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Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Annual Compliance Report, 2012 | Docket No. ACR2012

PUBLIC REPRESENTATIVE REPLY COMMENTS

(February 19, 2013)

Respectfully submitted,

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In accordance with the Commission's Notice in this proceeding,[1] these Public Representative Reply Comments are filed in response to Comments on the Postal Service's Annual Compliance Report (ACR2012) prescribed by 39 U.S.C. 3652.[2] Eight Comments were filed by participants in this proceeding.[3]

The Postal Service's ACR is "to demonstrate that all products during the year complied with all applicable requirements of [title 39]." 39 U.S.C. 3652(a)(1). These reply comments address several matters including the Postal Service's (1) reduced service and inability to recover its costs due to artificial financial constraints and missed opportunities for additional revenues, (2) First-Class cost coverage disparities and worksharing issues, (3) Standard Mail Flats costs and worksharing issues,

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[1] Notice of Postal Service's Filing of Annual Compliance Report and Request for Public Comments, January 3, 2013. Reply Comments were due on or before February 15, 2013. The Public Representative is filing with these Reply Comments a motion for leave to file the reply comments one business day late.

[2] United States Postal Service FY 2012 Annual Compliance Report (ACR2012), December 28, 2012.

[3] In addition to Comments of the Public Representative, Comments were filed on February 1, 2013, by (in alphabetical order) Alliance of Nonprofit Mailers (ANM), American Catalog Mailers Association (ACMA), Direct Marketing Association (DMA), Greeting Card Association (GCA), National Postal Policy Council (NPPC), Pitney Bowes Inc. (Pitney Bowes) and Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. (Valpak).

(4) discriminatory Standard Mail Nonprofit Workshare Discounts, and (5) service performance wait-in-line time.

I. FINANCIAL CONDITION IS AFFECTING SERVICE

A. The Financial Constraints on the Postal Service Continue to Foster its Worsening Financial Condition and Deteriorating Service.

Most of the Comments in this proceeding offered a litany of reasons why the Postal Service should continue to provide below cost service for their businesses. Only Valpak voices great concern about the deplorable financial condition of the Postal Service that was engineered by Congress with both artificial and exorbitant Retirement Health Benefit Fund (RHBF) payments and a price cap constraint that is meticulously applied while the Postal Service ship is sinking. *See* Valpak Comments at 21 n. 22. The Postal Service must, of course, continue cutting costs consistent with the fall-off in the volume of mail. Nevertheless, until the RHBF is corrected and the hobgoblin of persistent consistency that applies the price cap so rigidly is swept away, the financial problems of the Postal Service will increase geometrically and the taxpayer, rather than mailers, will pay the bill.

Experience under the PAEA has demonstrated that it removed one of the essential tools of business the Postal Service needs to operate properly—the ability to flexibly increase prices as necessary to ensure its costs of operations are covered by revenue. In fact, by removing the important flexibility over pricing that normally allows businesses, when necessary, to price products above the cost of inflation based on forward looking estimates, the PAEA has, so far, very nearly fatally damaged the Postal Service. The Postal Service cannot and will not, in the foreseeable future, comply with section 403 of title 39 that requires it to provide adequate and efficient postal services at fair and reasonable rates and fees. Nor is the Postal Service meeting the objectives of 39 U.S.C. 3691 to reasonably assure customers delivery reliability, speed, and frequency consistent with reasonable rates and business practices. Most delivery standards were extended by one day in FY 2012. The Postal Service is assuring its customers that service is not diminished, but its closure of processing plants has extended delivery standards and diminished the speed of delivery. Further, a reduction in the frequency of delivery from 6 days to 5 days is planned because rates are unreasonably low due to financial constraints on market dominant products. The price cap constraint must be relaxed and modified.

Given the downturn in the postal services that is forced by artificial price cap constraints that fail to return adequate revenue, consumer groups might be expected to argue for increased prices to maintain their services. While the need to raise prices above the rate of inflation for some products is obvious and responsible, consumer groups are understandably unwilling to request an increase in their own First-Class rates. More surprising, is that only Valpak and the Public Representative respond to the onslaught of arguments favoring below cost pricing that reduces the Postal Service's financial health and whittles away at customer services. Yet, it is necessary to point out the fundamental rule of pricing. Neither econometrics, nor differential equations, nor statistical sophistry are required to comprehend the need stated so succinctly by one legendary book on the subject of ratemaking: "…the utility's obligation to serve does not extend to customers who will not or cannot pay reasonable charges."[4] That rule is ignored by the price cap and also by the Postal Service despite the Commission's prodding that the Postal Service must increase the prices of its money losing products. The price cap is also undermining the more fundamental policy that the Postal Service should be self-sustaining.

Reduced demand is resizing the Postal Service. While the demand and supply seek their own level and fall back into balance, steady, measured and incremental price increases above the price cap to recover costs should be part of the rebalancing effort. There has been and remains an opportunity to recover many billions in revenue by only

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[4] Garfield and Lovejoy, *Public Utility Economics,* Prentiss-Hal, Inc. 1964 at 139.

slight increases in First-Class rates, measured in pennies, as well as by requiring Standard Mail and Periodicals products to recover their costs. Unless the opportunity is taken, the potential benefits will be lost forever.[5] The increasing Postal Service debt will force either its effective liquidation or a huge taxpayer bailout. Better to adjust prices along the way with pennies before reasonable service must be eliminated altogether.

B. First-Class Postage Rates Remain Unusually Low

The price cap constraint is keeping the price of the First-Class stamp in the United States well below the postage rates of the rest of the industrialized world. The concern that the internet is siphoning off First-Class volume has not prevented other countries from charging substantially, and presumably necessary, higher rates for the equivalent of first and second ounce letters. They too have well-developed internet services and are subject to the same downward pressures on demand for postal services as the Postal Service. In Comments in the ACR2009 proceeding, the Public Representative pointed out the large dichotomy of rates between the United States and selected industrialized countries. In fact, the Postal Service at that time bragged about the bargain its rates offered.[6]

Today, the differential in rates is even more startling. The postage in other countries is often based on grams weight. The 30 gram letter is representative of a one ounce letter (one ounce equals 28.25 grams). In Canada, the one ounce equivalent rate is $0.54 cents; in Great Britain that rate is $0.78 for three day delivery and $0.94 for overnight delivery; in Germany the rate is $0.74; in France the rate is $0.78; in Japan the rate is $0.85; and in Norway the rate is $1.50. The rate for the 50 or 60 gram letter, roughly equivalent to a two ounce letter, in Canada is $0.98; Great Britain is the same

[5] See, *e.g.*, Docket No. ACR2009, Public Representative Comments on Annual Compliance Report 2009, February 1, 2010 at 4-27; Docket No. ACR2011, Public Representative Comments, February 3, 2012 at 6-13.

[6] Docket No. ACR2009, Public Representative Comments on Annual Compliance Report 2009, February 1, 2010 at 31. *See also* United States Postal Service, 2009 Annual Report at 1.

as one ounce, or $0.78 and $0.94; in Germany $1.21; in France $1.94; and in Japan $0.96.[7] Given the relatively smaller size of those countries, their relatively high postage rates are actually even higher. These differences demonstrate the First-Class pricing in the United States is very likely underpriced by a large margin.

C. Other Postal Service Revenue Opportunities

Apart from the liability for payments to the RHBF, the Postal Service lost $4.6 billion in FY 2012.[8] As noted at length in the Public Representative's Comments and those of Valpak, the Postal Service is very short of cash. It is supposed to be run like a business, but it is forced to operate with limited financial resources similar to those available only to a failing business. Despite this, the Postal Service has not pursued its opportunity to obtain price relief for the extraordinary and exceptional circumstance of the recent recession. The Commission agreed in response to one such rate proposal to increase rates that extraordinary and exceptional circumstances were demonstrated. The Commission further held some relief was warranted, but only the Postal Service could demonstrate its cost due to the recession.[9] The Postal Service apparently has abandoned its opportunity to continue that request for higher rates in January 2011. That case alone was expected to add about $3 billion per annum to the empty coffers, and would have added $6 billion by the end of FY 2012.

The Postal Service states, on the one hand, that it is cutting services as needed to maintain operations due to financial constraints, but it is not taking some obvious and necessary steps available to it. The Postal Service has added a few new but minor revenue enhancers for package services. Besides not pursuing the needed extraordinary emergency rate relief above the price cap, the Postal Service does not

[7] Based on exchange rates on February 12, 2013 and official web sites of the postal services in the various countries listed.

[8] For an informative table, *see* Valpak Comments at 5.

[9] Docket No. R2010-4, Order Denying Request for Exigent Rate Adjustments, Order No. 547, September 30, 2010,

attempt to undertake other potential programs that could potentially add huge amounts of revenue without damaging postal services.

The Postal Service is now authorized to offer advertising services as a nonpostal service.[10] The lease of space for advertising on its fleets of vehicles and real estate offers the opportunity to recover billions of dollars without harming services. No indication of a plan to expand its advertising services has been mentioned in the ACR2012.

A Postal Service lottery would be another huge revenue producer that would require Congressional approval, but it is not championed by the Postal Service. It could operate its own national or regional lotteries through its over 30,000 retail outlets as well as its own website. There are already dozens of highly profitable and popular lotteries. Millions of people would participate, as they do for all lotteries, if they know their purchases would assist in maintaining postal services they rely upon, or simply want. It is suggested that only approximately 30 to 40 percent of people surveyed would prefer six day delivery to continue. That percentage alone constitutes almost 100 million voters interested in maintaining their services who may eagerly buy lottery tickets to maintain their postal services.

As noted in the Comments of the Public Representative and Valpak, the Postal Service has ignored the Commission's orders to raise Standard Mail Flats rates that violate the law. Also, the Postal Service has technically violated the law in not paying into the RHBF at the Department of Treasury. Further, it recently announced plans to curtail six-day delivery in apparent contravention of current law. Yet, the Postal Service has not exercised its section 3622(d)(1)(E) authority to request further pricing relief due to the extraordinary and exceptional circumstances of continued artificially imposed

[10] Docket No. MC2008-1, Review of Nonpostal Services Under the Postal Accountability and Enhancement Act, December 19, 2008, Order No. 154; *see also* Docket No. MC2008-1, Errata Notice, January 9, 2009; petition denied, *United States Postal Service v. Postal Regulatory Comm'n*, 599 F.3d 705 (D.C. Cir. 2010); Docket No. MC2010-24, Order Approving Mail Classification Schedule Descriptions and Prices for Nonpostal Service Products, Order No. 1575, December 11, 2012.

financial constraints that are bankrupting the Postal Service. When an organization or individual is unable to pay its liabilities when due, it is bankrupt. The Postal Service's Integrated Financial Plan warns that it will reach that point in October, 2013.

Extraordinary and exceptional circumstances have developed with the unforeseen and continuing inability of Congress to provide financial relief to the Postal Service. Congress has been unable to reduce the RHBF payments, raise the Postal Service's debt ceiling limit, or relieve the constraint of the price cap. This inaction demands that the Postal Service undertake the effort to propose, at this point, that extraordinary and exceptional circumstances exist to warrant financial relief above the price cap in order to permit delivery operations to continue unfettered without further violation of the law.

Other authority for actions to administratively correct enforcement problems are included in the PAEA to insure that both adequate costs are recovered and Postal Service compliance with the law. As Valpak points out, one Commission remedy for noncompliance under section 3662 of title 39 is "ordering the Postal Service to discontinue providing loss-making products." 39 U.S.C. 3662(c). Alternatively, for each incidence of noncompliance, fines are authorized in the case of deliberate noncompliance. 39 U.S.C. 3662(d). These are extreme measures, but the condition of the Postal Service's finances requires unusual action to maintain service that is fair and reasonable as well as compliant with all other directives of the PAEA. The Commission is not without powerful authority to encourage improvements in the Postal Service finances.

D. Financial Constraints Causing Reduced Delivery Speeds Are Lowering the Satisfaction of Big Business and Will Further Drive Away Mail Volume

Big business is now starting to question the service being offered. One comment points out, as the Public Representative did, that the Postal Service's service performance met many targets for FY 2012, but should be assessed cautiously because those targets were moved during the year. It may be that the reported improved service performance resulted from merely moving the goalposts. NPPC Comments at 11-12.

NPPC also believes the Postal Service's theory that customers care more about service consistency than speed of delivery is not entirely correct. Many large commercial mailers require speed as well as consistency. For instance, speed is required to "satisfy regulatory obligations to provide timely notice, to manage invoices, statements, and payments, and generally to conduct business throughout the nation in the 21st century." NPPC Comments at 12. The failure to provide this needed service will drive away still more mail volume. *Id*. at note 11. Thus, not surprisingly, large business satisfaction with market dominant products fell in FY 2012, and is less satisfied than residential or small businesses with market dominant products. ACR2012 at 36. This is one more example supporting the Public Representative's continuing concern about the reduced service levels engendered by the artificial financial and business constraints imposed on the Postal Service.

E. Implications of Service Reductions on Price Cap

Recent service reductions appear to have implications for the price cap. NPPC suggests the Commission should address this issue. NPPC Comments at 13. Reducing service lowers the value of the service received. If price is not adjusted when service is reduced, the price is effectively increased. In the case of the Postal Service, an increase in price over the short term appears to pierce the price cap. However, measuring the amount of the effective cost increase due to lowered service would be difficult and perhaps impossible to measure accurately.

Normally, when products are re-priced after service declines, cost savings from the service decline can be reflected in lower prices so that, in time, because price generally reflects cost, the price adjusts for the reduced service. In the longer run, under normal competitive market conditions, the customer receives less service and should therefore pay less. But, in the case of the Postal Service, the pricing benefits of cost reductions are not apparent because, generally, prices are not based on costs but prices increase up to the price cap even if cost savings would otherwise justify a reduced price below the price cap. Where losses are large and rates must be pushed to the price cap limit, it is not clear what would be gained by investigating the implications of system-wide service reductions on the price cap. It is highly unlikely that rates would be or could be reduced to reflect lesser service.

II. FIRST-CLASS PRODUCTS

A. First-Class Mail Coverage-Contribution Disparities

1. Comments on First-Class Mail coverage-contribution disparities

Contribution disparities occupied a significant share of the Comments of Pitney Bowes, NPPC, and Valpak. This section of the Public Representative's Reply Comments will focus on the comments of these parties.

Both Pitney Bowes and NPPC initially discuss what they term as the inequitable contributions of First-Class Presort Letters and Cards (Presort Letters) towards the recovery of the Postal Service's institutional costs. NPPC compares Presort Letters' contribution to the lower contribution made by First-Class Single-Piece Letters and Cards (Single-Piece Letters). NPPC states that Presort Letters have been making a substantially higher contribution than Single-Piece Letters for several years, in spite of the fact that the average unit cost is more than one-half the average unit cost of Single-Piece Letters. NPPC Reply at 2-3. Pitney Bowes notes that the contribution of Presort Letters is more than 5 cents per piece greater than the contribution made by Single-Piece Letters, and that Presort Letters have nearly twice the cost coverage of Single-Piece Letters. Pitney Bowes Comments at 1.

Pitney Bowes and NPPC both reflect on the negative effects from failing to rebalance the unit contributions of these 2 mail categories. Pitney Bowes states:

> [M]ore equitable rebalancing of the cost coverage and unit contributions among First-Class Mail products (which would lower Presort Letters prices) would substantially increase the total contribution from First-Class Mail to the financial benefit of the Postal Service…especially since Presort Letters are much more price sensitive than Single-Piece Letters. Pitney Bowes Comments at 2.

NPPC goes further than Pitney Bowes by suggesting that overly high prices for Presort Mail are responsible for significant First-Class Mail volume reductions:

> [Due to] perpetual overpricing of the Presort product…Presort volumes continued to erode…charging the largest volume product excessive rates year after year: results in steadily hemorrhaging volumes year after year. NPPC Comments at 3.

Valpak generally takes a broader view of contribution inequity. It promotes a simple pricing rule and would maximize revenues from every product. It states that "the Postal Service will need to adjust prices in ways designed to increase the contribution from every low-profit postal product." Valpak Comments at 18. It envisions a substantial price increase for unprofitable products to become profitable, and concedes "it is unknown what will happen if the Postal Service begins to use its pricing flexibility to achieve a markedly higher contribution from marginal products, because prices will need to be increased far above the range where current elasticity estimates apply." *Id.* at 19. Nevertheless, Valpak believes even modest increases on loss-making products should be implemented.

> Price adjustments designed to (i) reduce losses from underwater products, and (ii) increase coverage on marginally profitable products, would help. Valpak Comments at 23.

2. Public Representative reply to comments on First-Class Mail coverage/contribution disparities

The Public Representative favors prices that reflect Efficient Component Pricing (ECP) as the goal in pricing products and rate elements within products to maximize contribution. The Commission changed the historical benchmark for First-Class Presort Letters/Cards from Bulk Metered Mail to the broad metered mail category that includes metered, IBI, and PVI letters in Docket No. RM2010-13.[11] That ruling is pending review in the Court of Appeals. The Public Representative supported IBI as the new benchmark for First-Class Presort Letters/Cards, and is hopeful the Court will uphold the Commission's Order.[12] A new First-Class benchmark rate from the Postal Service should be established that will better align the coverages of Single Piece Letters and Presort Letters mail to maximize the overall contribution from First-Class Mail. The Public Representative, as well as other commenters, hopes that this will stem to some degree the risk of continued volume losses from Presort Letter mail. NPPC Comments at 2-4, Pitney Bowes Comments at 1-3, 6.

The Public Representative agrees with Pitney Bowes and NPPC that it would be more efficient, and it would increase revenues, if the relative contributions of First-Class Single-Piece Mail and First-Class Presort Mail were in proportion to their respective elasticities. This would mean a combination of raising prices on First-Class Single Piece Mail and reducing prices on First-Class Presort Mail.

The disparity in contribution, cost coverage, and unit costs has been stable and consistent since 2008. Table 1 below compares the average contribution per piece, average unit cost, and cost coverage of these two mail categories between 2008 and 2012. Chart 1 graphs these differences.

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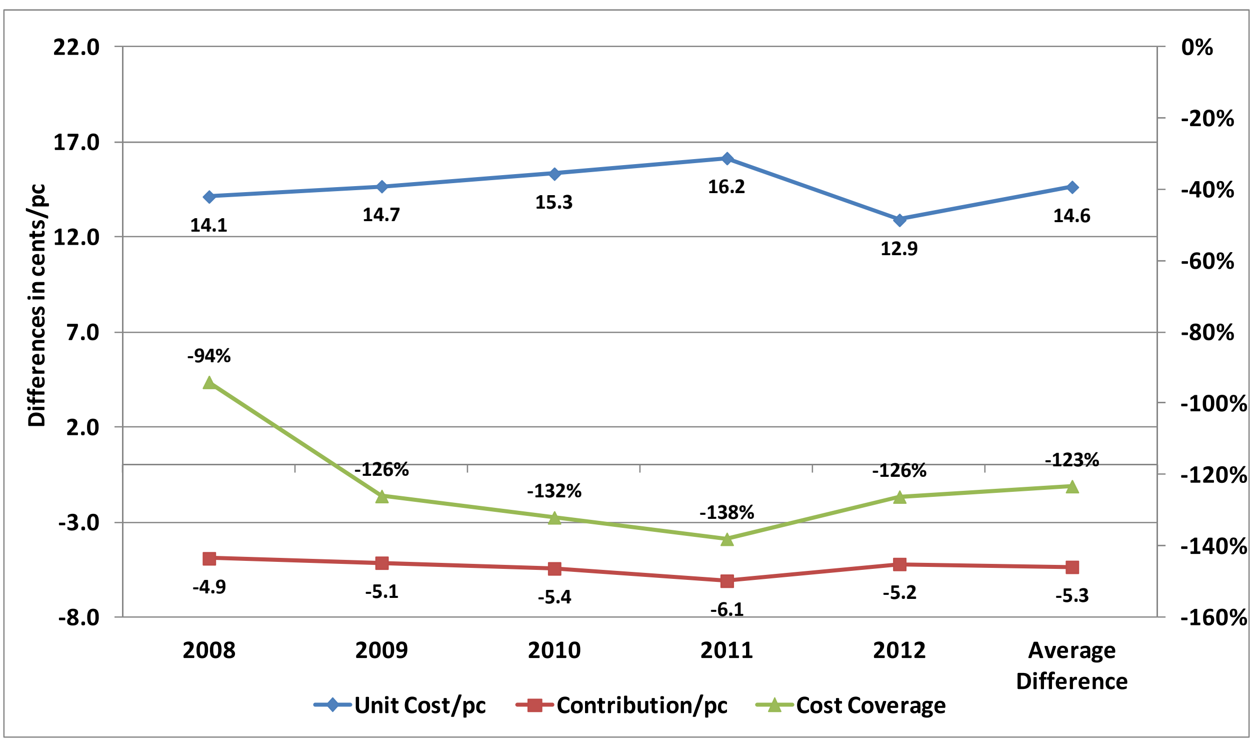
[11] Docket No. RM2010-13, Order Resolving Technical Issues Concerning the Calculation of Workshare Discounts, Order No. 1320, April 20, 2012.

[12] Docket No. RM2010-13, Reply Comments of the Public Representative in Response to Order No. 537, April 4, 2011.

Table 1
Comparison of Contribution and
Unit Costs of Two First Class Mail Groups

	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Unit Contribution (cents/pc)					
FCSP L/C	17.10	17.32	17.63	17.25	18.10
FCPS L/C	22.00	22.45	23.06	23.33	23.30
Unit Cost (cents/pc)					
FCSP L/C	25.15	26.37	27.01	27.80	25.00
PRESORT LETTERS	11.02	11.70	11.68	11.65	12.10
Sources: ACDs FY 2008-2011, ACR FY2012					

Chart 1
Annual Differences in Cost/pc, Contribution/pc and
Cost Coverage Between FC Single Piece and FC Presort Mail



Sources: ACDs FY 2008-2011, ACR FY2012

The Chart shows that these relationships have remained fairly stable since the PAEA was enacted. Presort Letters made an average contribution of more than 5 cents/pc between FY 2008 and FY 2012, with very little variation from year to year. The average difference in unit costs per piece has been 14.6 cents, and the average difference in cost coverage has been 123 percentage points. FY 2012 saw a modest reduction in unit cost per piece differences and cost coverage differences, but at the moment the data for FY 2012 appear to be outliers. The Public Representative also supports contribution rebalancing, according to relative elasticities of Standard Flat and ECR Mail.

The difficulty with increasing the price difference between First-Class Single Piece and First-Class Presort Mail is that the latter will see substantial increases in passthroughs. As required by section 3622(e)(2)(D), before approving such substantial increases, the Commission would need to agree that to do otherwise would impede efficiency. The Public Representative recommends that the Commission direct the Postal Service submit rates for these two mail categories at the next rate case of general applicability to rebalance contributions.

B. First-Class Worksharing

1. Workshare rulemaking

A pending Commission rulemaking in Docket No. RM2012-8 is reviewing the Postal Service’s proposed modifications to improve the First-Class Flats worksharing cost model. The proposal would improve the accuracy of passthroughs.[13] Pitney Bowes Comments at 7. Pitney Bowes requests the Commission to estimate costs using these modifications when calculating First-Class Flat worksharing passthroughs. Pitney Bowes Reply at 7. The Commission has not issued a final order in this docket. The

[13] Docket No. RM2012-8, Periodic Reporting (Proposals Eight and Nine), Notice of Proposed Rulemaking on Analytical Principles Used In Periodic Reporting (Proposals Eight and Nine), October 2, 2012.

Public Representative generally supports the proposals in Docket No. RM2012-8 and supports using costs from the modified models if the final order in that docket is released before the ACD.

2. Volatile Avoided Costs

NPPC presents four rate elements where passthroughs have changed substantially as a result of substantial changes in estimate avoided costs. It recommends the Commission "explore why the estimate of costs avoided has declined so abruptly in so short a time." NPPC Reply at 9. The Public Representative maintains it is too early to investigate the changes in avoided costs associated with First-Class Presort worksharing discounts. Chart 1, above, shows the difference in unit costs for and unit contribution between First-Class Single Piece Letters and First-Class Presort Letters. It shows that the difference in unit costs of these two mail categories has been fairly constant, although there has been a notable change this year. The Public Representative believes this is an anomaly, and does not support NPPC's recommendation, at least not until and unless subsequent data shows more sustained cost volatility.

3. Worksharing—Errors in Calculating Avoided Costs Inhibit ECP

Workshare discounts based on properly modeled costs assist in ensuring efficient component pricing and production efficiency. Pitney Bowes expressed concern that current worksharing cost models provide discounts that do not maximize production efficiency for First-Class Presort Letters. They provide the wrong pricing signal for workshare-related costs. Pitney Bowes Comments at 4-6. A Commission rulemaking is reviewing the analytical principles for measuring avoided workshare costs of First-Class Presort Letters.[14] Hopefully, that rulemaking will correct some of the apparent costing

[14] Docket No. RM2012-6, Notice of Proposed Rulemaking on Analytical Principle Used In Periodic Reporting (Pitney Bowes Inc. Proposal One), Order No. 1510, October 23, 2012.

anomalies that have arisen since the PAEA was passed. Where passthroughs are below 100 percent, they should be rectified.

4. First-Class Mail worksharing-prices and costs for a blended AADC/3-digit tier

Pitney Bowes and NPPC both argue that improving First-Class worksharing models and avoided cost estimates would improve pricing signals, productive efficiency, and compliance with section 3622(e)(2) of the PAEA. They both argue against inflated measurement of avoided costs for 5-digit Presort Letters and flats, but have different understandings. Pitney Bowes argues that if the Commission adopts a blended AADC-3-digit tier, avoided costs of 5-digit mail will increase. Pitney Bowes Reply at 5. NPPC argues that the adoption of a blended tier will increase the 5-digit discount, and implicitly suggests passthroughs for 5-digit mail will increase (despite the increase in avoided costs calculated by Pitney Bowes). NPPC Reply at 5. Despite this apparent difference, both parties maintain that passing through 100 percent of avoided costs for 5-digit presort mail will send efficient pricing signals and improve the Postal Service's contribution outlook. The Public Representative supports passing through 100 percent of avoided costs for First-Class, 5-digit Mail, once the blended AADC/3-digit rate is established.

5. Establish multiple CRA-adjustment factors

Pitney Bowes repeats its argument that the substantial difference in the ratio of CRA-to-modeled costs for incoming secondary and non-incoming secondary First-Class and Standard Presort Letters justifies separate CRA Adjustment Factors for mechanized and non-mechanized letters. Docket No. ACR-FY2011, Pitney Bowes Reply at 6.

The Public Representative argued against this position in its ACR Reply Comments last year; echoing arguments made by the Postal Service.

> The Postal Service has criticized the practice of judging the accuracy of a worksharing model by measuring the difference between modeled worksharing costs and accrued costs, arguing that many accrued costs are not included in the worksharing cost models.
>
> Consequently, until and unless parties successfully respond to the Postal Service's argument on this issue, the Public Representative does not support using the size of the CRA adjustment factor for different categories of worksharing activities as evidence that the worksharing cost models are flawed. Public Representative Reply Comments, ACR2011 at 6-7.

The Public Representative has more closely examined the worksheets of Pitney Bowes this year, and sees that Pitney Bowes has removed all non-worksharing related activities from its analysis. Even after limiting the ratio of the CRA adjustment factor to worksharing modeled costs, Pitney Bowes finds that the CRA Adjustment factor for First-Class and Standard mail, which receives a mechanized incoming secondary sort, is much closer to the CRA costs for these products than it is for these mail products that do not receive a mechanized incoming secondary sort. Docket No. ACR2011, Pitney Bowes Comments at 10.

The Public Representative has examined the SAS programs and output and agrees with Pitney Bowes.[15] The Postal Service's earlier criticism of Pitney Bowes' analysis, upon which the Public Representative relied, was based solely on the failure to limit the analysis to worksharing related costs. Pitney Bowes explains that it did, in fact, limit its analysis to worksharing related costs.

Pitney Bowes has raised a legitimate, significant, issue. A more accurate CRA adjustment that improves the measurement of workshare costs and accuracy of modeled costs of Presort Letters would contribute to more efficient component pricing. The Public Representative supports Pitney Bowes' call for a rulemaking to investigate the appropriateness of two CRA adjustment factors as soon as possible. *See* Pitney Bowes at 6. The Public Representative believes the Commission has more important

[15] Docket No. RM2011-3, Comments of Pitney Bowes Inc., February 18, 2011, at 2-3.

rulemakings to undertake soon, and a rulemaking on multiple CRA adjustment factors is not called for immediately.

C. Workshare Discounts Below 100 Percent May Be Exclusionary

Pitney Bowes repeats arguments it made in last year's ACR that worksharing discounts less than avoided costs are "exclusionary because they prevent equally efficient competitors from participating in the market for upstream mail processing." Pitney Bowes Reply at 9. In ACR2011, Dr. Panzar commented that worksharing discounts less than 100 percent "are exclusionary."[16] However, Pitney Bowes notes that the Commission rejected that request on the grounds the issues involved were beyond the scope of its annual compliance determination. The Commission concluded that issue may be addressed in a separate rulemaking, if appropriate. ACD2011 at 102.

Pitney Bowes requests the Commission to initiate a separate rulemaking to consider the competitive, and possibly other, effects of passthroughs substantially less than 100 percent as soon as possible, once it has released this year's ACD. Pitney Bowes Comments at 9. The Public Representative supported the arguments made by Pitney Bowes and Dr. Panzar in last year's ACR. *See* Docket No. ACR-FY2011, Reply Comments of the Public Representative at 4-6. Although the Public Representative favors ECP, without additional study and findings to support this view that passthroughs lower than measured avoided costs are exclusionary, the Public Representative is not prepared to recognize that all worksharing discounts below 100 percent of avoided costs are not in compliance with the policies of title 39, even if assumed to be *per se* exclusionary. The Commission may review this question at an appropriate time, but a rulemaking at this time is not warranted.

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[16] Docket No. ACR2011, Comments of John C. Panzar on Behalf of Pitney Bowes Inc. at 5.

III. STANDARD MAIL

A. Standard Mail Flats Losses Require Aggressive Price Increases

The large negative contribution of the Standard Mail Flats product requires other products to subsidize Standard Mail Flats, and continuing cost improvements are unlikely to eliminate the FY 2012 Standard Mail Flats losses of 9.0 cents per piece, totaling $532 million.

The Postal Service is very pessimistic in its projections for removing the Standard Mail Flats losses. It says, "Given the product's low coverage and the limitations of the price cap system, the shortfall is unlikely to be eliminated by the end of 2016."[17] Its recent projections about annual Standard Mail Flats, using assumptions about CPI-U, are that these prices will increase by only 5 percent above CPI so that by 2016, unit revenue and unit attributable cost for Standard Mail Flats will equal $0.408 and $0.465, respectively.[18]

The Public Representative has encouraged more aggressive Standard Mail Flats rate adjustments tailored to reach full cost coverage in a reasonable period of years. Public Representative Comments, ACR2011 at 19 and Docket No.R2013-1, November 1, 2012 at 13-17. Valpak submits similar arguments with respect to Standard Mail Flats and ECR pricing. It says, "…prices will need to be increased far above the range where current elasticity estimates apply." Valpak Comments at 19. Nevertheless, Valpak believes even modest increases on loss-making products should be implemented and price increases should be higher for products with lower elasticity, such as Standard Mail Flats, compared to products with higher elasticity, such as Enhanced Carrier Route (ECR) mail. Valpak Comments at 111.

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[17] Responses of the United States Postal Service to Questions 1-9 and 12-15 of Chairman's Information Request No.1, January 14, 2013, question 2c.

[18] Response of the United States Postal Service to Question 3 of Chairman's Information Request No. 4, January 28, 2013, IHS Global Insight, question 3a.

Valpak does not limit substantial price increases to Standard Mail Flats, but to all products that have consistently failed to make contributions towards the recovery of the Postal Service's institutional costs. These appear to be: Standard Mail Flats, Standard Mail NFMs and Parcels, Within Count and Outside County Periodicals, Single-Piece Parcel Post and Media and Library Mail. *Id.* at 35. At the moment price increases are not possible, so "Valpak requests the Commission to make a finding of noncompliance with respect to the seven products that have been, collectively, underwater continuously since FY2008." *Id.* at 37.

The Public Representative supports Valpak's recommendations, but its support is limited to Standard Mail Flats, Standard NFMs and Parcels; and Single-Piece Parcel Post. With the exception of Inbound International Single-Piece First Class Mail, the Postal Service's obligation to provide the other products at affordable rates limits their price increases. Inbound International Single-Piece First Class Mail is not out of compliance because it includes negotiated rates that often involve offsetting benefits to the Postal Service from outgoing mail.

B. Christensen Associates Model of Contribution Amounts

The Public Representative reviewed the Postal Service's model prepared by Christensen Associates (Christensen) for the ACR2012, and concluded the model does not demonstrate, as claimed, that smaller price increases over a period of years to eliminate Standard Mail Flats losses would yield greater total contribution than a more aggressive and sustained price increase. Public Representative Comments at 35-39. In fact, when appropriate inputs are applied to the model, it demonstrates a nearly opposite conclusion.

The Public Representative's analysis shows that an annual price increase between 2-3 percent for 5 or more years will maximize cumulative contribution compared to the estimates made by Christensen, who assumes an aggressive price increase for only 3 years, after which increases would no longer be above the annual

CPI. The option favored by the Public Representative in its initial comments is a notable 2-3 percent increase above the CPI, but not aggressive. Price increases on Standard Mail Flats, sustained for 5 or more years, will maximize contribution and minimize losses.

Valpak's analysis, discussed below, also reached the same conclusions. Valpak Comments at 59-79. Pitney Bowes concurs with these conclusions, finding that using more accurate assumptions, such as changing the price elasticity of Standard Mail Letters shows that larger price increases on lower-contribution products improves Postal Service finances. Pitney Bowes Comments at 3-4.

1. Valpak's analysis of Christensen models illustrates the advantage of steadily increasing prices for Standard Mail Flats by at least 2-3 percent over the annual increase in the CPI.

Valpak's Comments analyzed Christensen's models (USPS-FY-43) using modified assumptions. The analysis and conclusions are consistent with the views expressed in the Public Representative's Comments. Valpak's analysis provides some additional findings the Public Representative believes are worthy of comment.

Valpak previously advocated a 5 cent nominal increase in Standard Flat for two years, followed by price increases equal to the annual CPI. Valpak comments at 49. In the current Christensen models, Valpak applied a less aggressive approach. Valpak assumed fairly steady above-CPI increases for Standard Mail Flats for an 8-year period (starting with 3 percent in Year 1, reaching the maximum of 8 percent by Year 5, and then declining). *Id*. 64. Such a steady price increase over the annual increase in the CPI is consistent with the Public Representative's analysis. Public Representative Comments at 36-37.

As Valpak points out, using modified assumptions for the Standard Mail Flats price increase premiums above the CPI annual price (which the Christensen study refers to as in “Scenario 2” while Valpak names it “Scenario 3”) provides not only a larger cumulative contribution and higher cost coverage, it also results in a significantly lower cumulative loss. This observation is critical. Valpak concludes, "scenario 3 is preferable because it phases out the cross-subsidy burden on All Other profitable products." Valpak Comments at 71.

Valpak also determines that Scenario 3 yields a volume increase for All Other Standard Mail by the end of Year 8, which is 1.2 billion pieces, or 1.7 percent greater than in Scenario 1. Per piece cost coverage for All Other Standard Mail Flats is slightly less in Scenario 3 than in Scenario 1. However, Valpak suggests that specific price increases, and the number of years prices increase above the CPI is only one example that increases contribution and volume for Standard Mail Flats. It is not necessarily the optimal price pattern. Other combinations of notable, but non-aggressive, and sustained price increases above the CPI could achieve higher contributions for both Standard Mail Flats and All Other Standard Mail, and might even maximize coverage from Standard Mail Flats.

2. The Commission should encourage the Postal Service to work on development of optimal pricing methods under price-cap constraints.

The Public Representative agrees with Valpak that in addition to the Postal Service's risk analyses models, it is important to present a "pricing model designed to maximize contribution from any class of mail." *Id*. at 81. With price-cap constraints, price increases for one product in the class require certain trade-offs to determine price changes for other products of the class.

Valpak offers its own model described as the unconstrained maximum contribution available under price-cap. *Id*. at 83 and Appendix A. The purpose of Valpak's model is to identify product price changes inside the Standard Mail class that would lead to an optimal set of prices for the whole class. The goal of the model is to achieve a Pareto optimal result meaning that no further change in prices would increase total contribution for the upcoming fiscal year. *Id.* at 90.

The Public Representative finds that Valpak's approach definitely has merit. Pareto optimality is a classic concept of operations research applicable to economic situations that assume trade-offs.[19] Christensen's models (*i.e*. the retrospective model), as well as the prior Postal Service models filed in Docket No. R2013-1, also assumed trade-offs. The trade-off for the Postal Service was between "Flats" and "All Others" and "Flats" and "Letters". However, the models presented by the Postal Service were not optimization models, but risk analyses scenarios "intended to show that contribution can be reduced in the long run if limited price-cap space is dedicated to a product in systemic volume decline."[20] The Public Representative believes that optimal pricing models based either on Pareto optimality (as suggested by Valpak) or other valid approaches would be highly beneficial for the Postal Service and provide technical tools necessary to perform price adjustments under price-cap constraints.

3. The Postal Service should employ a demand-based pricing policy and rely on more realistic elasticities of demand when performing risk analysis.

Valpak discusses the importance of elasticity of demand in setting prices for mail products and emphasizes that its importance is reflected in section 3622(c)(3) of title 39. Valpak expresses a significant concern that the Postal Service does not employ demand-based pricing when setting prices for Standard Mail. Valpak Comments at 107-108. Although the demand models published annually in January contain own price elasticities for a few subclasses of Standard mail, they do not seem to be considered by the Postal Service when deciding price increases for Standard Mail products. *Id.* at 108-111.

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[19] *See, e.g.* Silberberg E., *The Structure of Economics: A Mathematical Analysis*: McGraw-Hill, 1978 at 471-482; Boyd S. and Vandenberghe L., *Convex Optimization,* Cambridge University Press, 2004 at 181-187.

[20] USPS-FY 2012-43, Scenario Analysis for Standard Mail Contribution, Christensen Associates, December 27, 2012 at 2.

The Public Representative's Comments noted that it would be reasonable to assume different elasticity values than were assumed in Christensen's models for both Standard Mail Flats and All Other Mail. Public Representative Comments at 35. Pitney Bowes expresses similar concern about the price elasticity for Standard Mail letters of -0.2 used in the retrospective model and suggests it should be equal to –0.437.[21] Among Standard Mail sub-classes/products only Standard Nonprofit mail has an own-price elasticity lower (in absolute value) than -0.437. Standard Regular Mail, Standard Enhanced Carrier Route and Standard ECR Nonprofit have elasticities of -0.437 or higher. Analysis of own-price elasticities for Standard Mail subclasses published by the Postal Service in 2011, 2012 and 2013, shows that the elasticities of the afore-mentioned products increased over this time period.[22] Consequently, the assumptions regarding own-price elasticities for All Other Standard Mail that the Public Representative applied in the Comments are reasonable and conservative. After analyzing Christensen's models, the Public Representative concluded the cumulative contribution results are especially sensitive to elasticity of All Other Standard Mail. Actual own price elasticity of demand for All Other Standard Mail might be higher, and, in this case, a price increase of 2-3 percent above CPI would provide even better results than the Public Representative demonstrated in the Comments.

4. ACMA's critique of Christensen's models is neither justified nor supported by calculations.

In the analysis of the Christensen models, both the Public Representative and Valpak provide detailed calculations and justifications with their analysis. *See* Public Representative Comments at 33-39 and Attachment 1; Valpak Comments at 57-80. While arguing that Christensen's study "might understate the magnitude of any negative

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[21] Comments of Pitney Bowes, February 1, 2013 at 3-4.

[22] For more information on the most recent own-price elasticities, *see* Demand Analyses FY 2012–Market Dominant, January 22, 2013. For comprehensive analysis of elasticities of demand and their role in pricing policy, see Valpak Comments at 107-111.

effects," ACMA does not provide any calculations in support of this statement. ACMA Comments at 19. Instead, ACMA lists seven reasons to support its argument. *Id*. at 19-21. Based on review of these reasons, the Public Representative concludes that they are unjustified and in some cases, do not have a logical connection to the subject matter.

The Public Representative replies to a few of the reasons that ACMA offered to illustrate the potential negative consequences of increased Standard Mail Flats rates. ACMA is of the opinion that catalogers' actual price elasticity is much higher than -0.6 (the elasticity assumed for Standard Mail Flats in Christensen's models). ACMA mentions that its members make business decisions assuming "elasticities in the neighborhood of 1.35" in absolute value. *Id.* at 19. While not arguing against such a possibility, the Public Representative doubts that such a high elasticity for catalogers could influence the elasticity for Standard Mail Flats. There is even more doubt about the influence of such high elasticity on the overall results of the Christensen models. The Demand Model filed this January by the Postal Service reported elasticity for Standard Regular Mail is -0.437. For the Comments, the Public Representative tested the models under the assumption that, after three years, Standard Mail Flats would be more elastic than the Christensen models assume. Public Representative Comments at 35-36 and Attachment A.The results favor Scenario 2 rather than Scenario 1. Under higher elasticities, the All Other Mail Scenario 2 provides higher cumulative contribution than Scenario 1.

While arguing that the elasticity of attributable costs for letters and flats with respect to volume (what the Commission refers to as the volume variability of attributable costs) could be significantly below 90 percent, 0.9. ACMA does not clarify how this would influence the results of the model. The Public Representative tested "V2b" types of Christensen models under the assumption that the volume variability of the attributable costs is less than 90 percent. In the case of lower volume variability, Scenario 2 would still return more contribution than Scenario 1, but with a 1-2 percent annual price increase above the CPI applied for a longer time period (7 years and more).

ACMA criticizes Christensen's models for neglecting the multiplier effect, particularly between Standard Mail Flats and Carrier Route Mail. ACMA Comments at 20. ACMA states that "if the rates increase for Standard Mail Flats, and the associated volume is reduced, the volume would also be reduced in Carrier Route." *Id*. ACMA expresses concern that this would have a negative effect on the profitability of the Postal Service. In its discussion of multipliers, ACMA refers to its comments in ACR2011.[23] However, this document does not contain any quantitative analysis of the actual multiplier effect on products, but only states that "the 'possibility' of secondary effects in the Postal Service is real and pronounced" and refers to articles for support. *Id* at 31. This justification is not sufficient. As the Postal Service states, currently observed independent volume declines for Standard Mail Flats could systematically continue. ACR2012 at 17. The Public Representative assumes that the volume decrease of Standard Mail Flats due to price increases could eventually be significantly less than the decrease due to the historic trends. This was partially illustrated by Christensen's models that separate two independent volume growth rates from growth rates that result from price change. The negative multiplier effect of a price increase on a Carrier Route volume will almost certainly be smaller, if any at all, than its effect on Standard Mail Flats volumes.

C. The Commission Should Continue to Use Cost Coverage to Evaluate Pricing and Eliminate Cross-Subsidization

DMA suggests the Commission's pricing recommendations for services that are underwater in FY 2012 may create "incorrect pricing signals to the marketplace" unless the Commission is mindful of the Postal Service's efforts to slash costs of services that may by FY 2013 put them "above water." DMA Comments at 1. Unfortunately, cost

[23] Initial Comments of the American Catalog Mailers Association, ACR2011, February 2011 at 31-32.

cutting measures will not put Standard Mail Flats above water. That product is so far underwater that no amount of successful cost cutting in FY2013 will approach eliminating the losses generated by the product. Standard Mail Flats coverage was only 80.7 percent in FY 2012. ACR2012 at 15. Despite several rate increases in recent years, the coverage remains nowhere near 100 percent. Therefore, in this ACR2012, the Commission does not need to be concerned about overshooting the mark when ordering corrective rate increases for Standard Mail Flats.

DMA also suggests that coverage from a mailing as a whole, rather than coverage of individual products, should be considered before ordering rate increases for "underwater" products such as Standard Mail Flats. DMA Comments at 1. For instance, a single mailing may pay carrier route postage and pay the Standard Mail Flats rate for residuals. DMA suggests that increasing the cost of the underwater flat-shaped products for mailers where Standard Mail Flats is a residual of an ECR mailing, will not encourage mailers to prospect for new customers, thus reducing their volume and requiring the attribution of higher institutional costs to non-Standard mail. *Id*. at 1. DMA's suggestion to maintain relatively low price increases for Standard Mail Flats in order to encourage residuals, which make up only a small portion of that product's volume, would literally have "tail-end" residuals "wag the dog" of money losing Standard Mail Flats. Moreover, DMA does not attempt to quantify or demonstrate the questionable validity of its claim that lower residual prices would encourage additional volume.

In addition, insufficient cost coverage for Standard Mail Flats leads to cross-subsidization of Standard Mail Flats by other products in violation of title 39. The Commission should evaluate compliance of products individually and collectively. Valpak. Comments at 33. The Postal Service tries to eliminate "the inequity of cross-subsidy." *Id.* at 59. Under pricing Standard Mail Flats would negatively influence such highly profitable products as High Density/Saturation Letters. *Id*. at 121. DMA's arguments also contradict the Postal Service's position that is in agreement with the

Commission: "having products cover their costs is an appropriate long-term goal." ACR2012 at 15.

Also, current historic trends for Standard Mail Flats volume do not provide a solid basis for assuming increased volumes in the near future. DMA does not clarify what "the encouragement" should be and how to achieve volume growth. In its ACR2012, the Postal Service consistently repeats that mail volume declines for Standard Mail Flats will likely continue. Also, ACR2012 data shows a decrease for the overall Standard Mail class as well.

The Public Representative agrees with Valpak that the Postal Service should increase coverage and contribution for all products and eliminate intra-class cross-subsidization. Valpak Comments at 59 and 64.

D. ACMA Has Not Demonstrated Its Cost Index Should Be Applied by the Commission to Measure Standard Mail and Periodicals Costs

1. The purpose of ACMA's cost index

Mr. Mitchell has now used the cost index he formulated in ACR-FY2011, three times.[24] He has claimed that the ratio of the Price Index for a product to the product's cost coverage is a Laspeyres-type cost index which holds volumes constant.[25] Docket No. ACR-FY2011, ACMA Comments at 2. The original purpose of the index held out the hope that it would allow parties to compare unit attributable costs, abstract from cost changes caused by changes in worksharing discounts, rate changes, or any other changes that might make volume change. Keeping volume constant is the key to creating a price or cost index.

[24] It was initially proposed in Docket No. ACR-FY2011, Initial Comments of The American Catalog Mailers Association (ACMA), Appendix A; Docket No. R2013-1, ACMA Comments, Appendix II, and, Docket No. ACR-FY2012 Initial Comments of The American Catalog Mailers Association (ACMA).

[25] It is worth noting that by holding volume constant, a Laspeyeres cost index, not a Paasche volume index would allow the comparison of unit costs not influenced by declining volumes or a change in the volume mix.

Unfortunately, ACMA has used its index to cast doubt upon the accuracy of the measurement of the costs of Standard Mail Flats. For example, ACMA stated near the end of its Comments in Docket No. ACR-FY2011, that:

> "The cost increases for Standard Flats and Periodicals have been substantially in excess of what can be explained by factor price increases or in any other way. For this reason, and for supporting reasons discussed herein, reliance cannot be placed on these costs. They do not provide an adequate basis for evaluating rates or assessing compliance. At most, the costs themselves are out of compliance." ACMA Comments at 33.

In Docket No. ACR-FY2011, the Public Representative provided a mathematical analysis of this index, and showed that the ratio of a product's price index to its cost coverage was not a Laspeyres cost index. *S*ee Public Representative Reply Comments, Appendix. Mr. Mitchell now claims that because no party rebutted his use of the same index in R2013-1, it should now be presumed to be a valid cost index. ACMA Comments at 7. He then uses this index to question whether Standard Mail Flats' cost coverage is below 100 percent; whether the costs of excess capacity are unfairly attributed to Standard Mail Flats (because the gap between the Postal Price Index and his cost index for Standard Mail Flats are much higher than Standard Letters); and whether the Commission's costing methods are reliable. For example:

> There appears to be the possibility of some tension between effective rates and a focus on cost coverages, under a price cap. ACMA Comments, ACR-FY2012 at 14.
>
> It is true that the costs of excess capacity must be paid by the Postal Service overall, but it is not true that they are properly attributed to specific products. *Id.* at 16*.*

2. ACMA's index is not a Laspeyres cost index

The Public Representative did not comment on the re-emergence of Mr. Mitchell's cost index in R2013-1 because he did not mathematically address the Public Representative's proof that the ratio of a price index to cost coverage is not a Laspeyres cost index. He asserts, without evidence or support, that the Public Representative's proof that Mr. Mitchell's ratio is not a Laspeyres cost index "relates to his work, not mine." Docket No. R2013-1, ACMA Comments, Appendix II, at 18. More important is the Commission's lack of reliance on the index.

The Public Representative first will simplify its mathematical proof in the hope this issue will be finally settled. It is worth noting that that the formulas presented in Mr. Mitchell's 2011 Comments do not match the formulas he used in his spreadsheets.[26] The Public Representative first examined the formulas in his spreadsheet, for these are the calculations used in support of ACMA's Comments. For ease of presentation, assume a single product, with a single cost function, with a single rate element. These assumptions allow dropping the summations. The left hand side of the following equation, Mr. Mitchell's index, is the ratio of a Laspeyres price index for a product to its cost coverage in period 2.[27] The right hand side is a Laspeyres index of unit costs, where 1,2 are time periods, P is price, V is volume, and UC is unit cost.

$$\frac{\left(\frac{P_2V_1}{P_1V_1}\right)}{\left(\frac{P_2V_2}{UC_2V_2}\right)} = \frac{UC_2V_1}{UC_1V_1} \qquad (1)$$

The left hand side may be simplified by multiplying the numerator by the inverse of the denominator:

$$\frac{P_2V_1 \cdot UC_2V_2}{P_1V_1 \cdot P_2V_2} = \frac{UC_2V_1}{UC_1V_1} \qquad (2)$$

Simplify by cancelling P_2, and $V_{1,}$ and then V_2, gives:

$$\frac{UC_2V_2}{P_1V_2} = \frac{UC_2}{P_1} \neq \frac{UC_2}{UC_1} = \frac{P_1}{UC_1} = 1, or\ P_1 = UC_1 \qquad (3)$$

[26] *See* ACMA_ACR2012_Workbook.xlsx, submitted with ACMA's Comments in this docket.

[27] A Laspeyres index holds base period volumes constant, and can measure rate, cost, and generally, price-related changes in abstraction from any effects caused by changes in volume.

The calculations in Mr. Mitchell's spreadsheets reduce to a statement that prices equal unit costs in period 1. The reduced terms in equation (3) are not index numbers. They are simply expressions that are almost certainly untrue. In order for a term to be an index it must compare the value of something in two periods in terms of a variable that is constant in both periods and is appropriate for the question(s) on which the index is meant to shed light.

The formulas in Mr. Mitchell's Appendix differ from those used in his spreadsheets. This formula is the Price Index in period 2, divided by the cost coverage in period 2, divided by the price index in period 1, divided by the cost coverage in period 1. After simplifying, he correctly presents the following terms:

$$\frac{V_2 UC_2}{V_1 UC_1} \cdot \frac{V_1 P_2}{V_2 P_2} \qquad (4)$$

He correctly describes the first term as the ratio of total costs in period 2 to period 1, and correctly describes the second term as a Paasche volume index. Instead of deriving a rate or cost index, Mr.. Mitchell has derived a volume index. A volume index is useful for determining the change in volumes if costs or prices are kept the same. He claims that a volume index solves "the mix problem" by holding volumes constant at different prices. *Id.* at 37.

Unfortunately, a volume index does not allow comparison of costs across time in abstraction from volume changes, which was the original stated purpose of this index. Rather, a volume index allows determination of the changes in volume or demand abstracting from changes in price or cost. The Public Representative maintains that a volume index is not only a different index than Mr. Mitchell proposed, but it does not permit comparison of unit attributable costs of a product over time in abstraction from changes in worksharing discounts or prices.

3. Conclusion on ACMA index to measure Standard Mail and Periodicals costs.

In summary, neither Mr. Mitchell's spreadsheet calculations nor his original formula use or provide an index that would allow comparison of unit costs by controlling for volume changes over time. Consequently, ACMA's charts and discussion to not represent information the Commission should rely upon.

E. Nonprofit Workshare Discounts

ANM's Comments contend the FY 2012 worksharing discounts for nonprofit Standard Mail discriminate against nonprofit mailers in favor of Commercial Standard mailers without a reasoned justification. ANM Comments at 2. The Standard Mail nonprofit workshare discounts were clearly less than the commercial discounts in FY 2012. For instance, from January 22, 2012 through the remainder of FY 2012, the rate discount differentials between nonprofit and commercial Standard rates for Auto 5-Digit Flats, Nonauto 3-Digit Flats and High Density Letters were 0.9 cents, 1.0 cent, and 0.3 cents, respectively.[28] *See* ANM Comments at 11.

It is settled law that unequal worksharing discounts offered to commercial mailers and nonprofit mailers is discriminatory and contrary to section 403(c) of title 39 "absent some reasonable ground for differential treatment."[29] The Postal Service has not justified the FY 2012 differential in this docket. The Commission must determine a reasonable ground for the disparity or order the discrimination corrected.

The Commission's recent rate adjustment Order in Docket No R2013-1 authorized the disparity to continue. ANM Comments at 7.[30] The Postal Service's rationale and the Commission's reasoning in that case allowing the discrimination to

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[28] There were similar, but not identical, differentials prior to January 22, 2012 during FY2012. *Id*.

[29] *National Easter Seal Society v. USPS*, 656 F.2d 754, 760-762 (D.C. Cir. 1981).

[30] Docket No. R2013-1, Order on Standard Mail Rate Adjustments and Related Mail classification Changes, Order No. 1573, December 11, 2012 at 9.

continue do not appear to meet the standard of *National Easter Seal Society* that a "reasonable ground" must be demonstrated.

In response to a Commission interrogatory in Docket No. R2013-1, the Postal Service justified the disparity as "protecting against over 100 percent passthroughs for both Commercial and Nonprofit" services.[31] Subsequently, in response to Commission Order No. 1541, the Postal Service cited, among other insufficient reasons for the disparity, that equalization is too complex to be practical.[32] That is, it is "impractical to satisfy" the requirement of 39 U.S.C. 3626(a)(6) while simultaneously equalizing worksharing discounts between nonprofit and commercial Standard Mail.[33]

Section 3626(a)(6) requires the average revenue per piece from Nonprofit products to equal, as nearly as practicable, 60 percent of the average revenue per piece from the corresponding Commercial products. The straightforward answer to the Postal Service's dilemma is that equalizing the discounts takes precedence over maintaining the average revenue per piece of Nonprofit products "as nearly as practicable" at 60 percent of the corresponding Commercial products. Also, in this case the amount in issue is so low that the impact of removing the discrimination would have virtually no impact on maintaining, as nearly as practicable, the 60 percent differential. ANM points out, "fully equalizing nonprofit Standard Mail worksharing discounts with their commercial counterparts would result in less than $3.1 million in additional revenue leakage per year…." ANM Comments at 20.

The Commission's Order in the rate adjustment docket authorized the discount disparity to continue.[34] It did not accept the Postal Service's justifications. The Order pointed out the *National Easter Seal Society* case was decided prior to the PAEA. The

[31] USPS Response to Chairman's Information Request No. 5, November 5, 2012, Question 8(b).

[32] USPS Response to Order No. 1541, November 26, 2012 at 6-8.

[33] *Id.* Other insufficient rationales offered by the Postal Service at that time are listed in ANM's Comments at 7-8.

[34] Docket No. R2013-1, Order No. 1573 at 9.

PAEA provides that commercial and nonprofit rate differentials shall reflect the policies of title 39, including factors in 3622(b). 39 U.S.C. 3626(a)(6)(C). Section 3622(b) includes such factors for consideration in rate decisions as "pricing flexibility" and permitting changes in rates "of unequal magnitude within" classes of mail. In approving the differential in workshare discounts in the rate case, the Commission found i "the Postal Service may use its pricing flexibility in setting workshare discounts for commercial and nonprofit Standard Mail, and that in the circumstances of this rate adjustment, its justification is reasonable." Order No. 1573 at 9.

Approvals of rate adjustment proceedings are provisional and subject to subsequent review that the rate does not contravene Chapter 36, Subchapter I. 39 CFR 3010.13(j). The Commission's rules do not indicate whether the Commission views approval as provisional with respect to section 403(c) violations. However, Order No. 1573 has been appealed by ANM and it seeks clarification in this proceeding about the Commission's ruling in that Order as well as in this docket. ANM at 2, 26.

The discriminatory pricing disparity has yet to be fully justified. The Postal Service's reasons have been rejected and the Commission's ruling in Order No. 1573 that pricing flexibility warrants the discrimination appears to effectively read section 403(c) out of title 39. Any differential in pricing *per se* would reflect flexibility in pricing. No underlying justification or need for the pricing flexibility has been presented. The Postal Service did not explain why removing the disparity is too complex. Moreover, pricing flexibility can be maintained by establishing equal discount rates within a zone of rates while maintaining nondiscriminatory prices. To pass muster, the grounds for discrimination must be reasonable and that has yet to be demonstrated.

The Postal Service suggestion that eliminating the pricing disparity is "complex" is not explained and is questionable. The dollar amount in issue is extremely small. The difficulty in simply increasing the discount for nonprofits to the commercial level and making a minor adjustment in another Standard Mail product is not apparent and unexplained. The Postal Service frequently adjusts all of its market dominant rates to insure compliance with the rate cap. That process is far more complex than a minor upward adjustment of its nonprofit discounts. The Public Representative is concerned that while pricing flexibility may be a factor to consider in setting rates, without an underlying explanation of the necessity for flexibility in pricing to justify the discrimination, no reasonable grounds have been shown to continue the discrimination. Moreover, the Commission's general reasoning that the discrimination is warranted "in the circumstances of this case" does not point to the particular circumstances warranting continued discrimination. Lacking that explanation, or other reasonable rationale, the disparity during FY 2012 was in violation of section 403(c) and must be eliminated.

IV. SERVICE PERFORMANCE—WAIT-IN-LINE TIME

The Public Representative's Initial Comments identified a large discrepancy between the wait-in line time presented by the Postal Service in its ACR, and the wait-in-line time the Postal Service calculated from USPS-LR38. The Public Representative calculated wait-in-line time by multiplying the number of respondents by the midpoint of each time interval, and divided by the total number of useable surveys and obtained an average wait-in-line time of 3.9 minutes, compared to the Postal Service's average national wait-in-line time of 2 minutes and 34 seconds. PR Comments at 59.

Using the number of respondents rather than useable surveys widens the discrepancy in the Postal Service's wait-in-line time. Table 2, below, shows that the wait-in-line time was 4.83 minutes when total minutes are divided by the number of persons who answered this question (respondent count). In contrast, the average wait-in-line time was 3.95 minutes, when total time was divided by the number of useable surveys. The Public Representative believes the former is the correct denominator. The result is an even greater discrepancy between the data provided in USPS-LR38 and USPS-LR33.

Residential & Small Business Combined				
	Response Value*	**Number of Respondents***	**Midpoint of Wait Time Interval***	**Minutes in Line**
				(2)
Recent Wait in Line Time	Less than 1 minute/No wait/No line	95,806	0.5	47,903
Recent Wait in Line Time	1-3 minutes	160,590	2	321,180
Recent Wait in Line Time	4-5 minutes	120,941	4.5	544,235
Recent Wait in Line Time	6-10 minutes	79,617	8	636,936
Recent Wait in Line Time	11-15 minutes	32,996	13	428,948
Recent Wait in Line Time	16 minutes or more	25,359	20	507,180
Total Time				**2,486,382**
Number of Useable Surveys	**629,632**			**3.95**
Respondent Count	**515,309**			**4.83**
*Source, USPS-FY12-38 Preface				

V. CONCLUSION

The Public Representative respectfully submits the foregoing comments for the Commission's consideration.

Respectfully submitted,

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