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ORDER NO. 606

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION

Before Commissioners: Ruth Y. Goldway, Chairman;
Mark Acton, Vice Chairman;
Dan G. Blair;
Tony L. Hammond; and
Nanci E. Langley

Classification and Price Adjustments for First-Class Mail and Standard Mail Incentives

Docket No. R2011-1

ORDER APPROVING MARKET DOMINANT CLASSIFICATION AND PRICE CHANGES, AND APPLYING PRICE CAP RULES

Washington, DC 20268-0001

December 10, 2010

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(Issued December 10, 2010)

I. INTRODUCTION

On November 2, 2010, the Postal Service filed notice of three price adjustments and related classification changes for First-Class Mail and Standard Mail products.[1] The changes, scheduled to become effective January 2, 2011, provide pricing incentives for First-Class Mail Automation Letters (Reply Rides Free) and Saturation and High Density Standard Mail. In addition, the Move Update Assessment Charge threshold increases to 75 percent for presorted First-Class Mail and all Standard Mail.

[1] United States Postal Service Notice of Market Dominant Price Adjustment, November 2, 2010 (Notice).

Reply Rides Free and Saturation and High Density incentives generate rate reductions, while the Move Update Assessment Charge alteration yields a rate increase.[2]

Each of these proposals is approved.

The Move Update price increase for First-Class Mail and Standard Mail impacts current and prospective rate adjustment authority. While it may be a very small increase, it is nonetheless an increase that will have impact on mailers. The other two proposals establish volume incentive discounts for mailers meeting certain threshold conditions and thereby do not impact current and prospective rate adjustment authority.

As the following brief history of events makes clear, it will be helpful in this case for the Commission to address the proper application of its Rules for Applying the Price Cap, 39 CFR 3010 subpart C.

As discussed in this Order, the "annual limitation" and "unused rate adjustment authority" are inputs in the calculation of the price cap when prices are increased. Implementation of the Move Update proposal thus alters those inputs. As a result, if the Move Update change is implemented by the Postal Service as planned and approved, the maximum allowable size of the next price increase is reduced by more than 0.6 percentage points. For example, the maximum allowable increase for First-Class Mail as of the date of this Order would decline from 1.799 percent to 1.113 percent. A full explanation of how and why this occurs is provided in chapter II.B. of this Order.

Almost a month before submitting this Notice, the Postal Service sought clarification regarding calculation of the annual limitation on price changes (price cap) when more than 12 months had elapsed since the previous Postal Service notice of rate

[2] The instant proposals were initially filed in Docket No. R2010-4. Because the Commission rejected the Postal Service's exigent rate request in that proceeding, it did not address the merits of the instant proposals. The Commission indicated, however, that if the Postal Service wished to pursue one or more of these proposals, it could refile them as separate proposals and designate relevant testimony and/or supporting documents from Docket No. R2010-4. *See* Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, September 30, 2010, at 30. The Postal Service did not designate any material from Docket No. R2010-4.

adjustment. The Postal Service asked for an interpretation of 39 CFR 3020.26 or other applicable Commission rules that it should follow "if it were to begin preparation of the requisite documentation for a CPI-U rate adjustment."[3] A prompt informal response distinguished between rate adjustments premised solely on the annual limitation (Type 1-A), and those premised on unused rate adjustment authority as well as the annual limitation (Type 1-B). The response describes the function of rule 3010.26 as "to compute unused rate adjustment authority should the Postal Service seek to utilize any 'banked' authority."[4]

Shortly thereafter, a mailer coalition submitted a reply arguing that the calculations described in rule 3010.26(c) should be applied in all rate adjustments when more than 12 months has elapsed between the filing of notices of rate adjustment.[5]

The Notice in this case generated a Chairman's Information Request to clarify how the Postal Service applied rules 3010.21 and 3010.26, respectively, to calculate the applicable annual limitation and unused rate adjustment authority.[6] The Postal Service response acknowledged that it continues to be "uncertain how the rules defining the price cap should be applied."[7] Concurrently, the Postal Service requested the Commission to initiate a rulemaking regarding calculation of unused rate authority.[8]

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[3] Letter from R. Andrew German, Managing Counsel, Pricing & Product Development, United States Postal Service to Shoshana Grove Regarding Available CPI-U Authority, October 6, 2010.

[4] Letter from the Commission's General Counsel in Response to Andrew German, October 12, 2010, at 1.

[5] 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 the General Counsel, October 13, 2010.

[6] Chairman Information Request No. 1, November 10, 2010 (CHIR No. 1).

[7] Response of the United States Postal Service to Questions 1-3 of Chairman's Information Request No. 1, November 16, 2010, at 2 (Response to CHIR No. 1).

[8] Specifically, it requests "formal clarification of whether 39 CFR 3010.26(c)(1)-(3) or the CPI-U data provided on the Commission's website determine the amount of unused rate adjustment authority when rate adjustments are more than 12 months apart." Petition for Rulemaking Regarding the Calculation of Unused Rate Adjustment Authority, November 10, 2010, at 3 (Petition for Rulemaking).

The Commission provides in this Order a general review of how the rules operate, with particular attention to the separate roles of the annual limitation and the unused rate adjustment authority. These explanations then are applied to the Postal Service proposals in this case.

To provide clarity so that the Postal Service and other interested persons can make properly informed decisions, the Commission also develops in chapter II.B. the comparative calculations of the annual limitation and the unused rate adjustment authority assuming that the three price adjustments approved in this case are implemented on different dates.

This discussion provides the formal determination sought by the Postal Service in its Petition for Rulemaking. Nonetheless, the Commission also will initiate a rulemaking to allow the Commission, the Postal Service, and all interested persons to suggest additions or alterations to 39 CFR 3010 subpart C to avoid future confusion.

II. COMMISSION PRICE CAP RULES AND THEIR APPLICATION

A. Existing Rules are Applied to Calculate Price Cap Authority

The Postal Service's concern about the price cap calculation focuses on rule 3010.26, and on the relationship between the annual limitation on rate increases and unused rate adjustment authority. The letter from Andrew German seeks clarification of the rule and the Postal Service petition seeks clarification of how this rule is to be applied. Specifically, the concern seems to center on subpart (c)(2), which provides for the inclusion in unused rate authority of changes in CPI-U that occurred between the filing of the previous notice of rate adjustment and the beginning of the 12-month period covered by the annual limitation applicable to the instant proceeding (interim unused rate authority).

To understand the purpose and function of rule 3010.26, it is helpful to briefly review the structure and terms of 39 U.S.C. 3622(d). A central element is the annual limitation whereby the percentage change in rates cannot exceed the percentage change in CPI-U for the year preceding the filing of a rate adjustment by the Postal Service, as set forth in section 3622(d)(1)(A).

The difference between the annual limitation and the actual percentage change made in the corresponding year is defined as "unused rate adjustment authority" in section 3622(d)(2)(C)(i). The method for calculating unused rate adjustment authority is set out in rule 3010.26.

Unused rate adjustment authority is not an adjustment to the annual limitation. It is a separate and distinct reservoir of potential rate increases that is available for use for up to 5 years. It is only available after the annual limitation has been used. *See* rule 3010.25. At its discretion (and subject to limitations), the Postal Service may supplement the annual limitation with unused rate adjustment authority generated prior to the most recent 12 months. *See* 39 U.S.C. 3622(d)(2)(C)(ii).

In Docket No. R2009-2, which was filed 12 months after the previous Type 1-A adjustment, the Postal Service correctly calculated the annual limitation, and the amount of unused rate authority for each class generated by proposed rate adjustments.[9] In that case, the new unused authority for each class was the difference between the annual limitation and the actual size of the rate increase with the exception of the adjustment for Periodicals. For that class, a Type 1-B adjustment was used. In a Type 1-B adjustment, the Postal Service exercises its option to use previously generated unused rate authority to allow an increase greater than the annual limitation. Therefore, no new unused rate authority was generated for Periodicals in that case.

For a notice filed more than 12 months after the previous Type 1 adjustment, calculation of the annual limitation is unchanged. However, the calculation of unused rate authority requires an additional step.

Section 3622(d)(2)(C)(i) defines unused rate authority as the difference between the amount of rate increase authorized "in any year" and the size of the actual rate adjustment made "in that year." When notices of rate adjustment are filed more than 12 months apart, there is an interim between the periods covered by the previous and current annual limitations. The unused rate authority that accrues between the previous rate change and the 12 months immediately preceding a current adjustment is known as interim unused rate authority. This occurs because an annual limitation becomes applicable when a rate adjustment is filed.

When the Postal Service delays filing for a rate adjustment for more than 12 months, it may defer, for up to 5 years, some of its authority to adjust rates (equal to the change in CPI-U). Section 3622(d)(2)(c)(i). First, it must use the annual limitation authority for the most recent 12 months, as specified in section 3622(d)(1)(A). In this circumstance, the interim rate authority is combined with any unused portion of the

[9] Docket No. R2009-2, United States Postal Service Notice of Market Dominant Price Adjustment, February 10, 2009, at 2-6.

annual limitation to derive total unused rate adjustment authority generated by the rate adjustment.

The treatment of changes in CPI-U that occur in the interim between annual limitations for rate adjustments filed more than 12 months apart is codified in rule 3010.26(c)(2). **Interim unused rate authority is not reflected in the annual limitation**.[10] Instead, it is added to new unused rate authority, if any, generated by subtracting the actual increase for each class of mail from the annual limitation.[11] The sum of the two forms of unused rate authority constitutes the total unused rate adjustment authority available as a result of the latest rate adjustment.

In Order No. 26, the Commission addressed this very scenario, specifically identifying how interim unused rate authority is to be calculated.

> [2062] A corresponding adjustment can be made should the Postal Service file a notice of rate adjustment more than 12 months after the last adjustment. **This scenario provides no reason to alter the calculation of the annual inflation-based limitation**, but does present a different concern; there are several months of CPI–U changes that the Postal Service may lose. The clear intent of the statutory provision allowing for recapture of unused rate authority is to encourage the Postal Service to whenever possible refrain from imposing the maximum permissible rate increases. If the Postal Service can delay imposing increases on the public, it should not be penalized. *See* proposed rule 3100.26(c). **To address this concern, the interim unused rate authority will be added to the cumulative unused rate authority**.

Docket No. RM2007-1, Order Proposing Regulations to Establish a System of Ratemaking, August 15, 2007, at 30-31 (Order No. 26). (Emphasis added.)

In the instant case, the interim unused rate authority is negative, -0.713, reflecting a period of deflation. While deflation is atypical, both the statute and the Commission's rules allow for the possibility. Whether the changes to the CPI-U are

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[10] *See* 39 U.S.C. 3622(d)(1)(A) and 39 CFR 3010.21 and .22.

[11] *See* 39 U.S.C. 3622(d)(2)(c) and 39 CFR 3010.26(c). This approach is consistent with the statutory design that prior months' unused rate authority may be applied on a first-in, first-out basis at the Postal Service's discretion.

positive or negative, the relationship between the annualized percentage change in the CPI-U and the price cap available since the last rate adjustment remains the same; *i.e.*, the annualized change in the CPI-U is by definition the annualized price cap.[12]

Performing the calculations for the instant case is relatively straightforward. Both the annual limitation (1.685%) and interim unused rate authority (-0.713%) have been correctly calculated by the Postal Service. For the reasons explained below, the percentage change in rates is calculated only using the effects of the changes to the Move Update Assessment. The Reply Rides Free and Saturation discount incentives do not have cap implications. The change in the Move Update Assessment threshold increases First-Class Mail and Standard Mail rates by 0.0004%, which rounds to 0.000% for each class.[13] *See* PRC-LR-1.

The unused rate authority generated by the adjustment is calculated in three steps, following the instructions of rule 3010.26(c):

- The unused rate authority for the 12 months represented by the annual limitation is equal to the difference between the annual limitation and the actual percentage change in rates.

$$1.685\% - 0.000\% = 1.685\%$$

- The additional (interim) unused rate authority is measured by dividing the Base Average applicable to the instant notice of rate adjustment by the

[12] This mathematical relationship is also addressed on the Commission's website. *See http://www.prc.gov/PRC-DOCS/home/CPI.pdf*. A bar chart demonstrates the relationship between changes in CPI-U and the annual limitation for rate adjustments less than 12 months apart and those more than 12 months apart. Moreover, as noted there, "[w]hen the time between rate adjustments exceeds twelve months, interim unused rate adjustment authority is generated. This authority is excluded from the price cap calculation because the Postal Service is not required to use any of its unused rate adjustment authority in traditional rate adjustments." *Id*. at 3, n.1.

[13] In Docket No. RM2009-8, the Commission provides that the annual limitation, expressed as a percentage, be rounded to 3 digits. *See* Docket No. RM2009-8, Order Amending CAP Calculation in System of Ratemaking, September 22, 2009.

Recent Average utilized in the previous notice of rate adjustment (Docket No. R2009-2) and subtracting 1 from the quotient.

$$(213.768 \div 215.303) -1 = -0.00713 = -0.713\%$$

- The results from step 1 and step 2 are added together.

$$1.685\% + -0.713\% = \mathbf{0.972\%}$$

This represents the amount of unused rate authority banked by the Postal Service in this case.

If the Postal Service should make effective the change in the Move Update Assessment threshold as requested, *see* 39 U.S.C. 3622(d)(2)(C)(i)(II), the net effect of this proceeding will be to reset the CPI-U base to September 2010 for First-Class Mail and Standard Mail. Thus, if a general rate increase is filed before September 2011 data is available, the filing will cover less than a 12-month period for those two classes and the applicable partial year limitation pursuant to rule 3010.22 will apply.[14]

The instant proceeding involves Type 1-A rate changes as they do not rely upon unused rate adjustment authority. The table below presents the unused rate authority available for First-Class Mail and Standard Mail from this and the two previous rate adjustments.

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[14] *See discussion* in Order No. 236, Docket No. R2009-4, Order Approving Price Adjustment for Standard Mail High Density Flats, July 1, 2009, at 7.

Unused Rate Adjustment Authority
Summary by Class

Class of Mail (1)	R2008-1 Unused Rate Adjustment Authority[1] (2)	R2009-2 Unused Rate Adjustment Authority[2] (3)	R2011-1 Unused Rate Adjustment Authority (4)	Sum Unused Rate Adjustment Authority (5)=(2)+(3)+(4)
First-Class Mail	0.014%	0.030%	0.972%	1.016%
Standard Mail	0.062%	0.041%	0.972%	1.075%

[1] Order No. 69 for Standard Mail; Order No. 66 for First-Class Mail.
[2] Order No. 201 for Standard Mail; Order No. 191 for First-Class Mail.

B. Impact of This Price Adjustment on the Next Calculation of Price Cap

If the Postal Service implements the approved increase of the Move Update Assessment threshold in this case, it would have significant implications for the maximum allowable size of the next price increase for First-Class Mail and Standard Mail.[15] To demonstrate this point using currently available information, one can examine the rate adjustment options that would be available (a) assuming a January 2, 2011 implementation of the Move Update changes, and (b) assuming the Postal Service chooses to postpone implementation of the Move Update changes by incorporating them into the next rate adjustment filing. In each scenario, the most recent currently available CPI-U data (October 2010) is used. This reflects the actual calculations used for First-Class Mail and Standard Mail if the next notice of rate adjustment is filed before the release of the November 2010 CPI-U figure. The actual figures would be slightly

[15] As noted elsewhere in this Order, if the Postal Service chooses to implement only the Reply Rides Free and Saturation Mail incentive programs, there would be no impact on future price cap calculations. The only element of the instant proposal with price cap implications is the Move Update Assessment threshold increase.

different if the next notice of rate adjustment is filed after additional CPI-U figures are reported.

Scenario 1—Postal Service Implements Move Update Changes

Assuming the Move Update proposal is implemented on January 2, 2011, and a new notice of rate adjustment is filed before the November 2010 CPI-U figure is released, only one month would have passed since the previous notice of rate adjustment. Therefore, the less than annual limitation under rule 3010.22 would apply. The Recent Average for October 2010 (217.580) would be divided by the Recent Average from the previous (R2009-2) case (217.369), and one would be subtracted from the quotient.

$$(217.580 \div 217.369) - 1 = 0.00097 = 0.097\%$$

Thus, a 0.097% increase would be allowable under a Type 1-A rate adjustment. At the Postal Service's discretion, it could file a Type 1-B rate adjustment and use all of the unused rate authority to allow for larger increases. The unused rate authority that would be available after implementing the Move Update change is 1.016% for First-Class Mail and 1.075% for Standard Mail.[16] Therefore, a Type 1-B rate adjustment would allow for the increases shown here:

First-Class Mail: 0.097% + 1.016% = **1.113%**

Standard Mail: 0.097% + 1.075% = **1.172%**

Scenario 2—Postal Service Defers Move Update Changes Until Next Adjustment

Alternatively, if the Postal Service chooses to forgo implementation of the Move Update changes and instead incorporates them into the next rate adjustment, the annual limitation under rule 3010.21 would apply. The Recent Average for October

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[16] These figures appear in the table in the previous section of this Order.

2010 (217.580) would be divided by the Base Average for October 2009 (213.735), and one would be subtracted from the quotient.

$$(217.580 \div 213.735) - 1 = 0.01799 = \mathbf{1.799\%}$$

Thus, a 1.799% increase would be allowable under a Type 1-A rate adjustment. Compared with the largest Type 1 rate adjustment that would be possible if the Postal Service were to implement the Move Update changes in this (R2011-1) docket, this is **0.686% larger** for First-Class Mail and **0.627% larger** for Standard Mail.

Theoretically, the Postal Service could chose to file a Type 1-B rate adjustment to use unused rate authority. However, the interim unused rate authority as calculated under rule 3010.26(c)(2) would be -0.728%.[17] According to rule 3010.28, use of unused rate adjustment authority for any year may not exceed the lesser of (a) 2 percent, or (b) the sum of any unused rate adjustment authority for that class. The sum of unused rate authority for First-Class Mail (0.014% + 0.030% + -0.728% = -0.684%) and Standard Mail (0.062% + 0.041% + -0.728% = -0.625%) would be negative.[18] Therefore the use of unused rate authority would not be beneficial.

C. Affordable Mail Alliance Comments

In Order No. 588, the Commission extended the comment period in this proceeding and invited interested persons to comment on the Postal Service's response to CHIR No. 1 "and, in the context of the Postal Service's filing in this proceeding, comment on the appropriate application of the Commission's rules under 39 CFR 3010

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[17] This is calculated by dividing the Base Average (213.735) by the Recent Average from the previous rate case, R2009-2 (215.303) and subtracting one from the quotient.

[18] These example calculations do not include any new unused rate authority calculated under rule 3010.26(c)(1) because they assume a Type 1-B rate adjustment. Type 1-B rate adjustments use all of the annual (or less than annual) limitation in addition to using unused rate adjustment authority.

subpart C."[19] The Affordable Mail Alliance and the Public Representative submitted comments.[20]

AMA argues that the "price cap provisions" of 39 U.S.C. 3622(d) limit "price increases to changes in the rate of inflation over time" and "require[] that the price cap reflect periods of deflation as well as inflation." AMA Comments at 4. The statutory provisions on which AMA relies are: (a) section 3622(d)(1)(A)(1), which establishes an annual limitation on price increases based on changes in the Consumer Price Index–Urban (CPI-U) "over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates;" and (b) section 3622(d)(2)(C), which, among other things, authorizes the Postal Service to accrue "unused rate authority," defined as the difference between the maximum amount of a rate adjustment that the Postal Service is authorized to make in any year under section 3622(d)(1)(A)(1) and the amount of the rate adjustment it actually makes in that year.[21]

AMA's discussion focuses on the application of rule 3010.26(c). AMA Comments at 3, 5-6, 9-10, 12-13. It asserts that "Rule 3010.26(c) explains how to calculate the CPI cap when the interval between rate adjustments is longer than 12 months." *Id.* at 12. AMA concludes:

[19] Order Concerning Comments Due November 22, 2010, November 17, 2010, at 2 (Order No. 588)

[20] Comments of the Affordable Mail Alliance, November 24, 2010 (AMA Comments); Public Representative Comments in Response to the United States Postal Service Notice of Market Dominant Price Adjustment, November 23, 2010 (PR Comments). The Public Representative provides a useful discussion of the issues, correctly applying the Commission's rules to the Postal Service's filing in this proceeding.

[21] 39 U.S.C. 3622(d)(2)(C)(i)(I) and (II). As discussed above, the Commission's rules implementing these statutory provisions are rule 3010.21, calculation of annual limitation, and rule 3010.26(c), calculation of unused rate authority when a notice of rate adjustment is filed more than 12 months after the previous notice of rate adjustment.

> The method of calculating the price cap limitation that comports best with the language and policies of 39 U.S.C. § 3622(d) and the Commission's rules is to add the interim unused rate authority to the annual price cap limitation, following the calculation method prescribed in 39 C.F.R. § 3010.26.

AMA Comments at 14.

AMA's contention that the annual limitation on price changes, as specified in section 3622(d)(1)(A)(1), must reflect unused rate authority from prior periods is flawed. Section 3622(d)(1)(A)(1)'s annual limitation on rate changes is based on changes in the CPI-U "over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to increase rates." By its terms, this provision expressly applies to the most recent available 12-month period. Thus, it does not require that CPI-U changes occurring in months prior to the most recent 12 months be included in the calculation of the "annual limitation."

AMA's reading of section 3622(d)(1)(A)(1) does not give sufficient recognition to the plain meaning of the phrase "most recent available 12-month period." Its contention that all intervening months between notices of rate adjustment must be reflected in the annual limitation is contradicted by the language of section 3622(d)(1)(A)(1). Had Congress intended the annual limitation be computed in that fashion, it would have adopted a wholly different standard, not one that precludes the result that AMA advocates.

The annual limitation on price changes is a stand-alone calculation which is implemented by Commission rule 3010.21. Under that rule, the annual limitation, the 12-month percentage change in CPI-U, is the ratio of two 12-month averages of CPI-U data 12 months apart, minus one.[22] Regardless of whether the CPI-U is positive or negative, the Commission's rules take all such changes into account.

The Commission's rules recognize that the Postal Service may file a notice of price adjustment that (a) is less than or equal to the annual limitation (Type 1-A filing), or (b) that uses unused rate authority in whole or in part (Type 1-B filing).[23] In this proceeding, the Postal Service submitted a Type 1-A filing more than 12 months after its most recent notice of rate adjustment. When more than 12 months have lapsed between filings, the annualized change in the CPI-U and the price cap available since the last rate adjustment will be equal until the Postal Service files notice to change market dominant rates.

AMA's contention that rule 3010.26(c) "explains how to calculate the CPI cap when the interval between rate adjustments is longer than 12 months" is misplaced. AMA Comments at 12. AMA correctly calculates the annual limitation, 1.685%. It also correctly identifies the interim unused rate authority, -0.713%. *Id*. at 3, 12-13. It argues that these figures should be summed to yield "a net unused rate authority of 0.972 percent...." *Id.* at 3. AMA conflates the annual limitation with interim unused rate authority and thus is in error.

As discussed above, interim unused rate authority is not added to the annual limitation. They are separate calculations. A rate adjustment for less than the maximum amount (of the annual limitation) generates new unused rate authority. *See* rules 3010.26(b) and (c)(1). That amount is added to the "additional unused rate authority," *i.e.,* interim unused rate authority, which accrues during the intervening months between the filing of the most recent and instant notices of rate adjustment.

[22] The formula for calculating the annual limitation is (Recent Average/Base Average)−1, where the Recent Average is the sum of the most recently available 12 monthly CPI–U values from the date the Postal Service files its notice of rate adjustment divided by 12, and Base Average is the sum of the 12 monthly CPI–U values immediately preceding the Recent Average divided by 12. *See* rule 3010.22 for calculation of less than the annual limitation for notices of rate adjustment filed less than a year apart.

[23] *See* 39 CFR 3010.3 and 3010.4.

The sum of these two figures, 0.972%, represents the unused rate authority available as a result of the Postal Service's instant notice of rate adjustment. That total does not represent, as AMA contends, "the unused rate authority currently available to the Postal Service under Rule 3010.26(c), based on the September 2010 CPI-U monthly index[.]" *Id.* at 3. (Footnote omitted.)

D. Treatment of Volume Incentive Rate Discounts

Limited availability rate discounts to stimulate volume growth have been approved in previous dockets, but until now, the Postal Service has not requested credit for what it views as a price decrease. In Docket No. R2009-2, the Postal Service introduced the Saturation Mail Volume Incentive Program. At that time the Postal Service did not include the discounts in the cap calculation for the Standard Mail class. Similarly, in recent cases, the Postal Service proposed to ignore the effect of any price decrease resulting from volume incentive programs on the price cap for both future and current prices and to follow a procedure parallel to that described in rule 3010.24.[24] In each of these cases, the Commission accepted the Postal Service's proposal, noting the incentive program's short duration and the uncertainty over the amount of new volume that might be generated. Additionally, the Commission indicated that this was the proper treatment "because ineligible mailers will not be charged higher rates based on the amount which otherwise would be banked from the program." Order No. 439 at 12.

In the present docket, the Postal Service calculates a cap authority amount based on volume estimates for a future 1-year period with the incentive in place. From these estimates, the Postal Service determines the volume that it considers incremental and calculates the "incentive prices revenue" by applying the discounted rates to the

[24] Docket No. R2009-3, United States Postal Service Notice of Market-Dominant Price Adjustment, May 1, 2009, at 8; Docket No. R2010-3, Order Approving Standard Mail Volume Incentive Pricing Program, April 7, 2010, at 12 (Order No. 439); Docket No. R2009-5, Order Approving First-Class Mail Incentive Pricing Program, Order No. 299, September 16, 2009.

incremental volume and the current rates to the remaining volume. For the current revenue, the Postal Service applies the current prices to all forecasted volume. It calculates the percentage change by dividing the "incentive prices revenue" by the current prices revenue and subtracting 1 from the quotient.

ACMA does not view the incentive as a price reduction because the discount only applies to incremental volumes. Mailers would not be able to purchase the same volume (basket of goods) for the discounted price. ACMA Comments at 2. It contends the Postal Service's estimates are at variance with the Commission's rules. *Id*. at 2. The application of the price index to the Saturation incentive is problematic because the meaning of the rate attached to the additional volume in the numerator is quite different from the meaning of the rate attached to the additional volume in the denominator and thus the ratio cannot be taken as a measure of a rate decline. *Id.* at 6-7. ACMA argues that the incentive should go forward without price cap implications. *Id*. at 3. Alternatively, ACMA suggests that any additional banked authority that the incentive creates should accrue to the customer or product that created it rather than other Standard Mail mailers. *Id*. at 10.

The Saturation Mailers/Valassis Reply Comments agree with ACMA that the Saturation and High Density mail incentive should not result in a rate cap increase, but that the ACMA alternative proposal to make any rate cap adjustment applicable only to Saturation and High Density mail as that would reduce the opportunity to stimulate volume growth. Also, in response to NAA's Comments, they request clarification that rebates will apply only to total volume above the threshold regardless of rate category. Saturation Mailers/Valassis Reply Comments at 4-5.

The Commission considers the treatment that was applied to previous incentives to be appropriate. Since only mailers that meet minimum volume requirements and produce Saturation and High Density volume above calendar year 2010 plus 5 percent are eligible for discounts, allowing the Postal Service to bank rate adjustment authority would unduly penalize other mailers that do not qualify. The requirement that a mailer's volume exceed the prior year's level introduces the problematic concept of assuming a changing basket of goods for the index used to measure the percentage change in rates. ACMA Comments at 3-7. Adjustments to the volume weights should reflect the application of new or changed classifications to the historical set of volumes; they should not attempt to anticipate changes in mailers' behavior in response to changes in prices or classifications. ACMA correctly explains that if the actual volume turns out to be less than the projected volume, the authority already put into the bank will be unjustified. *Id*. at 8.

Mailers that are not eligible to participate should not have negative consequences resulting from the incentive. Moreover, increasing unused rate authority could encourage the Postal Service to offer incentives that are otherwise unlikely to improve its financial condition.

The alternative proposal of ACMA to make a rate cap adjustment applicable only to Saturation and High Density mail is not an option under section 3622(d)(2), as rate cap limitations apply to a class of mail and not a rate category.

The Postal Service proposes to treat Reply Rides Free in the same way as the Saturation and High Density incentive. It calculates a rate decrease with price cap implications. For the reasons discussed above, it is appropriate to treat the incentive program in the manner of negotiated service agreement volumes under rule 3010.24(a), thereby excluding the effect of the incentives in the program from the percentage change in rates used to compute unused rate adjustment authority.

III. PROCEDURAL HISTORY

Order No. 577 noticed the request, appointed a public representative to represent the interests of the general public in this proceeding, and invited interested persons to express views and offer comments on whether the planned changes are consistent with the policies of 39 U.S.C. 3622 and the Commission's applicable regulations.[25]

Chairman's Information Request No. 1 noted that the Postal Service's Notice appears deficient with respect to sections 3010.14(b)(1) and (b)(4) of the Commission's rules relating to the Postal Service's method for calculating the annual price cap limitation and the new unused rate adjustment authority.[26] The Postal Service responded to CHIR No. 1 on November 16, 2010. In its response, the Postal Service concluded that no "revision to its November 2, 2010 Notice in this docket is appropriate." Response to CHIR No. 1 at 4, 8.

To encourage comments on the Postal Service's Response to CHIR No. 1 and the appropriate application of the Commission's rules in 39 CFR 3010 subpart C in the context of this filing, the deadline for filing comments was extended to November 24, 2010. Order No. 588 at 2. Comments on the three classification changes and the appropriate price cap calculation were received from the Public Representative. PR Comments at 4-8. Other comments on the price cap calculation methodology were filed by the Affordable Mail Alliance and the American Catalog Mailers Association.[27] Comments also were received on the Reply Rides Free program,[28] the Saturation and

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[25] Notice and Order of Market Dominant Price Adjustments and Classification Changes, November 4, 2010 (Order No. 577).

[26] CHIR No. 1, question 3, inquired about the Postal Service's view about rate decreases filed together with rate increases on the need to re-compute the price cap.

[27] Comments of the American Catalog Mailers Association, November 24, 2010 (ACMA Comments).

[28] Comments of the National Postal Policy Council, November 23, 2010 (NPPC Comments).

High Density discounts,[29] and the Move Update changes.[30] Upon motion, Saturation Mailers/Valassis submitted a reply to ACMA and NAA.[31]

[29] Comments of the Newspaper Association of America, November 23, 2010 (NAA Comments); Comments of the Saturation Mailers Coalition and Valassis Direct Mail, Inc., November 24, 2010 (Saturation Mailers/Valassis Comments); ACMA Comments.

[30] Comments of the Major Mailers Association, November 24, 2010 (MMA Comments); Comments of the Association for Postal Commerce, November 24, 2010 (PostCom Comments); ACMA Comments.

[31] Reply Comments of the Saturation Mailers Coalition and Valassis Direct Mail, Inc. to American Catalog Mailers Association and Newspaper Association of America, December 1, 2010 (Saturation Mailers/Valassis Reply Comments). Motion of the Saturation Mailers Coalition and Valassis Direct Mail, Inc. to Submit Reply Comments to American Catalog Mailers Association and Newspaper Association of America, December 1, 2010. As noted by movant, the comments addressed could not have been anticipated and the motion will be granted.

IV. CLASSIFICATION PROPOSALS

Reply Rides Free. This pricing initiative offers mailers an incentive to include reply envelopes in mailings to generate revenues and offset mailing costs. First-Class Mail Automation Letters weighing more than 1 ounce, but not more than 1.2 ounces, may qualify for postage at the 1-ounce rate if the letters include a courtesy reply card or reply envelope. Mailers must agree to meet a volume threshold. A typical reply envelope weighs 0.2 ounces. All presort and automation letter volumes will count toward the volume threshold; however, only Automation Letters (until May 1, 2010) and thereafter only Automation Letters with the full-service Intelligent Mail barcode (IMb) would qualify for the discounts. Only customers who mailed First-Class Mail Presort and Automation Letters in FY 2009 and FY 2010 qualify for this initiative. The minimum volume to qualify is the trend of those volumes between FY 2009 and FY 2010 plus 2.5 percent. Notice at 4.

For compliance purposes, samples must be presented with each mailing. *Id*. at 3.

In support, the Postal Service states that the initiative is designed to slow the diversion of mail to online bill and statement delivery, and payment acceptance. Currently, mailers include promotional inserts only if a mailpiece remains subject to the 1-ounce rate. Reply Rides Free would increase the value of the mail for marketing purposes and encourage mailers to use mailings for direct marketing purposes. It would also encourage customers to reply with single-piece First-Class Mail and thus slow electronic diversion of responses. *Id*. at 3-4.

The two comments received about this initiative generally support the Reply Rides Free program. The Public Representative believes the public will benefit from the convenience of the Reply Rides Free program, and that recipients are more likely to use mail to make payments if they are provided with a reply envelope. The Public Representative observes that the Postal Service's adjustments to billing determinants correctly cause a slight decrease in revenues and concludes the volume assumptions are reasonable. PR Comments at 12.[32]

The Public Representative cautions that the Mail Classification Schedule (MCS) language the Postal Service proposes to describe this incentive program fails to inform potential customers of the terms and restrictions for qualifying for the program and, without more detail, may allow the Postal Service to modify important parameters without further Commission approval. *Id.* at 13-14. The Public Representative proposes more detailed MCS language for incorporation into the final order. The concerns expressed by the Public Representative about the proposed MCS language are well taken. Additional MCS language is needed to adequately inform mailers about this program. The enhanced description of the Reply Rides Free program proposed by the Public Representative should be incorporated as part of the MCS language for that initiative.

To restrict potential mailer abuse of the program that could lead to lost Postal Service revenue, the Public Representative proposes that the reply envelope or reply card must be associated with a response to the original mail owner, *i.e.,* returnable advertising inserts not associated with the mail owner should not qualify. In this circumstance, the Commission will not restrict the program.

NPPC supports the general concept to create new uses likely to add value to First-Class Mail, but believes that, to succeed, the program must have more flexibility, fewer restrictions and greater certainty of repayment to mailers than as proposed. NPPC Comments at 1, 2, 5. NPPC welcomes the quarterly payment reconciliation rather than the annual reconciliation proposed in the exigency rate case filing. *Id.* at 2. NPPC offers five examples of ways the Postal Service, by removing restrictions and

[32] The Public Representative notes that the Postal Service does not provide a rationale for its assumptions and requests that the Postal Service be directed to incorporate the program volumes into all future First-Class Mail quarterly billing determinants. *Id*. at 12, n.7.

requirements from the initiative, would increase participation volume. The Commission approves the Reply Rides Free incentive for 1 year as proposed.

Saturation and High Density incentive. The Standard Mail and High Density incentive would provide a rebate on incremental mailpieces above a predetermined volume baseline which, for each participant, equals the aggregate total Standard Mail Saturation and High Density volume in calendar year 2010 plus 5.0 percent.[33] Volumes above the baseline will be eligible for a rebate of 22 percent of participant's average revenue per piece for commercial Saturation mail and 13 percent for commercial High Density mail. For nonprofit High Density and Saturation volumes, the rebate is 8 percent. Notice at 4. The smaller nonprofit discount will meet the statutory requirement of 39 U.S.C. 3626(a)(6) that revenues from nonprofit mail equal 60 percent of revenue from commercial mail. *Id.* at 13.

To receive Saturation and High Density incentive discounts, mailers must meet several requirements including the following: Mailers must be current Saturation and High Density customers with at least six mailings in FY 2010 and be holders of a permit imprint advance deposit account or owners of qualifying volume entered through a similar account by a mail service provider at a facility having PostalOne! capability. Only owners of the mail volume will be eligible. *Id*. at 5. Mail service providers and customers supplying inserts or the components of Saturation or High Density mailings of another mailer are not eligible.[34] Customers have the option of participating under one of two market models:

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[33] A Standard Mail Saturation Mail Volume Incentive Program previously authorized by the Commission expired in May 2010. If approved, this program would replace the terminated program with a modified program that adds High Density mail to the initiative.

[34] Other program requirement details include mailers must electronically submit postage statements and mail documentation to the PostalOne! system during the specified period. Mailers using defined market area(s) must use Mail.dat or Mail.XML. Other applicants may submit postal statements via Postal Wizard. Customers may not participate in any other Standard Mail incentive or "sale" that includes Saturation or High Density products. *Id.*

— Total Market (or National) volume. Customers must demonstrate increased total Saturation and High Density mail volume letters and flats over the base year for their total market.

— Specific Geographic Markets. Subject to Postal Service approval, customers designate specific geographic target markets of specific Postal Service Sectional Center Facilities (SCFs) for increased volume over the base year. Up to 20 SCFs may be selected or up to five target markets (consisting of multiple contiguous SCFs). Customers must have made the qualifying six mailings during FY 2010 for each market in which they participate. *Id.* at 6.

The Postal Service's Notice explains the advantages of the program extension to High Density letters and flats. The new program will encourage customers to increase their mail volume above the baseline.

It is the Commission's understanding that the threshold to qualify for a rebate is based on the combined High Density and Saturation letters and flats mail volume. If the combined volume exceeds CY 2010 volume plus 5 percent (threshold), then the mailer qualifies for a rebate. Information on the computation of the rebates appears on the Postal service's website, but should have been filed in this proceeding.

If the combined volume of High Density and Saturation each exceed the threshold during the program period, then the rebate is based on all the volume above the threshold. If the combined volume of High Density and Saturation during the program period exceed the threshold, but either High Density or Saturation separately do not exceed the threshold, then the rebate is based on the volume above the threshold less the shortfall incurred by the category not meeting the threshold.

Four comments on the Saturation and High Density initiative were received.[35] All comments support this incentive. However, each commenter expresses some reservations about the program and suggests improvements.

The Public Representative sees benefit in growing existing volumes where there is already a healthy contribution to institutional costs with little risk to Postal Service revenues, but asks for clarification as to whether the incentive, being based solely on FY 2010 volumes, is intended to terminate at the end of FY 2011, or whether the incentive is intended to be based upon “previous calendar year volumes” and be made effective without a termination date. PR Comments at 17. Unless a termination date is specified, the incentive would continue, based on 2010 calendar year volumes plus 5.0 percent. The recently terminated saturation program also was based on credits for incremental volumes above a given level. It ended after 1 year and was effective from May 2009 until May 2010.[36] This incentive program will be authorized for a 1-year period during calendar year 2011 with the recognition that the Postal Service will need to reconsider the volume baseline and other incentives after 2011.

The Public Representative proposes enhanced MCS language to better inform potential customers of important information about qualifying for the program and to limit important modifications to the program without Commission approval. *Id*. at 17-20. Additional MCS language is needed to adequately inform mailers about this program. The enhanced description of the Saturation and High Density program as proposed by the Public Representative should be incorporated as part of the MCS language for that initiative.

NAA supports the extension of the Standard Mail Saturation program to High Density flats as an overdue step in the right direction. NAA Comments at 3. The

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[35] ACMA, NAA, Saturation Mailers/Valassis, and the Public Representative.

[36] Order No. 191, Docket No. R2009-2, Order Reviewing Postal Service Market Dominant Price Adjustments, March 16, 2009, at 54-55; United States Postal Service Response of Chairman’s Information Request No. 4, question 8, at 19.

initiative addresses the current risk of further erosion of newspaper Total Market Coverage (TMC) advertising programs and provides flexibility to newspapers to qualify for either the Saturation or High Density rate, thus expanding the number of potential newspaper users. *Id.* at 4. NAA says the credit of 22 percent of the average revenue per piece available to Saturation mailers should also be available to High Density mailers rather than the planned 13 percent. *Id.* This discriminatory rate advantage in favor of Saturation mailers, it says, could be eliminated by a sliding scale of discounts accurately reflecting the cost savings for walk-sequencing this mail. *Id.* at 4-5. The Commission does not consider the rate incentives, as filed, unduly discriminatory.

As noted above, ACMA argues that the incentive should go forward without price cap implications. ACMA Comments at 3.

Saturation Mailers/Valassis support the program, but find it too restrictive and optimistic given current market conditions. The growth rate requirement over baseline to qualify is “unrealistic” and even a “no growth” assumption might be optimistic. Saturation Mailers/Valassis Comments at 2. The incentive neither offers help to mailers in difficulty nor provides a longer-term incentive that should “match the market need.” *Id*. A reduction in general rates would better serve the Postal Service but, at a minimum, holding saturation rates at current levels or reducing them would be a more effective incentive. *Id*. at 3. The Commission finds no legal requirement to make such alterations to the Postal Service request.

Saturation Mailers/Valassis Reply Comments in response to NAA request clarification that rebates will apply only to total volume above the threshold regardless of rate category. Saturation Mailers/Valassis Reply Comments at 4-5. The Postal Service should immediately notify the Commission if this understanding is incorrect. The Commission approves the Saturation and High Density incentive for 1 year as proposed.

V. INCREASE IN MOVE UPDATE ASSESSMENT CHARGE THRESHOLD

For First-Class Mail subject to Move Update requirements and all Standard Mail, the threshold below which the Move Update Assessment Charge is assessed is increased from 70 to 75 percent. That is, the tolerance for incorrect addresses will be reduced from 30 percent to 25 percent. The change is consistent with plans announced in a previous docket,[37] is needed to encourage the use of Move Update processes, and will affect few mailings. Notice at 6-7.

ACMA believes this is a rate increase and that the weighting system used by the Postal Service is appropriate. It does not take a position on whether a change in the Move Update threshold is appropriate. ACMA Comments at 1-2. The Public Representative believes the Request is "not unreasonable" as it may result in a small revenue increase to the Postal Service and increase the mailers' incentive to comply with Move Update standards resulting in more efficient mail processing. PR Comments at 21.

Two commenters oppose changing the Move Update threshold. MMA attached to its comments concerns previously expressed to the Postal Service about Postal Service mailing standards. It asks the Commission to reject the change based on the need for additional information from the Postal Service regarding improvements and progress in Undeliverable As Addressed (UAA) mail and the quality of addressing mail. MMA "strongly suggests" that before modifications are made to the Move Update Performance Based Verification program, the Postal Service demonstrate "measureable improvement" in the data quality. MMA Comments at 1.

PostCom states that the 30 percent error threshold seems sufficient given the Postal Service's statements in Mailers' Technical Advisory Committee meetings that few mailings are close to either side of the 30 percent threshold. It is unclear to PostCom

[37] Docket No. R2010-1, United States Postal Service Notice of Market Dominant Price Adjustment and Classification Changes, October 15, 2009, at 3-4.

why this change is necessary at this time, and therefore, it should be rejected. PostCom Comments at 2-3.[38]

The proposed change is consistent with plans announced in a previous docket when the Postal Service initiated the Move Update Assessment Charge. The Commission favors reasonable changes that will serve to improve the processing of mail. MMA and PostCom question whether there is a sufficient need for the change in the assessment and wish to see improvements in UAA mail before the change is made. MMA Comments at 1; PostCom Comments at 2-3. However, there is no basis to condition the approval of this change upon an indeterminate future showing of improvements in UAA mail, the quality of addressing mail, or measurable improvements in data quality.

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[38] PostCom also objects that the Postal Service's plan to use its online publication, *Guide to Move Update*, is insufficient to communicate its policies on Move Update to customers. Moreover, PostCom asserts that the Postal Service needs to communicate its policies, processes, standards and compliance to the U.S. Postal Inspection Service so that its audits are consistent with publicly available standards. *Id.* at 2.

VI. OBJECTIVES AND FACTORS

The Postal Service lists and discusses the objectives and factors of 39 U.S.C. 3622 and their relationship to the proposed changes. The Postal Service asserts that the changes do not substantially alter the degree that First-Class Mail rates currently address the objectives and factors. Notice at 11. Reply Rides Free offers increased flexibility for the Postal Service (Objective 4), and enhances the Postal Service's financial position (Objective 5). It also encourages the use of First-Class Mail (Factor 3) and increases volume (Factor 7), yet maintains attributable cost coverage (Factor 2). The efficiency of mail processing is furthered by Move Update (Objective 1, Factors 5 and 12). *Id*. at 11-12.

Similarly, the Standard Mail changes do not alter the extent prices and system design will foster the objectives and factors of section 3622. Move Update improves overall efficiency (Objective 1, Factors 5 and 12). The Saturation and High Density initiative increases Postal Service flexibility (Objective 4) and incents mailers toward improving the Postal Service's financial position (Objective 5). The use of Standard Mail is incentivized and encouraged (Factors 3 and 7) and attributable cost coverage is not threatened (Factor 2). *Id*. at 12.

The Commission finds the three proposed classification changes are consistent with 39 U.S.C. 3622(b) and (c).

VII. ORDERING PARAGRAPHS

It is ordered:

1. The Commission approves Reply Rides Free rate and classification changes for calendar year 2011.

2. The Commission approves the Standard Mail Saturation and High Density rate and classification changes for calendar year 2011.

3. The Commission approves the increase in the Move Update Assessment Charge threshold to 75 percent.

4. The Mail Classification Schedule is modified to add Reply Rides Free and Standard Mail Saturation and High Density incentive programs, and change the Move Update Assessment charge threshold. The expired Saturation Mail Volume Incentive Program language will be stricken.

5. The alternative Reply Rides Free and Saturation and High Density Incentive Programs Mail Classification Schedule language proposed by the Public Representative will be adopted, subject to additional minor editorial corrections.

6. The rate increase resulting from this proceeding, if implemented by the Postal Service, will establish the basis for performing the next price cap calculations for First-Class Mail and Standard Mail classes.

7. The motion of Saturation Mailers/Valassis to file reply comments is granted.

By the Commission.

Shoshana M. Grove
Secretary