

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

POSTAL RATE AND FEE CHANGES

Docket No. R2006-1

INITIAL COMMENTS OF THE UNITED STATES POSTAL SERVICE
ON RECONSIDERATION OF RATES FOR STANDARD MAIL
(May 4, 2007)

On February 26, 2007, the Commission issued its first Opinion and Recommended Decision in this proceeding. On March 19, 2007, the Governors of the Postal Service issued their Decision in response, allowing the recommended decision to take effect under protest, and returning three matters to the Commission for reconsideration.¹ On March 28, 2007, the Postal Service filed its Initial Statement on Reconsideration, which included some suggestions on Standard Mail letters and flats, one of the matters returned for reconsideration.² On April 27, 2007, the Commission issued its Opinion and Recommended Decision On Reconsideration regarding the other two matters.³ Also on April 27, the Commission issued Order No. 13, which made certain procedural rulings and established a schedule for reconsideration of the issues

¹ Decision of the Governors of the United States Postal Service on the Opinion and Recommended Decision of the Postal Regulatory Commission on Changes in Postal Rates and Fees, Docket No. R2006-1 (March 19, 2007) (“Decision”).

² Initial Statement of the United States Postal Service on Reconsideration, Docket No. R2006-1 (March 28, 2007)(Initial Statement).

³ Opinion and Recommended Decision on Reconsideration, Docket No. R2006-1 (April 27, 2007).

relating to the rates for Standard Mail flats and letters.⁴ Pursuant to Order No. 13, the Postal Service hereby provides initial comments responding to the specific inquiries posed by that Order.

In Order No. 13, the Commission posed the following inquiry:

In filing comments and reply comments on the reconsideration of Standard Mail flats, the participants are invited to comment on the following:

1. Ordinarily, postal rates are viewed as a zero sum situation. That is, if certain rates are reduced, other rates must increase to offset the loss in revenue. If the Commission were to decide that certain Standard Mail flats rates were too high and that adjustments were necessary, specifically,
 - a. which particular rate cells should be reduced, by how much, and why;
 - b. which particular rate cells should be increased, by how much, and why.
2. If rebalancing among flats rate cells only is appropriate, specifically,
 - a. which particular flats rate cells should be reduced, by how much, and why;
 - b. which particular flats rate cells should be increased, by how much and why;
 - c. should the Commission adjust the flats pound rate, by how much, and why.

In returning this matter to the Commission for reconsideration, the Governors were principally concerned with the effect of some of the Commission's recommendations on the catalog industry. In their Decision, the Governors noted that the Postal Service's initial proposals for these rates appropriately balanced concerns about the impact of rate increases with efficiency considerations and the long-term

⁴ Order (1) Granting Coalition of Catalog Mailers' Motion for Late Intervention, (2) Denying Coalition of Catalog Mailers' Motion to Reopen the Record, and (3) Establishing Procedural Schedule, Order No. 13, Docket No. R2006-1 (April 27, 2007) (Order No. 13).

health of the catalog industry. Decision at 9. Concurrently, the Governors acknowledged the Commission's judgment regarding the rate design and other principles influencing the recommended rates. *Id.* at 9-11. Furthermore, while the Governors' Decision implied preference for the Postal Service's solution to the rate design, it did not reject the Commission's solution entirely. Rather, the Governors suggested that reconsideration would benefit from giving members of the catalog industry an opportunity to comment on the record evidence that might support more moderate increases. With regard to the specific rates recommended, the Governors stated:

[B]ased on the concerns we have expressed above, particularly regarding the vitality of the catalog industry to the economy as a whole, and the uncertainty inherent in rate increases of the magnitude recommended, we ask the Commission to reconsider whether some rebalancing between Standard Mail letter and flat rates might be appropriate, and we urge the Commission to use the opportunity to mitigate the recommended increases for catalog and other flat mailers. Returning the matter for reconsideration might also allow individual mailers and heir associations to address any unique problems created by the Commission's recommendations.

Id. at 12.

In Order No. 13, the Commission declined to reopen the record to receive new evidence bearing on these issues. It emphasized, however, that the Coalition of Catalog Mailers (CCM) and other interested parties would have the opportunity to present arguments based on the existing record regarding the impact of the recommended rates. Order No. 13, at 11. The Postal Service is confident that CCM, as well as other parties, will be able to argue for more moderate increases and will be able

to point to record evidence supporting those results. At the same time, the Postal Service readily acknowledges the opposition to this approach evident in pleadings filed by Valpak⁵ and the Financial Service's Rountable, Major Mailers Association, National Association of Presort Mailers, and National Postal Policy Council (FSR, et al.)⁶ It fully understands that, in postal economics, rate impacts can be a two-way street under an established revenue requirement.⁷ In this regard, the opponents of rebalancing will have the same opportunity as CCM to demonstrate how the existing record would support not rebalancing, in light of CCM's arguments.

In these comments, the Postal Service's primary goal is to illustrate what changes might be made to reconcile the Governors' concerns with the Commission's recommendations, keeping in mind the impact on all mailers and on the Postal Service's financial needs. While the balancing of competing considerations in this instance is not necessarily an easy task, it does lend itself to a relatively simplistic approach that limits

⁵ Valpak Direct Marketing Services, Inc., and Valpak Dealers Association, Inc., Opposition to Late Intervention by Coalition of Catalog Mailers, Docket No. R2006-1 (April 13, 2007); Valpak Direct Marketing Services, Inc., and Valpak Dealers Association, Inc., Opposition to Motion to Reopen and Supplement the Record by Coalition of Catalog Mailers, Docket No. R2006-1 (April 19, 2007).

⁶ Response of Financial Services Rountable, Major Mailers Association, National Association of Presort Mailers, and National Postal Policy Council to Motion of Coalition of Catalog Mailers to Reopen the Record, Docket No. R2006-1 (April 19, 2007).

⁷ As the Commission noted in Order No. 13, "[o]rdinarily, postal rates are viewed as a zero sum situation." Order No. 13 at 12. In this regard, the Postal Service notes that it has been suggested that moderation of rate increases affecting catalog mailers, as suggested by the Governors, could be accomplished, if the Commission were to "reasonably assume that with a lower Standard flat rate and higher volume levels, the same amount of revenue would be generated." Letter from James R. O'Brien, Time, Inc., to Postal Regulatory Commission (April 11, 2007). The Postal Service, however, does not believe that such an assumption or adjustment would be supported by the

the changes to the rate relationships that the Governors suggested would be appropriate for modification. The approach, furthermore, is guided by certain technical and policy factors that the Postal Service believes should be respected in an attempt to rebalance.

Foremost among these considerations, the Postal Service, in its Initial Statement, identified two objectives that should not be impaired by any adjustments:

1. Ensure that the revised Regular/Nonprofit Regular 5-digit Automation Letters prices remain below the Basic ECR/NECR letters prices to continue our longstanding mutual efforts to support the letters automation program, and
2. Retain, for Regular and Nonprofit Regular letters and flats rates, drop-ship discounts as recommended. Differing drop-ship discounts for letters and flats in the Regular/Nonprofit Regular and ECR/NECR subclasses could potentially lead to disruptive rate relationships and send confusing and/or anomalous signals to mailers.⁸

In addition to these constraints, the Postal Service does not take issue with the Commission's recommendations and believes that a reasonable rebalancing could maintain the presort incentives recommended by the Commission, and not introduce anomalous rate relationships. The Commission was substantially guided in its rate design by its strong preference for applying the Efficient Component Pricing (ECP) principle to develop worksharing discounts.⁹ While the Postal Service does not necessarily agree with the Commission's application of ECP in all of its rate design choices in the area being reconsidered, it respects those judgments in the original

evidentiary record in this proceeding.

⁸ Initial Statement, at 10-11.

⁹ See PRC Op. R2006-1, Vol 1, at 81-91 (Feb. 26, 2007).

recommendations, and will understand if the Commission does not attempt to adjust the automation, presort, and drop-ship discounts recommended.

At the same time, the illustration provided here somewhat reconciles one major difference in views regarding application of ECP. In this regard, the Commission applied ECP in some instances believed to be inappropriate for strict adherence to the principle. In particular, the Commission followed the ECP approach in passing through cost differences between letters and flats that are not shown to be related to conventional worksharing activities. Several parties, however, including the Postal Service, expressed the view that ECP does not apply to these relationships, either as a matter of theory or for practical reasons.¹⁰ The illustrative rebalancing presented in these comments conforms to those views by limiting the adjustments to the letter-flat differential, and steering clear of affecting the application of ECP in the design of the automation, presort and drop-ship discounts that the Commission recommended.

The rebalancing illustrated here also maintains the Commission's recommended pound rate for flats. In its original pricing proposal in this docket, the Postal Service proposed higher pound rates for Standard Mail Regular and Nonprofit Regular parcels and Not Flat-Machinable (NFM) pieces than for flats. In his testimony, Postal Service witness Kiefer explained that, in the past, higher pound rates for nonletters were designed to recover more revenue from heavier parcels, and that, with the de-averaging of nonletters, it was appropriate to slightly reduce the pound rate for flats.¹¹ The

¹⁰ *Id.* at 86-87.

¹¹ USPS-T-36 at 16.

Commission did not accept higher pound rates for parcels and NFMs, and it recommended the same pound rate for all nonletters.¹²

Accordingly, the Postal Service here submits an approach to rebalancing the rate changes between letters and flats that would achieve the objective of moderating the rate increases affecting catalog mailers, while keeping intact most other features of the Commission's rate design. Under this approach, the following adjustments would be made:¹³

1. Reduce the price for minimum-per-piece rated pieces and the piece rate for piece-and-pound rated flats by \$0.03 per piece.
2. Raise the price for automation and nonautomation machinable letters by \$0.007 per piece.

These adjustments would be approximately revenue-neutral.¹⁴ A similar, but proportionately reduced set of adjustments could be made to Standard Mail Nonprofit Regular pricing. Alternatively, since the statutory relationship between nonprofit and commercial pricing is applied at the subclass level, and the adjustments in 1 and 2, above, would not change subclass revenue per piece, the Commission could maintain the required pricing relationship without adjusting Nonprofit Regular pricing, if it so

¹² PRC Op. R2006-1, vol 1, at 258. In fact, the Commission specifically cited the lack of record evidence on difference in costs by shape for heavier weight pieces as a reason to decline to differentiate the pound rate by shape.

¹³ We have refrained from attaching rate charts showing the specific rate adjustments, since the rebalancing would be applied uniformly across all rate cells.

¹⁴ In light of the "zero sum" approach described in Order No. 13, and reflected in the adjustments outlined above, the overall revenue impact should be very low. If the Commission decides to rebalance, the Postal Service expects it to calculate the precise revenue effect, depending on the rate design employed.

decided.

The adjustment for letters would also specifically exclude nonmachinable letters. Under the Commission's recommended pricing, nonmachinable letters were already slated to receive increases that, in some instances, exceeded the flats price increases for which rate relief is being sought in this reconsideration request. While the Postal Service is aware that the increases for nonmachinable letters are largely the result of a necessary de-averaging of nonautomation letter prices, it notes that the Commission recommended rates that in many cases exceeded the already substantial increases proposed by the Postal Service. In this regard, the Postal Service does not believe that nonmachinable letter mailers should receive even further increases, if a reasonable rebalancing granting rate relief for flats can be otherwise achieved. Also, excluding nonmachinable letters would not affect the presort and automation price relationships originally recommended by the Commission.

While the Postal Service acknowledges that many rate designs could achieve the goal of providing rate relief to Standard Mail flats mailers, the foregoing example is practical for the following reasons:

- It is simple: Flats would receive a 3 cent reduction in price; letters (except for nonmachinable letters) would go up in price by 0.7 cents.
- It would provide reasonable rate relief to catalog mailers without excessive increases for other mailers.
- It would be approximately revenue neutral.
- It would adhere to the reasonable guidelines for rebalancing described above: it would maintain the Commission's worksharing discounts; it would maintain the rate for 5-digit Automation letters below the rate for ECR Basic letters; and it

would preserve the unity of the pound rate among all Regular nonletter rate categories.

In Order No. 13, the Commission sought input on an approach that would limit rebalancing to flats rate categories and not affect letter rates. For several reasons, the Postal Service considers this to be a less viable, and unacceptable alternative. Confining rebalancing to flats, although within the Commission's authority to recommend, would be inconsistent with the Governors' suggested approach. It would also have several serious flaws.

First, because almost all flats volume is heavily presorted, no meaningful rate relief could be achieved for most of the mail without further raising the prices on some catalogs. The only other way to achieve flats-only rebalancing would be to offset some of the price increases for lighter-weight pieces with higher rates for heavier-weight pieces. As discussed above, raising the pound rate would introduce an odd situation where the pound rate for flats would be above the pound rate for parcels and NFM pieces. This result would also conflict with the Commission's rejection of the Postal Service's proposal to have different shape-based pound rates, and to recommend specifically a unified pound rate for all nonletters.¹⁵ Increasing the pound rate above the pound rate for parcels and NFMs would also be inconsistent with the Commission's views regarding lowering the pound rate for Enhanced Carrier Route (ECR) flats.

Finally, raising the prices for heavier-weight flats would not respond to the Governors' concerns which led to the reconsideration request. Many heavier weight

¹⁵ *Id.*

flats are, in fact, catalogs. Mechanically, confining adjustments within the flat rate design could be made. Such adjustments, however, would present new complications, since so much of the volume of flats falls into two categories: 3- and 5-digit automation flats. Adjusting these categories downward would create significant increases in other flat categories, and would necessarily change the rate relationships based on presort and automation that were recommended by the Commission. While the Commission may decide to revisit these recommendations, these comments do not attempt to illustrate any such adjustments.

The adjustments outlined above would address the Governors' principal concerns and would be supported on the record. Predictably, the moderation of the rate increases experienced by catalog and other flats mailers will not go far enough for some, while further increases for letter mailers will give rise to vigorous opposition. In this regard, the Postal Service is confident that the Commission will fairly balance the competing considerations embodied in the parties' arguments.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorney:

Daniel J. Foucheaux, Jr.
Chief Counsel

(202) 268-2989; Fax -5402
May 4, 2007

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon all participants of record in this proceeding in accordance with section 12 of the Rules of Practice.

Daniel J. Foucheaux, Jr.

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2989; Fax -5402
May 4, 2007