

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

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POSTAL RATE AND FEE CHANGES, 2000

Docket No. R2000-1

NOTICE OF THE UNITED STATES POSTAL SERVICE
OF DECISION OF THE GOVERNORS

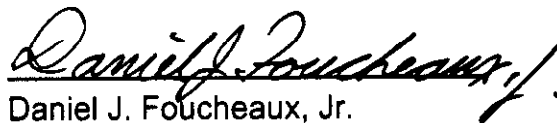
The following Decision of the Governors has been mailed to the service list in
Docket No. R2000-1:

Decision of the Governors of the United States Postal Service on the
Recommended Decision of the Postal Rate Commission on Selected
Mail Classification Matters, Docket No. R2000-1 (December 4, 2000)

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:



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**DECISION OF THE GOVERNORS OF THE UNITED STATES POSTAL SERVICE
ON THE RECOMMENDED DECISIONS OF THE POSTAL RATE COMMISSION
ON SELECTED MAIL CLASSIFICATION MATTERS, DOCKET NO. R2000-1**

December 4, 2000

STATEMENT OF EXPLANATION AND JUSTIFICATION

The Postal Rate Commission included in its Recommended Decision of November 13, 2000, four matters regarding mail classification which the Governors consider separately in this Decision. One concerns the establishment of a flat-rate envelope for Priority Mail at the one-pound weight increment. Two propose new classifications within First-Class Mail, one for a type of Information Based Indicia Program Mail (IBIP) and the other for Courtesy Envelope Mail (CEM). A fourth item regards the minimum weight for Standard A automation letter rates and the breakpoint. Our independent assessment and review lead us to exercise our statutory option to reject these recommendations. We discuss them below.

PRIORITY MAIL ONE-POUND FLAT RATE

Among the Priority Mail options provided to the public by the Postal Service is a flat-rate envelope, which many customers find convenient. All pay one fixed rate, without regard to weight. Under the existing mail classification schedule, in Domestic Mail Classification Schedule (DMCS) § 223.5, the applicable rate for flat-rate envelopes is set as the same as the rate specified for Priority Mail weighing not over two pounds. In the current case, the Postal Service requested adding a new rate for Priority Mail not over one pound, and did not propose a change in the link between flat-rate envelopes and the two-pound rate. The Recommended Decision, however, would revise the classification for flat-rate envelopes to apply the new rate for Priority Mail weighing not over one pound.

In previous rate cases, setting the flat rate equal to the price for mailing a pound would not have changed the applicable rate, since the rate for Priority Mail of any weight up to two pounds

historically has been the same. In the present case, however, with the establishment of a separate rate for pieces weighing one pound or less, moving the flat-rate price to that level would make the applicable flat rate \$3.50 rather than \$3.95.

This 45-cent differential in the rate could be expected to provide less revenue. Unfortunately, the extent of this revenue effect cannot be determined from the evidentiary record in this case, due to the way in which the proposal arose. No party sponsored this change with supporting cost, revenue, and volume information during the Commission's hearings. Instead, two participants first advanced the idea on brief, after the evidentiary record had been closed. Since the proposed classification was not supported by testimony, no party, including the Postal Service, was provided an adequate opportunity to test the validity of any assumptions upon which the proposal might rest, explore the revenue and volume consequences of the change, or provide rebuttal evidence.

In its Opinion, the Commission acknowledged the lack of scrutiny on the record, as well as the lack of an opportunity for the Postal Service and other participants to respond to the proposal except in limited arguments on brief. The Commission, nevertheless, was "sufficiently concerned about the fairness and equity of retaining the two-pound flat-envelope rate while recommending adoption of a new one-pound rate interval" that it felt compelled to recommend the disputed classification change over the Postal Service's objections. PRC Op. at 325. The Opinion justified this decision with conclusions about possible mailer reactions to the existing classification that were not founded on the record. The recommended decision also implicitly made a number of assumptions regarding potential revenue and cost effects without record foundation.

Classification and rate recommendations such as this one, which depend on extra-record analyses, present issues of due process, fundamental fairness, and lack of evidentiary support. It is undeniable that many of the key underlying conclusions lack a substantial basis in the evidentiary record of this case. Moreover, the Commission has acknowledged that the Postal Service and other parties did not receive an adequate opportunity to scrutinize and respond to the recommended reclassification during the proceeding.¹

¹ It has been well established that recommendations without record support are vulnerable to
(continued...)

We appreciate that parties legitimately may have wished to reconsider the link between flat-rate Priority Mail and the two-pound rate, once the Postal Service proposed a separate rate for pieces weighing one pound or less. Even if we concurred with the Commission's speculation regarding potential effects of the existing classification on some users of the flat-rate envelope, however, we would be reluctant to go forward at this time without an adequate evidentiary and procedural basis. Moreover, we are mindful that proponents of changes such as these should be encouraged to present their proposals in a timely manner in the context of the Commission's evidentiary hearings. The merits can then be tested by cross-examination and rebuttal testimony.

We conclude that the statutory standards for postal ratemaking and mail classification, including those of fairness and equity, are better served if a classification change having potentially significant revenue consequences, such as that at issue here, is first examined on the record, rather than emerging only after the record has been closed. We can have more confidence in a proposed classification change incorporated into a recommended decision when it has received a rigorous evidentiary evaluation by all sides. Under the circumstances, we exercise our option to reject the recommended change to the flat-rate envelope classification for Priority Mail.

FIRST-CLASS MAIL "SHELL CLASSIFICATION" PROPOSALS

The Commission has recommended the creation of two new classifications, one for a type of Information Based Indicia Program Mail (IBIP) and the other for Courtesy Envelope Mail (CEM). Before explaining the respective reasons for rejecting each recommendation, we will discuss some issues common to both.

IBIP enables mailers with a personal computer to obtain postage securely over the Internet and print postage indicia, or "PC Postage," directly on mail pieces. In what is called an "open"

(...continued)

reversal if legally challenged. *Mail Order Association v. United States Postal Service*, 2 F.3d 408, 420-22 (D.C. Cir. 1993).

configuration, Information Based Indicia software also allows the user to employ postal-certified "address cleansing" software to print delivery addresses, corresponding POSTNET barcodes, and Facing Identification Marks directly on the faces of the mail pieces or address labels. This address cleansing software is designed to ensure that, without exception, only addresses and corresponding barcodes recognizable by postal mail processing equipment databases are printed.

A second recommended classification again proposes that we approve Courtesy Envelope Mail (CEM), which would consist of single-piece First-Class Mail in preprinted, prebarcoded envelopes with postage stamps. These are the courtesy reply envelopes now often enclosed in billings sent by banks, utility companies, and other creditors to households and other customers for use in mailing their remittances back. The Governors have rejected essentially the same proposal on three previous occasions.

As it has in past cases, the Commission refrained from recommending a specific rate or discount from the basic First-Class Mail rate for the CEM classification, or for the new IBIP proposal. A grouping of mail identified for discrete rate treatment, but without its own distinct rate level recommended, has come to be known as a "shell classification." Thus, the IBIP classification language in the recommended decision, if approved by us, would create a shell classification, appearing as Domestic Mail Classification Schedule § 221.23. Likewise, the CEM classification language the Commission recommends, if approved, would create a shell classification, appearing as DMCS § 221.25.

One significant consequence of the Commission's decision to recommend shell classifications for IBIP and CEM is that it avoids complication of our consideration of the entire range of other Docket No. R2000-1 rate and classification recommendations presently before us. By refraining from making its other rate recommendations contingent upon our acceptance of a specific IBIP or CEM discount, with potential spill-over financial consequences for many other rate levels, the Commission has respected our right to review and evaluate the recommended PC Postage and CEM classifications on their own merits. We continue to find this approach worthwhile and commend the Commission for honoring our preference in this regard. Nevertheless, the

substantial questions raised on the record regarding discrete rate treatment for IBIP and CEM lead us to reject both recommended classification changes.

While shell classifications have no immediate rate consequences, we have stated in previous proceedings that we are reluctant to approve them unless satisfied that the record demonstrates the new classification is needed. Our observations on the shell classification recommendations in Docket No. R87-1 are applicable to almost any recommended shell classification. Our Decision noted:

The Act establishes an elaborate process for adding provisions to the mail classification schedule, and contemplates precisely the same process for removing them. If, in examining the rate question that the Commission postpones for the future, reliable data disclose that cost-based incentives ... are not justified, or if, for compelling reasons, the Postal Service finds that ... other operating policies must be adjusted to properly and efficiently serve customers, had we accepted the changes recommended here we would then be required under the Act to burden the Commission and the parties with additional proceedings to remove these changes. If upon that examination, reliable data disclose that additional rate incentives are warranted ..., the Act requires that additional proceedings be had before the Commission to establish those rate incentives; in that circumstance the task is not made more difficult if the classification schedule language emerges from those proceedings at that time.

Decision of the Governors on Commission's Recommended Decision on Mail Classification Changes, Docket No. R87-1, at 5 (May 2, 1988). In rejecting the shell classifications recommended in that proceeding, we concluded that "[u]ntil the questions posed can be answered with confidence, however, we believe the better practice is to leave the classification schedule silent on them." *Id.* at 6.

Information-Based Indicia Program Classification Proposal

PC Postage technology was introduced in August 1999. The private sector developers of Information Based Indicia and the postal managers who assisted them are to be commended for the development of technology enabling mailers to obtain and affix postage through their personal computers. Both the Postal Service and the mailing community benefit from the availability of yet another means of conveniently acquiring postage for use in mailing. We note

that the Postal Service has expressed its optimism about the role that products involving Information Based Indicia can play in improving the attractiveness of hard-copy mail and in better meeting the needs of customers. These are certainly worthwhile objectives for the Postal Service and tools that promote them merit consideration. At the same time, there are a variety of issues relating to providing a shell classification, particularly on the current record.

The classification proposal before us concerns only the "open" IBIP system which, in addition to affixing Internet-based postage, uses additional software designed to ensure correct addresses and readable barcodes. The postage acquisition feature of IBIP is not at issue in today's decision. Thus, the basis for any potential IBIP rate differential would not include the method by which mail pieces obtain their postage indicia. Instead, consistent with long-standing postal ratemaking principles, a proposed discount would rest on the potential to avoid certain mail processing operations and associated costs as a result of superior mail preparation with higher quality addressing.²

The record in Docket No. R2000-1 shows that PC Postage mail volumes are far from approaching the volumes projected by IBIP discount proponents. This may be due to the novelty of the technology. The evidentiary record reveals some disagreement even among proponents of a rate discount about whether a discount is vital to the long-term potential growth of IBIP.

In this docket the Commission was presented with two different IBIP discount proposals, including one for mail pieces on which the address and barcode could be printed on a mailing label that would eventually be affixed to the mail piece. We note that the recommended decision limited its proposal to envelopes onto which the address and barcode are directly printed, in recognition of Postal Service concerns about the impact of skewed placement of labels on mail pieces which, at this early stage, appears to be a problem.

² We observe that the Commission, in a determination with which we concur, declined to recommend a different Docket No. R2000-1 proposal for the establishment of a discounted First-Class Mail rate category based solely upon the use of postage metering technology to affix postage in lieu of postage stamps.

The evidentiary record reveals some uncertainty about the potential unit cost savings, even for mail pieces on which addresses and barcodes are printed directly on a mail piece via IBIP software. This uncertainty appears related to the type or mix of mail that converts to IBIP. The source of such conversions would serve as the benchmark for measuring cost avoidance. Added uncertainty about cost avoidance stems from the fact that postal mail processing operations presently are not configured to capture potential mail processing cost savings associated with "open" system IBIP.

The Commission posits that current IBIP, even at the present low volume, would provide the Postal Service with an opportunity, in the form of a shell classification, to "develop, test, and experiment with different mail flows." Postal Service witnesses presented testimony opposing this classification. We believe it is critical, in considering proposed classifications and discounts, to know what operational changes would need to be made and whether they would be appropriate in the foreseeable future, taking into account a credible projection of IBIP volume, an accurate assessment of IBIP mail flows, and potential changes in postal mail processing technology that may affect the First-Class Mail stream as a whole. Accordingly, we prefer that the recommended IBIP mail classification not be established at this time.

Courtesy Envelope Mail

This is the fourth proceeding in which the Commission has recommended the establishment of a shell classification for Courtesy Envelope Mail (CEM). As described above CEM would consist of single-piece First-Class Mail in preprinted, prebarcoded envelopes on which postage stamps must be affixed. The Commission describes its recommended CEM and IBIP classifications as "different species in the same genus." PRC Op. at 258. Although the two recommended classifications have similarities, their material differences warrant our separate consideration. Even though our ultimate conclusion is that both should be rejected, we reach that result for reasons unique to each recommendation.

The Commission's Opinion acknowledges that, in all material respects, the CEM shell classification recommendation in Docket No. R2000-1 is identical to the one we rejected in our June 28, 1998, Decision in Docket No. R97-1. Upon consideration of the present record, we find

no basis to depart from the conclusion we reached in Docket No. R97-1, or in Docket Nos. MC95-1, and R87-1, when we considered similar CEM recommendations.

As in Docket No. R97-1, we do not find that the Qualified Business Reply Mail (QBRM) rate category within First-Class Mail, which we accepted in that case, warrants approval of the CEM shell classification recommendation. As we observed in our Decision rejecting the R97-1 CEM proposal, the primary feature distinguishing CEM from the QBRM category would be the necessity for the sender of a CEM piece to affix First-Class Mail postage at a discounted rate before entering it into the mail stream. In contrast, QBRM discount postage is paid on each piece by the recipient as a condition of delivery. Since the postage on QBRM does not have to be prepaid by the sender and is deducted from an advance deposit account established by the recipient, QBRM does not create the need for a second basic First-Class Mail postage stamp for use by the general mailing public, with the associated administrative and enforcement needs. Our decision to approve QBRM substantially depended on the fact that QBRM does not involve the very significant administrative and enforcement concerns that discourage us from approving CEM.

In the CEM context, we remain unpersuaded that sufficient justification has been shown to single out courtesy reply envelopes from the highly diverse First-Class Mail stream for separate rate treatment. We continue to be concerned by evidence regarding CEM problems as presented by witnesses with actual experience in matters of postal operations and customer relations. As in earlier cases involving CEM, the record in this docket includes explanation of the administrative and enforcement complications and costs associated with the establishment of a "two stamp" system with a second basic First-Class Mail stamp for CEM, alongside the one for other letter mail. We remain unsatisfied in this docket that these concerns have been given sufficient weight. The Opinion accompanying the recommended decision explains that the ratio of postage underpayment to overpayment for single-piece First-Class Mail currently is too small to suggest that administrative and enforcement factors should be controlling. Postal operations experts have testified that a "two-stamp" environment substantially raises the level of concern, and we agree.

A perceived advantage of CEM is to invite a broader base of First-Class Mail users to participate more directly in the benefits of automation, by passing some automation cost savings through to household and other remittance mailers. Our R97-1 Decision rejecting CEM gave considerable weight to the record evidence regarding the preferences of household mailers. That evidence led us to conclude that a substantial majority prefer coping with one First-Class Mail rate and one stamp for household letters instead of two rates and two stamps. The same point is made in the record of the current docket. We continue to find that this research undercuts the case for CEM discounts.

In our Decisions to approve Qualified Business Reply Mail and to reject Courtesy Envelope Mail and Prepaid Reply Mail in Docket No. 97-1, we asked postal management, in its further review of QBRM, to explore whether there are ways to encourage more widespread use of prebarcoded automation-compatible reply letters and cards with discounts. In the present docket, the Postal Service proposed to de-average QBRM per-piece fees, in a manner more closely aligning the fees with costs. In response, the recommended decision includes an accounting fee structure for QBRM that should lower the total accounting costs for a significant portion of that mail stream, making it a more attractive medium of communication. In our primary Decision today, we allow the recommended fee structure to take effect. The recommended fees are based upon conclusions concerning the mix of accounting practices employed for high-volume QBRM. These conclusions merit further examination and cost analysis by the Postal Service. We will encourage postal management to continue searching for ways to increase the attraction of QBRM for postal customers. We reiterate our expectation that if reduced QBRM postage and fees can lower our customers' cost of conducting transactions with their customers, without posing unnecessary administrative challenges for the Postal Service, then regardless of whether the savings directly redound to the sender or to the recipient of the mail, the Postal Service can benefit, as its services remain an attractive alternative to competitive technologies. We observe that the combined rate and per-piece fee that we allow under protest for high-volume QBRM is now below the rate for basic First-Class Mail. We expect postal management to observe the implications of this development for both postal and QBRM recipient operations.

LETTER SIZE STANDARD MAIL AUTOMATION WEIGHT LIMIT FOR LETTERS AND THE BREAKPOINT

The Postal Service offers automation rates for bulk mailers of Standard Mail that recognize cost savings from cheaper handling. The weight limit for automation letters, currently 3.3 ounces, is not specified in the rate or classification schedules.

Postal Service direct testimony in this docket noted that it anticipated a future change in the weight limit for automation letters in current mail processing operations from 3.3 to 3.5 ounces. Based on its current understanding that this change would have a *de minimus* impact on costs and revenues, the Postal Service assumed no such effects in designing rates, and no separate rate was proposed for automation letters in the 3.3. to 3.5 ounce range. No party objected to the possibility of this change. The Commission's Opinion, however, specifically recommended limiting the eligibility for the minimum per piece rates for automation letters to 3.3 ounces or less. Schedule 321B, Note 2. The Opinion acknowledged that there is no reason to expect that "letters or flats slightly above the breakpoint have significantly different characteristics than letters or flats slightly below the breakpoint," and that the breakpoint itself is essentially arbitrary. PRC Op. at 345. The Opinion stated, however, that a single dividing line is fair, and objected to a different maximum for certain Standard mailers absent a more comprehensive assessment. We respect the Commission's position regarding the fairness of a single weight limit and note that the Postal Service does not intend to proceed with the administrative extension to 3.5 ounces for automation letters suggested in the Postal Service's direct testimony. We do think, nevertheless, that the recommendation has a classification effect that was not explicitly addressed or supported on the record. Accordingly, as a classification matter, we are rejecting the recommendation insofar as it would establish in the rate schedules a specific weight limit for automation letters.

The Commission inserted a 3.3 ounce breakpoint weight in the rate schedules. The existing rate schedules do not indicate an explicit breakpoint weight for purposes of applying the minimum per piece rates. While Postal Service testimony anticipated using a rounded 3.3 breakpoint for all Standard Mail with the implementation of new rates, no participant proposed changing the rate schedules in this respect. Although we do not believe there is fundamental disagreement between the Commission's and the Postal Service's views on this issue, we do think that the

recommendation has a classification effect that was not explicitly addressed or supported on the record. Accordingly, as a classification matter, we are rejecting the recommendation insofar as it would establish in the rate schedules a specific breakpoint for Standard Mail rates. We appreciate the Commission's desire for clarity regarding the breakpoint, and intend that the rate tables and supporting information promulgated by the Postal Service will clearly denote 3.3 ounces as the breakpoint.

ESTIMATE OF ANTICIPATED REVENUE

The Postal Reorganization Act requires that our Decision include an estimate of the estimated revenue impact. 39 U.S.C. § 3625(e). In this Decision, we are rejecting four recommended classification changes. Even if we had accepted all of them, however, the IBIP Mail and CEM categories would not have had revenue consequences as they were recommended as "shell" classifications. We estimate that our rejection of the recommendation to set the flat envelope rate for Priority Mail at the one pound rate has the effect of increasing test year revenues by approximately \$55 million. We estimate that our rejection relating to certain Standard Mail Rate Schedule notes has no appreciable revenue consequence for the test year.

ORDER

In accordance with the foregoing Decision of the Governors, recommended changes in the application of the one-pound rate to the flat rate envelope in Priority Mail, in Rate Schedule 223 and DMCS § 223.5 of the Domestic Mail Classification Schedule, are rejected, as are any corresponding cross-references to that recommendation. Changes in the Domestic Mail Classification Schedule to include new sections recommended by the Commission on November 13, 2000, to appear as DMCS §§ 221.23, 221.25 are rejected, as are any corresponding cross-references to those sections. Provisions in the notes to Rate Schedules 321A through 324 are rejected insofar as they would establish a specific breakpoint for Standard Mail rates and a specific weight limit for automation letters.

The foregoing was adopted by the Governors on December 4, 2000.

By The Governors:

A handwritten signature in black ink, appearing to read "L. B. Hays", is written over a horizontal line.

Chairman