

Before the
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Regulations Establishing System) Docket No. RM2007-1
of Ratemaking)

OFFICE OF THE CONSUMER ADVOCATE
REPLY TO UNITED STATES POSTAL SERVICE SUBMISSION
OF PROPOSED INITIAL MAIL CLASSIFICATION SCHEDULE
(October 9, 2007)

INTRODUCTION

The Office of the Consumer Advocate (“OCA”) hereby replies to the United States Postal Service’s submission pursuant to Commission Order No. 26 of its proposed initial Mail Classification Schedule (“MCS”).¹

OCA’s previous comments filed in response to the Commission’s proposed rules pointed out a potential gap in those rules.² As drafted, the rules would allow the Postal Service, without submitting changes to its product list, to modify product descriptions in ways that would have significant impacts on service to customers upon only 15 days advance notice and without opportunity for comment or other customer input or protective procedures. (OCA Comments at 15-17.) This is because the proposed rules (Part 3020, Subparts B and E) provide for only two types of alterations to product lists:

¹ “Order Proposing Regulations to Establish a System of Ratemaking,” Order No. 26, August 15, 2007, at 100.

² “Office of the Consumer Advocate Comments in Response to Order No. 26 Proposing Regulations to Establish a System of Ratemaking,” September 24, 2007.

either a change in the product list itself by adding, deleting or moving a *product* from the list (§3020.30 *et seq.*) or, alternatively, by updating the description of products by “correction.” (§3020.90 *et seq.*) As explained by the Commission, the rules do not provide for intermediate types of modifications to the product descriptions. For instance, intermediate-type changes could relate to changes in eligibility, mail preparation or entry requirements, all characteristics within the current DMCS description of products. A strict reading of the proposed rules and the Commission’s explanation of their meaning would seem to permit the elimination of an entire price category or categories without adequate protective procedures. The rules could also permit the elimination of presort levels within each of the products as proposed by the Postal Service—again with only limited notice.

As OCA noted in its earlier comments, Order No. 26 recognized some of these potential difficulties: “A proposed update may not change the nature of a service to such an extent that it effectively creates a new *product* or eliminates an existing *product*. This subpart is not intended for such changes.”(Emphasis supplied, Order No. 26 at 97, para 4041.) However, while the Commission would not allow an update to eliminate an “existing *product*” (emphasis supplied), the Commission did not discuss the procedure if the Postal Service proposes an update that would eliminate a *segment or segments* of a product such as a price category or entry level. The procedures applicable to major modifications of eligibility and mail preparation standards are also not clear from the rules or the Commission’s explanation.

THE PROPOSED MCS PRODUCT LIST MUST MORE FULLY ACCOUNT FOR
DISTINCT MARKET AND COST CHARACTERISTICS

The Postal Service has explained that the proposed MCS, for now, is not intended to make any substantive change in the eligibility, mail preparation and entry requirements: “Moreover, the DMM and IMM remain in full force and effect.”³ However, the Postal Service acknowledges that future changes will be made pursuant to the “proposed rules regarding product identification and categorization changes (i.e. §3642 changes), size and weight changes, and product description changes (noting changes would be noticed in the Postal Bulletin or in the Federal Register).⁴ It would, of course, be appropriate for the Postal Service to follow the Commission’s rules regarding changes to the product lists and descriptions. But, as noted above, the proposed rules do not establish procedures for many types of potential changes within the individual products proposed by the Postal Service. Many changes could clearly have substantial substantive impact on all types of mailers without those mailers having opportunity for timely recourse.

The Commission has pointed to the availability of the complaint process as a check to prevent abuses, allowing for flexibility to the Postal Service and after-the-fact review. However, the proposed rules would apparently allow the elimination of price categories, entry levels or presort categories on a short 15 days advance notice

³ MCS Submission, at 3-4. “Moreover, the DMM and IMM remain in full force and effect.”

⁴ *Id.* at 4.

(§3020.91), as often as the Postal Service chooses and at irregular dates and times with limited Commission review (§3020.92) and without provision for customer input.⁵ Neither the complaint procedure, nor the annual review process, provides adequate timely intervention where the impact on customers is immediate and substantial.

This gap in the proposed rules is exacerbated by the Postal Service's proposed product list for market-dominant products. The proposed MCS list of products fails to conform to the language of the PAEA as interpreted by the Commission regarding the definition of a product. The relatively short product list in the proposed MCS does not set forth as separate products those postal services which exhibit either a distinct cost or market-characteristic. The Postal Service list of products is too compact. Rather, it bundles groups of services that serve more than one market and often several markets representing services with more than one distinct cost, all as readily evidenced by the separate cost analyses in omnibus rate proceedings.

The product list is so narrow that it does not even separate products at the subclass level. The Commission expressly declared in Order No. 26 that a product list that represents merely subclass levels "forfeits transparency and serves no legitimate business or regulatory need. Stated differently, it will not provide for accountability, a bedrock principle underlying the PAEA." (Order No. 26 at 78, para. 3070.) Thus, the proposed MCS must be recast to include more products that reflect services exhibiting either a distinct cost or market characteristic as specifically provided for in the PAEA.

By establishing a limited and amalgamated product list, the Postal Service would be able to eliminate entire segments of its proposed products, without eliminating the

⁵ The proposed rules provide for notice and comment for updates to size and weight limitations (3020.111) but not for other product description modifications.

entire product. If an entire product were proposed for elimination, the Commission's proposed rules would require a notice and comment with the potential for further proceedings (§3020.53-56). In actuality, segments of the proposed products have distinct market or cost characteristics warranting procedural protections of timely notice, comment, and other processes.

The Postal Service's submission explains its approach to developing the MCS, but it does not justify the final result.

In developing this list, the Postal Service has endeavored to follow the principles enunciated by the Commission in its Order, by segmenting its market-dominant postal services into "products" based on business realities, while also providing an appropriate level of transparency and accountability. The designation of the market-dominant products was based on two main criteria: 1) discernible differences in how customers use the mail; and 2) distinct methods of transportation and/or processing which may produce measurable differences in cost. These principles reflect the statutory definition of "product" and adhere to the Commission's call for "products" that reflect business and regulatory needs. The Postal Service was also mindful, however, of the Commission's acknowledgment that administrative considerations serve as a practical brake on the designation of products, preventing the recognition of every conceivable cost or market difference within the classes of mail. For example, in several instances (discussed below), the Postal Service decided against disaggregating a grouping of mail on the grounds that one or more of the resulting products would have very low volumes.

A noticeable feature of the Postal Service's proposed list is its use of shape in distinguishing between the products in each class. Shape is of fundamental importance in terms of both cost and market considerations, and is therefore an important factor in differentiating mail for pricing purposes.⁶

Despite the Postal Service's contentions, the MCS list of products does not reflect the "statutory definition of cost" as the Postal Service contends. The Postal Service has not

⁶ "United States Postal Service Submission of Initial Mail Classification Schedule in Response to Order No. 26," September 24, 2007, at 9.

demonstrated that the list of products is divided along the lines of “how customers use the mail” nor does the MCA reflect the limits of “measurable differences in cost.” The Postal Service’s reference to a practical brake on product designation is instead an amalgamation that would serve its administrative advantages while leaving customers without the protections to which separate products are entitled under the PAEA.

Order No. 26 clearly says the term product” should not be applied in a blanket fashion: it is neither practical nor justified.(Order No. 26 at 75, para. 3063.) The Postal Service has essentially ignored the Commission’s admonition that a “product cannot reasonably be read as equivalent to subclass”(Order at 75, para. 3064). The Commission has already expressly rejected the Postal Service’s attempt to define product as a subclass.(Order No. 26 at 76, para. 3066.) The PAEA plainly prohibits a consolidation of services with distinct cost or market characteristics.(§102(6).) There is no doubt that, in virtually all cases, the mixture of services proposed for listing as segments of individual products represent more than one distinct market. For instance, in First-Class, letters and cards are proposed for consolidation into one product although clearly postcards are a different market segment as evidenced by the separate elasticity studies for letters and cards that have been conducted by witness Thress for omnibus rate cases. (See, for instance, Docket No. R2006-1, USPS-T-7 at 5.)

OCA is not contending the remedy to the Postal Service’s MCSproposal is to apply the term product at the rate cell level. The Commission has held that such an application of the directives of the PAEA wouldbe too narrow, and would undercut pricing flexibility.(*Ibid.*) Rather, the Commission should apply the rule of reason as it intends to do.(*Ibid.*) OCA recognizes, as does the Commission (Order No. 26 at 77,

para. 3066), that there may be cases where a product may be appropriately a current subclass. However, business reasons exist to list a greater number of products than those proposed by the Postal Service. The PAEA specifically recognizes the need for the Commission in making decisions on new products and transfers of products on the product list to give due regard to “the views of those who use the product involved on the appropriateness of the proposed action.” (§3642(b)(3)(B).)

The underlying purpose of the procedural protections included in §3642 of the PAEA is apparent. The provisions protect mailers from hasty changes in the list of products without offering an opportunity for comment and other procedures. The broad definitions of products offered in the Postal Service’s proposed MCS would preclude mailers from the protection that the ability to comment affords and would avoid the opportunity for Commission oversight before elimination of a service for which a separate market exists and which is relied upon by mailers. Logically, the application of procedural protections *before* significant changes to the product descriptions are implemented affords mailers necessary protections. Where a separate market is affected, the product must be subject to review prior to elimination. The after-the-fact oversight afforded by the complaint process or the annual review process would be insufficient protection for a mailer relying upon the continuing existence of a segment of a product as proposed by the Postal Service. Based upon the definition of a product in the PAEA, the Postal Service’s proposed products are in actuality, separate products. If a product segment is suddenly eliminated, the market for the product could, in many cases, disappear long before the check and balance of the complaint process or the annual review process may be completed. The sudden elimination of a service that is

defined as a product by the PAEA, but not in the MCS, would be disruptive to mailers and could significantly impact their plans and budgets.

Looking to the procedure that the PAEA established for such changes provides insight into the purposes for the process. The Congress clearly intended in §3642 that changes in postal services with different cost or market characteristics were to be subject to prior review and not merely recorded for future review. When mailers using products are immediately impacted, prior review is far more desirable than permitting the elimination or major modification of a product with potentially significant and perhaps disastrous consequences for a mailer or mailers, subject only to after-the-fact review. In any event, the prior review of a change in the list of products would be more focused. The review would relate to only the specific change proposed rather than occur as part of a broader annual comprehensive review where the advantages of immediate review and protection of markets could be easily lost.

A further business purpose is served by disaggregating postal services into a longer list of market-dominant products. It would better reflect cost or market characteristics. As the PAEA recognized, it is desirable to assure rate stability and certainty, as well as transparency, so customers can be assured the postal services they have planned to be available for their businesses and for which they have budgeted (such as specific price levels, presort levels, and entry points, not to mention significant mail preparation and eligibility requirements) will not be eliminated on a mere 15 days notice without opportunity to provide their input.

Inadequate reasons are cited by the Postal Service for its decision to aggregate “closely related subclasses” such as First-Class letters and postcards and Library Mail

and Media Mail and Non-profit and Commercial Standard Mail.(MCSSubmission at 10.) Merely because they are closely related products does not mitigate their separate market characteristics and, in the case of postcards in particular, separate cost characteristics.

The Postal Service's proposed product, "Single-Piece Letters/Postcards" contains several separate services, each with distinct market or cost characteristics that warrant treatment as separate products under the PAEA. Each of the price categories for both letters and postcards warrant treatment as a separate product inasmuch as each has either a distinct market or cost characteristic. Likewise, the Bulk Letters/Postcards category includes several individual products with distinct market or cost differences. Each price category, automation letters and automation postcards, machinable letters and postcards, nonmachinable letters, as well as customized letter pricing all fall within the definition of separate products under the PAEA. To ease administrative burdens, OCA does not propose that the current 5-digit and 3-digit, AADC and Mixed AADC segments of letters and postcards should be defined as separate products, although they too might be construed as products with distinct cost characteristics.

Similarly, the Postal Service's proposed First-Class flats product should be expanded to at least three products: automation flats, presorted flats and single-piece flats. As with Single-Piece Letters/Postcards, above, First-Class flats include automation 5-digit, 3-digit, ADC and Mixed ADC, but to ease administrative burden, do not need to be identified as separate products. Also, First-Class parcels consist of at

least three separate presorted parcel products: presorted nonbarcoded parcels, nonmachinable parcels, and Single-Piece or Mixed ADC parcels.

Although we do not discuss each of the other classes at this time, as a minimum, each of the price categories, if not the specific entry levels, represents separate products as defined by the PAEA. In each of these cases, the products relate to a distinct market or cost characteristic. OCA recognizes the need for a reasonable and easily administered list of products, yet one that permits oversight authority by the Commission to prevent elimination of important services that have distinct market or cost characteristics which, according to the PAEA, should not be subject to elimination without a before-the-fact opportunity for mailers to comment and to express their views as to the likely impact on small business concerns prior to a Commission decision. (§3642(b)(3)(C).) An expansion of the product list, as compared to the narrower list of products proposed by the Postal Service, more nearly reflects current realities of the pricing structure and so would not add administrative burden for the Postal Service, but would foster increased transparency and protections against sudden and cataclysmic changes in the services mailers are provided.

CONCLUSION

Wherefore, OCA respectfully submits these comments in response to the Postal Service's submission of its proposed initial Mail Classification Schedule.

Respectfully submitted,

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