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

Notice of Market Dominant Price Adjustment	)))	**Docket No. R2018-1**

COMMENTS OF THE ASSOCIATION FOR POSTAL COMMERCE
(October 26, 2017)

Pursuant to Order No. 4153, the Association for Postal Commerce ("PostCom") respectfully submits the following comments concerning the Notice of Market Dominant Price Adjustment ("Notice")[1] filed by the Postal Service in Docket No. R2018-1 on October 6, 2017. While PostCom has not identified any instances in which the proposed prices violate the price cap limitation of the Postal Accountability and Enhancement Act, PostCom submits these comments to bring certain features of the price change to the Commission's attention, including one instance in which the Postal Service may have improperly calculated the price cap impact of a change to mailing standards. In addition, PostCom encourages the Commission to seriously consider the petition filed by the Chamber of Commerce to unseal inbound international mail and parcel rates for public review.

I. <u>5-DIGIT PALLET INCENTIVES</u>

The Postal Service is proposing to amend the Domestic Mail Manual with regard to the preparation of USPS Marketing Mail and Periodicals Carrier Route bundles on 5-Digit Carrier Route pallets in non-FSS zones. Notice at 30. USPS intends to reverse the current pallet preparation order such that mailers would prepare their volume on lower-priced pure Carrier Route pallets before having to resort to the 5-Digit merged pallets. *Id.* While PostCom intends

[1] Docket No. R2018-1, Notice of Market Dominant Price Adjustment (October 6, 2017).

to address these changes further in its comments on the proposed rule implementing this change, some aspects of this proposal are worth bringing to the Commission's attention.

The Postal Service states that this change is being made to increase the preparation of USPS Marketing Mail and Periodicals Carrier Route bundles on 5-Digit Carrier Route pallets in non-FSS zones, and that the change "will reduce mailers' postage by enabling them to access lower rates while creating operational cost savings for the Postal Service." Notice at 30.

At this time, PostCom does not have sufficient information to evaluate the impacts of this change. While PostCom understands the effort to modify mailing standards to encourage more efficient mail entry and appreciates that the change has the potential to reduce costs for some mailers, it is not clear that the incentive offered by additional Carrier Route pallets will be sufficient to induce the behavior the Postal Service is seeking.

If there are truly operational savings associated with this change of behavior, USPS should offer incentives tied to those cost savings to prepare the mail in this manner. Doing so is a more efficient way of changing behavior in that it is more likely to result in the preparation and entry of mail at lowest *total* cost (*i.e.*, combined costs of mailers and the Postal Service).

Focusing solely on changing mailer behavior through regulation to provide the Postal Service with operational efficiencies without providing price incentives tied to those cost savings is, in PostCom's view, a primary factor driving the Postal Service's inability to process Flats mail in a cost-effective manner. Perhaps the most notable example of this misguided strategy was the implementation of the 250 pound minimum pallet requirement in FSS zones. As PostCom has pointed out both formally and informally since the inception of the FSS categories, the cost of requiring mailers to prepare these pallets far outweighed any incentive provided by the Postal Service to enter this mail in FSS zones. To the extent such preparation requirements realize cost savings to the Postal Service, the Postal Service should concentrate on developing incentives that pass on those cost savings to mailers rather than attempting to drive change by regulatory fiat. For instance, the Postal Service could have retained the 500 pound pallet minimum but provided incentives for preparation of 250 pound pallets where doing so would realize cost savings for the Postal Service. Then, where the postage savings exceeded the additional cost of preparing those pallets, mailers would have voluntarily prepared 250 pound pallets, and both mailers and the Postal Service would have gained the benefit of those savings.

In the current case, the Postal Service has not provided any information regarding the operational cost savings it expects to realize from this change in mailing standards. The change may work to the benefit of both mailers and the Postal Service, but only experience will bear this out. If the Postal Service had instead focused on providing incentive rates tied to its optimal mail preparation, mailers could better evaluate the costs and benefits of changing their behavior.

II. WORKSHARE DISCOUNTS

The Postal Service continues to significantly reduce workshare passthroughs, and in doing so, it risks introducing serious unintended consequences, particularly with regard to drop entry. In addition, PostCom questions why the Postal Service has provided for such a significant variation in discounts for drop entry, seemingly without regard to actual avoided costs.

The Postal Service's avoided cost calculations and proposed drop entry discounts are at best curious. Avoided costs associated with drop entry are almost entirely determined by transportation; that is, the elimination of the cost of freight in shipping the pallet to the destination sectional center facility (DSCF) drives the avoided costs. And in fact, the entry discounts offered for different categories of mail were relatively close to each other through 2016. Beginning in 2017, however, entry discounts diverged—for instance, whereas the CR Basic SCF and Nonautomation-HD/Sat SCF discounts were identical in 2016 at $0.043, in 2017 they diverged significantly, with CR Basic moving to $0.038 and Nonautomation-HD/Sat moving to $0.054. This same divergence appears in the proposed 2018 rates and is in some cases more severe. The Postal Service has not articulated a reasonable justification for setting such greatly dissimilar entry discounts for these products. The Postal Service's proposed discounts would have it assess a materially different entry discount for each tray of a pallet depending on its contents. But the contents of each tray are irrelevant; it is the volume of weight being shipped that determines avoided costs. And given that a pallet is allowed to contain every postage rate, there is no reasonable justification to assess such widely different entry rate discounts.

Additionally, further decreasing dropship entry discounts will provide mailers with less incentive to enter mail at the DSCF, and more mail may be shifted to upstream. While this shift might appear to be rationally based on calculated cost avoidances, that conclusion ignores that there are limits to the Postal Service's ability to efficiently accept and process such mail. If sufficient volume moves upstream, the Postal Service will incur costs not currently reflected in the reported costs of mail entered at upstream points to handle this mail. Further, the entry discounts do not account for differences in service performance for mail entered at different levels. For some service-dependent mailers, moving mail upstream is simply not an option because the decline in service performance at earlier entry points is too great. If discounts continue to be reduced, raising the cost of SCF-entered mail, these mailers will not react to the new price signals by entering mail at the NDC. Instead, they will leave the mail entirely.

PostCom understands that the Commission has directed the Postal Service to reduce passthroughs associated with workshare discounts and that these directives are driving some of the disparities shown. But in evaluating the compliance of the workshare discounts contained in the Postal Service's filing, the Commission should mind these potential impacts as well as 39 U.S.C. § 3622(e)(2)(D), which allows discounts to exceed avoided costs where "reduction or elimination of the discount would impede the efficient operation of the Postal Service," and § 3622(e)(3)(A), which provides that a discount need not be reduced if doing so would "lead to a loss of volume in the affected category or subclass of mail" that would reduce that category's contribution to institutional costs below what it would have been had the discount not been reduced. Further, to the extent these disparities are driven by an attempt to match discounts to avoided costs, it appears that the avoided costs are not being measured correctly, since the same freight costs should be avoided for each of these products.

III. INTERNATIONAL PRODUCTS

A. Outbound Rate Changes:

The Postal Service also provides that while it is not changing prices for Outbound Single-Piece First-Class Mail International, it is making a change to mailing standards that will have the effect of changing prices for mail currently mailed at these rates. Notice at 10-11. The Postal Service intends to change the mailing standards in the International Mail Manual to prohibit goods from being included within First-Class Mail International pieces.[2] As the Postal Service recognizes, this change requires an adjustment to billing determinants. It is not clear, however, that the billing determinants associated with the 9.1 million pieces affected by the change should be reduced to zero, as the Postal Service proposes.

The question before the Commission is whether to treat this change as a deletion of a rate cell where there is no alternate rate cell available pursuant to Rule 3010.23(d)(4), as the Postal Service does, or whether it should be treated as a deletion or redefinition of a rate cell requiring

[2] The Postal Service states this change is the result of change in Universal Postal Union (UPU) regulations outside its control.

reasonable adjustments under Rules 3010.23(d)(2) and (d)(3). The Postal Service explains that there is no market dominant rate at which mail within this deleted cell can now be sent. It can, however, still be sent at competitive rates. The question is how to account for the rates this volume must now pay since it is no longer eligible for the rate it paid prior to the effective deletion of the rate cell.

As the Postal Service notes, in MC2015-8, the Commission stated, "if the deletion of a rate cell does have an alternative (even if that alternative exists on the competitive product list), rule 3010.23(d)(2) applies." Notice at 11 (citing Order No. 2322 at 10). The Postal Service, however, contends this statement is "dicta" because there were in fact market dominant alternatives in that case. *Id.* at 11. While the Postal Service claims that the Commission has since clarified this position in R2017-1 and confirmed in briefing to the D.C. Circuit that volume from the deleted rate cell should be excluded from price cap calculations in this situation, its reading of the Commission's statements is too expansive.

In its brief in Case No. 16-1412, the Commission specifically refers to a situation in which a market-dominant rate cell is deleted because the product in question has been shifted to the competitive side. Brief for the Postal Regulatory Commission at 23, *United States Postal Service v. Postal Regulatory Commission*, No. 16-1412 (D.C. Cir. May 5, 2017). In this situation, there is no need to account for the volume in market-dominant price cap calculations because the Commission has expressly determined that volume paying that rate is subject to competition that will prevent the Postal Service from raising rates on that volume to unreasonable levels. In the present situation, however, the Commission has made no such finding. This volume is being mailed at market-dominant rates, and the Postal Service has not demonstrated that it lacks market power over these volumes. Simply because the mail *could* be sent at competitive rates does not mean the Postal Service faces competition for the carriage of this particular type of mail. Because the Postal Service has made no showing that it lacks market power over the volume from the deleted rate cells, it must account for any increased rate this volume will pay after the deletion of the cell in its price cap calculations under Rule 3010.23(d)(2). To hold otherwise would be to allow a transfer of this volume to competitive classes of mail without the requisite finding of a lack of market power.

In Docket No. R2017-1, the Commission did note that the change in question pushed "mailers who seek to utilize [the discontinued service] from market dominant to competitive products." Order No. 3670 at 13. But in that proceeding, no adjustments could be made because the service had been eliminated in May of 2015 and no mailer was able to use the service during the year in question. *Id*. Thus, under the Postal Service's reasoning, the Commission statement that Rule 3010.23(d)(4) should apply in this situation is just as much dicta as its statement that Rule 3010.23(d)(2) should apply in docket MC2015-8. Moreover, the Commission expressed concern that pushing mailers seeking to use this service to competitive products "may change the composition of the market for the competitive products coupled" with the service, and it pledged to "monitor those affected markets and determine whether any action is required" pursuant to the product transfer provisions of 39 U.S.C. § 3642. Order No. 3670 at 13. Thus, the Commission recognized the potential that the deletion of the rate cell could result in a de facto transfer of products to the competitive products list. The Commission should, at a minimum, take an equally cautious approach in this docket.

B. Inbound Letter Post (UPU)

PostCom encourages the Commission to extend transparency to the Inbound Letter Post products that are a part of the Universal Postal Union (UPU). Last year, the Commission found that these inbound letter post products lost $134 million and that domestic mailers are subsidizing the entry of Inbound Letter Post. However, as the Inbound Letter Post rates have been filed under seal, PostCom and other concerned parties have little to no ability to provide input on the legality of these rates in determining the First-Class Mail cap compliance. As the Chamber of Commerce points out in its request to unseal these prices in this docket, the rates apply to products classified as market dominant. As such, the Commission should be wary of any claims that publicly releasing information related to those rates would cause the Postal Service competitive harm. Accordingly, PostCom urges the Commission to critically evaluate the Postal Service's claims that releasing this information would cause it competitive harm.

IV. <u>CONCLUSION</u>

Overall, PostCom has not identified any instances in which the proposed rates are unlawful. Further, PostCom commends the Postal Service for maintaining key rate relationships in the First-Class Presort Letters rate design, among others. The Postal Service increased the 5-Digit discount in the last price adjustment in response to comments filed by PostCom and others urging USPS to send more efficient pricing signals, and maintaining the stability of that key rate relationship is critical for many PostCom members.

On other matters, PostCom is skeptical that the proposed rule change in pallet preparation will drive the change in behavior and operational efficiencies that the Postal Service is seeking. If there are truly operational savings, USPS should offer clear price incentives to prepare the mail in this manner. Additionally, the Commission should request that USPS explain how its drop entry discounts reflect actual avoided costs and consider the unintended consequences of further disencentiveizing drop entry mail. Next, the Postal Service should also account for its change in mailing standards for First-Class Mail International pieces including goods with the mailpiece in its price cap calculations. These adjustments are equivalent to the deletion of a rate cell that causes the mail previously subject to the rate to be mailed at a higher (albeit competitive) rate.

As the Postal Service has not demonstrated that it lacks market power over the volume in this rate cell, it should account for this increase in its market dominant price cap calculations. Finally, the Commission should carefully consider whether Inbound Letter Post (UPU) rates should be made public, protecting these rates only if it determines that their release is likely to result in a definite competitive harm to the Postal Service.

Respectfully submitted,

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