Order No. 220, June 22, 2009, at 3.

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At the time of Docket No. R2009-4, the calculated price cap was negative (see the Postal Service's response to ChIR No. 1, Question 3, in that docket (June 12, 2009)) suggesting that a targeted price decrease for High Density flats may not have been possible if deflation were occurring. If this were to be the implication of the application of a "negative" pricing authority due to deflation, then a perverse incentive would exist for the Postal Service not to decrease any price in a deflationary circumstance. In other words, the price cap **could protect customers against price decreases**, a clear distortion of the general regulatory theory behind the application of a price cap regime

The Commission recognized these challenges in its decision in Docket No. R2009-4 noting:

The Commission's rules are designed for price adjustment proposals during periods of inflation. However, . . . this case has highlighted some problems with the application of the Commission's current rules in unforeseen factual circumstances. Accordingly, the Commission will accept the Postal Service's approach here based on the unique facts of this particular situation.

Order No. 236 at 8.