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

PERIODIC REPORTING (PROPOSAL EIGHT)	Docket No. RM2017-12

PETITION OF THE UNITED STATES POSTAL SERVICE FOR THE INITIATION OF A PROCEEDING TO CONSIDER PROPOSED CHANGES IN ANALYTICAL PRINCIPLES (PROPOSAL EIGHT)
(July 31, 2017)

Pursuant to 39 C.F.R. § 3050.11, the Postal Service requests that the Commission initiate a rulemaking proceeding to consider a proposal to change analytical principles relating to periodic reports and compliance determinations. The proposal, relating to the level of aggregation at which the provision setting the required ratio between Nonprofit and Commercial mail (within USPS Marketing Mail) at 60 percent is applied, is labeled Proposal Eight and is discussed in detail in the attachment to this Petition describing the proposal.

Respectfully submitted,

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PROPOSAL EIGHT

NONPROFIT PRICING: RESTORING SUBCLASS APPLICATION OF PUBLIC LAW 106-384 TO USPS MARKETING MAIL

INTRODUCTION

Under the PAEA, the Postal Service has been applying Section 1(d) of Public Law 106-384 (the "60 percent rule," governing the ratio of average revenue per piece between Nonprofit and Commercial mail) at the class level, i.e., to USPS Marketing Mail (formerly Standard Mail) overall. The Postal Service now proposes to return to its pre-PAEA convention of applying the rule at the former Domestic Mail Classification Schedule "subclass" level, i.e., to USPS Marketing Mail Regular and USPS Marketing Mail Enhanced Carrier Route (ECR) separately.[1] Such an approach is consistent with the language of the statute, and will help alleviate an ongoing problem: a failure to reach 60 percent in the Nonprofit-to-Commercial average revenue per piece ratio, at the subclass level, due to a different mail mix between Nonprofit and Commercial. The focus of the instant filing is on the effects of this different mail mix, but *changes* in the mail mix can also have an effect on relative Nonprofit and Commercial prices. That issue is briefly addressed in an appendix. It has also been taken up in an interesting and thought-provoking way by the American Catalog Mailers Association in the past two Annual Compliance Reviews.[2]

[1] Regular comprises the Letters, Flats and Parcels products in the Mail Classification Schedule (MCS). Enhanced Carrier Route is a pre-PAEA classification comprising mail types that appear in the MCS today as High Density and Saturation Letters, High Density and Saturation Flats/Parcels, Carrier Route, and Every Door Direct Mail—Retail.

[2] See Docket No. ACR2015, Reply Comments of the American Catalog Mailers Association (February 12, 2016), at 10 - 13; and Docket No. ACR2016, Initial Comments of the American Catalog Mailers Association(February 2, 2017), at 3, in particular footnote 3.

BACKGROUND

Section 1(d) of Public Law 106-384, promulgated on October 27, 2000, and codified in 39 U.S. Code § 3626(a)(6)(A), stipulates for USPS Marketing Mail that the "average (Nonprofit) revenue per piece…….shall be equal, as nearly as practicable, to 60 percent of the estimated average revenue per piece to be received from the most closely corresponding regular-rate ***subclass*** of mail."[3] (Emphasis added.) Nevertheless, in Docket No. R2008-1, the Postal Service began applying the "60 percent rule" at the class level. This was because, pursuant to the PAEA, "subclasses" no longer were explicitly defined in the Mail Classification Schedule.[4]

The change had merit for its simplification, but, due to a different mail mix between Nonprofit and Commercial, had the unintended effect of giving relative price relief to Nonprofit mail. Specifically, Nonprofit is by a certain margin less concentrated in Enhanced Carrier Route than Commercial. As a result, Regular and Enhanced Carrier Route both have a lower Nonprofit-to-Commercial average revenue per piece ratio than USPS Marketing Mail overall.[5] This means that previously, when the Regular and

[3] The importance of the subclass designation was emphasized by the then Postal Rate Commission in Docket No. MC95-1: "The 'subclass issue' is paramount in this docket……and the function of mail classification is to create mail groupings which allow, and even help, the Postal Service to charge fair and equitable rates. The significant role of 'subclasses' has evolved through Commission decisions—they have become integral to ratemaking in accordance with the Act. Courts have confirmed that such classification distinctions exist for the purpose of ratemaking." Docket No. MC95-1, Postal Rate Commission, *Opinion and Recommended Decision*, January 26, 1996, at III-6 - III-7.

[4] See Docket No. R2008-1, *United States Postal Service Notice of Market-Dominant Price Adjustment*, February 11, 2008, at 24.

[5] In FY 2016, for example, the overall ratio was 59.2 percent, but the ratio was lower for both Regular, at 56.8 percent, and Enhanced Carrier Route, at 57.4 percent. This may seem a paradox. How can 56.8 percent and 57.4 percent combine (as a weighted average) to 59.2 percent? The answer is a different Regular versus Enhanced Carrier Route mail mix between Commercial and Nonprofit. Those mixes were, by volume, 65.1 percent Regular and 34.9 percent Enhanced Carrier Route for Commercial, and 85.9 percent Regular and 14.1 percent Enhanced Carrier Route for Nonprofit. Meanwhile, the Nonprofit-to-Commercial average revenue per piece ratio was $0.1409 ÷ $0.2479 = 56.8 percent for Regular, and $0.1165 ÷ $0.2029 = 57.4 percent for Enhanced Carrier Route. Solving for the class level: [(85.9% x $0.1409) + (14.1% x $0.1165)] ÷ [(65.1% x $0.2479) + (34.9% x $0.2029)] = 59.2 percent.

Enhanced Carrier Route ratios were both set at 60 percent, the overall ratio was above 60 percent. When the switch was made to setting the overall ratio at 60 percent, the two disaggregated (subclass) ratios were pushed below 60 percent.

Table 1 below offers a history of the Nonprofit-to-Commercial average revenue per piece ratio since FY 2000. Throughout the period, the Regular and Enhanced Carrier Route ratios, on their own, have been below the ratio for the class overall. This is because Nonprofit has by a certain margin been less concentrated in Enhanced Carrier Route than Commercial.

Table 1

USPS Marketing Mail
Nonprofit-to-Commercial Average Revenue per Piece Ratio History, FY 2000 to Docket No. R2017-1

	Regular	Enhanced Carrier Route	Total
FY 2000	61.6%	49.7%	63.6%
FY 2001	60.6%	53.5%	62.8%
FY 2002	59.1%	55.5%	63.2%
FY 2003	59.8%	55.2%	62.0%
FY 2004	60.2%	54.5%	62.2%
FY 2005	60.7%	55.7%	62.3%
FY 2006	60.0%	57.4%	62.4%
FY 2007	59.5%	58.7%	62.0%
FY 2008	58.3%	57.2%	60.7%
FY 2009	56.6%	58.7%	60.0%
FY 2010	57.7%	57.0%	60.5%
FY 2011	57.2%	56.8%	59.4%
FY 2012	56.0%	54.2%	58.2%
FY 2013	56.6%	56.4%	58.7%
FY 2014	57.2%	54.8%	59.0%
FY 2015	56.9%	56.9%	59.0%
FY 2016	56.8%	57.4%	59.2%
R2017-1	57.8%	56.0%	60.0%

Several rows in the table are highlighted. FY 2000 was the last full year before the 60 percent rule was implemented. FY 2003 was the first full year after implementation of the first omnibus rate case (Docket No. R2001-1) in which the 60 percent rule was applied. In that rate case, the Enhanced Carrier Route Nonprofit-to-Commercial average revenue per piece ratio was set at 59.9 percent.[6] Yet the ratio achieved only 55.2 percent in FY 2003 (and languished in the absence of a recalibrating rate case for several years afterwards). This appears to be due to a relative shift in Enhanced Carrier Route Nonprofit's mail mix to lower-priced downstream entry.[7]

FY 2007 was the last full year before the Postal Service switched from applying the 60 percent rule to Regular and Enhanced Carrier Route separately to applying it at the class level. What can explain Regular (59.5 percent) and Enhanced Carrier Route (58.7 percent) both coming in below 60 percent is that the last calibration of the 60 percent rule was on average 15 months earlier, on January 8, 2006, when Docket No. R2005-1 was implemented. Over that time period, changes in the mail mix produced some natural average revenue per piece drift.[8]

FY 2009 was the first full year after the Postal Service switched from applying the 60 percent rule to Regular and Enhanced Carrier Route separately to applying it at the class level. Consistent with this, the class-level ratio was 60.0 percent. However, a permanent shortfall versus 60 percent set in for Regular and Enhanced Carrier Route,

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[6] See Docket No. R2001-1, Direct Testimony of Laraine B. Hope on Behalf of the United States Postal Service, filed October 2, 2001, at 35.
[7] The base year in Docket No. R2001-1 was FY 2000. From FY 2000 to FY 2003, the origin-entry plus DNDC share of Nonprofit volume declined by 15.7 percentage points, from 40.9 percent to 25.3 percent. In contrast, for Commercial volume the decline was only 6.6 percentage points, from 22.2 percent to 15.6 percent. In both cases, and in approximately equal proportions, the shift was mainly to DSCF.
[8] The January 8, 2006 calibrations were slightly below 60 percent to begin with—59.7 percent for Regular and 59.8 percent for Enhanced Carrier Route. See Docket No. R2005-1, Postal Rate Commission, *Opinion and Recommended Decision*, at 129 - 130 and 141.

individually. The shortfall culminated most recently in a ratio of 57.8 percent for Regular and 56.0 percent for Carrier Route in Docket No. R2017-1.

PROPOSAL

The Postal Service proposes to return to its pre-PAEA (i.e., PRA) convention of applying Public Law 106-384's 60 percent rule to USPS Marketing Mail Regular and USPS Marketing Mail Enhanced Carrier Route separately. This is consistent with the language of the statute and is in accord with the pre-PAEA subclass definitions.

IMPACTS

Reestablishing the 60 percent rule's *status quo ante* would reverse the downward shift in the two subclass-level Nonprofit-to-Commercial average revenue per piece ratios that occurred when the Postal Service switched to applying the rule at the class level. Lifting Regular's ratio to 60 percent from Docket No. R2017-1's 57.8 percent would, on a revenue-neutral basis, require an average price change of +3.33 percent for Regular Nonprofit and -0.47 percent for Regular Commercial.[9] Lifting Enhanced Carrier Route's ratio to 60 percent from Docket No. R2017-1's 56.0 percent would, on a revenue-neutral basis, require an average price change of +6.94 percent for Enhanced Carrier Route Nonprofit and -0.27 percent for Enhanced Carrier Route Commercial.[10] To the extent that the +3.33 percent for Regular Nonprofit and especially the +6.94 percent for Enhanced Carrier Route Nonprofit could imply a certain amount of "rate shock," the Postal Service would aim to implement over more than one price-adjustment cycle, and submits that the resulting temporary shortfall from 60 percent (in either

[9] This reflects a split within Regular's Docket No. R2017-1 calculated revenue at new prices of 87.6 percent Commercial and 12.4 percent Nonprofit.
[10] This reflects a split within Enhanced Carrier Route's Docket No. R2017-1 calculated revenue at new prices of 96.2 percent Commercial and 3.8 percent Nonprofit.

subclass or both) could be justified with reference to the "as nearly as practicable" clause in Public Law 106-384.[11]

[11] Additionally, the +6.94 percent for Enhanced Carrier Route Nonprofit will only apply to 11.9 percent ($201 million) of Nonprofit's nearly $1.7 billion in total revenue.

APPENDIX: THE INFLUENCE OF CHANGES IN THE MAIL MIX ON RELATIVE NONPROFIT AND COMMERCIAL PRICES

In addition to the Postal Service's methodology change in FY 2008, other factors have come to bear on relative Nonprofit and Commercial prices. Importantly, the 60 percent rule stabilizes average revenue per piece, not prices—and average revenue per piece, prices and the mail mix can be said to form a *triad*: When average revenue per piece is fixed, as it is by the 60 percent rule, prices and the mail mix are forced to move oppositely. Consequently, relative Nonprofit and Competitive prices are swung by changes in the mail mix between the two. For example, since FY 2000, the flats and parcels share of Commercial volume has decreased by 15.7 percentage points (from 48.9 percent to 33.2 percent) while the same share for Nonprofit volume has decreased by only 4.9 percentage points (from 23.3 percent to 18.4 percent). All else being equal, this has required Nonprofit price restraint in order for the 60 percent average revenue per piece relationship with Commercial to be maintained—because for the most part flats and parcels are higher-priced categories than letters. This may help to explain the price trend in the dominant Automation 5-Digit DSCF Letters category.[12] Since Docket No. R2000-1, the last omnibus rate case in which the 60 percent rule was not applied, the Commercial piece-rated price has risen by 41.8 percent, from 15.3 cents to 21.7 cents, while its Nonprofit counterpart has risen by only 19.0 percent, from 8.4 cents to 10.0 cents.[13]

[12] The category accounts for 37 percent of all USPS Marketing Mail volume and an almost astounding 19 percent of all Postal Service volume.
[13] The Docket No. R2000-1 prices are as modified by the Postal Service's Governors on May 7, 2001, effective July 1, 2001.

On the other hand, there have been some differential mail-mix changes from FY 2000 to FY 2016 that, all else being equal, have required Commercial price restraint. As two examples, Nonprofit volume has shifted 1) more to relatively low-priced downstream entry, specifically DSCF, DFSS or DDU (+38.3 percentage points, versus +35.2 percentage points for Commercial), and 2) less to relatively high-priced Regular (+6.5 percentage points, versus +8.3 percentage points for Commercial).

In addition to differential mail-mix changes between Nonprofit and Commercial, parallel mail-mix movements between the two can also require adjustments to relative Nonprofit and Commercial prices (in order for the 60 percent average revenue per piece relationship between Nonprofit and Commercial to be maintained). Most notably, Nonprofit and Commercial have moved in virtual lockstep to Automation 5-Digit DSCF Letters. In FY 2000, the category accounted for 4.5 percent of all Nonprofit volume and 4.3 percent of all Commercial volume. By FY 2016, these shares had soared to 36.9 percent and 36.8 percent. Meanwhile, the category's Nonprofit-to-Commercial price ratio is only 46.1 percent.[14] Therefore, as Nonprofit and Commercial have moved in tandem to the category, the Nonprofit-to-Commercial average revenue per piece ratio has been pulled down (all else being equal). This has required Commercial price restraint in order for the 60 percent average revenue per piece relationship with Nonprofit to be maintained.

The attached Excel file *MMPrices16Years.xlsx* shows Nonprofit and Commercial price trends from the Public Law 106-384 baseline (Docket No. R2000-1) to the present (Docket No. R2017-1) for the major categories of USPS Marketing Mail—Table A-1 for

[14] The Nonprofit price is 10.0 cents per piece; the Commercial price is 21.7 cents per piece.

letters, Table A-2 for flats (with the Regular subset in Table A-2a and the Enhanced Carrier Route subset in Table A-2b), and Table A-3 for Marketing Parcels.