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BEFORE THE POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268

Notice of Price Adjustment **Docket No. R2008-1**

COMMENTS OF THE PARCEL SHIPPERS ASSOCIATION ON PLANNED RATE ADJUSTMENT ON MARKET DOMINANT POSTAL PRODUCTS AND LIMITED CLASSIFICATION CHANGES (Issued February 14, 2008)

Pursuant to Postal Regulatory Commission (Commission) Order No. 59[1] and Commission Rules of Practice, the Parcel Shippers Association (PSA) submits these comments on the price increases proposed by the United States Postal Service (Postal Service).[2] PSA appreciates this opportunity to comment on the first proposed market dominant price increases under the Postal Accountability and Enhancement Act (PAEA).[3]

PSA is a voluntary industry association consisting of members that ship packages, largely from business to consumers, and companies that support those activities. A list of PSA members is available on the association's web site at www.parcelshippers.org. PSA's mission is to promote competition in the

[1] Notice and Order on Planned Rate Adjustments for Market Dominant Postal Products and Limited Classification Changes (Docket No. R2008-1).

[2] United States Postal Service Notice of Price Adjustment (Adjustment Notice).

[3] Pub. Law No. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39.

package delivery sector. It strives to encourage a competitive environment that results in the best possible service at the lowest possible costs.

PSA's members, collectively, touch the vast majority of the Postal Service's product in the Package Services class now categorized as "competitive products." *See* §3631(a). PSA members also make extensive use of carriers other than the Postal Service. Its members, however, also ship, or consolidate for delivery to the Postal Service, hundreds of millions of packages, such as First-Class Mail parcels, Standard Mail parcels, Bound Printed Matter, and Media Mail, that are now categorized as "market-dominant products" and are addressed by this Order.

We do not ask the Commission to take any action *at this time* to change the prices proposed by the Postal Service. Section 3622(1)(c) governs this proceeding and permits onlya determination as to whether the price increases announced by the Postal Service comply with the "price cap." This is not supposed to be a "mini rate case," where parties may "litigate" the appropriateness, or even lawfulness, of proposed price changes. Those days have passed.[4] As the Commission noted in its Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products (Docket No. RM2007-1): "Major goals [of the PAEA] are to simplify and expedite the process

[4] Order No. 59 governing this proceeding invites public comments to address:

(1) Whether the planned rate adjustments measured using the formula established in rule 3010.23(b) are at or below the annual limitation established in rule 3010.11; and

(2) Whether the planned rate adjustments measured using the formula established in rule 3010.23(b) are at or below the annual limitation established in rule 3010.28.

PRC Order No. 59 at 10.

by which rates are adjusted." PRC Order No. 43 at 14. This approach promotes the pricing flexibility that is a key component of the PAEA and is addressed as both an "objective" and a "factor." *See* 39 U.S.C. §§ 3622(b)(4) and 3622(c)(1). However, as discussed below, we believe some of the proposed price increases should not stand if challenged or when reviewed in an appropriate proceeding.

DISCUSSION

Compliance with the Price Cap

It appears to us that the price increases announced by the Postal Service, at the class level, comply with the applicable provisions of the law which govern price increases for market dominant products and which impose an annual limitation, or "price cap." *See* 39 U.S.C. §3622(d). We expect that the Commission, in its diligence, may determine that modifications are necessary in the calculations of unused rate authority in order to determine the amount of such authority that may be "banked" for future use by the Postal Service. *See* 39 U.S.C. §3622(d)(2)(C).

Standard Mail Parcel and Not Flat Machinable (NFM) Prices

The second stated objective of the modern system of regulating rates and classes for market dominant products is "to create predictability and stability in rates." 39 U.S.C. § 3622(b)(1). As the Senate Committee put it:

> Predictability and stability, the Committee learned, allows (sic) mailers to better plan their mailing and could allow them to increase the amount of business they do with the Postal Service. Of primary importance, then, is the establishment of a regulatory system that will provide for limits on the percentage changes in Postal Service rates.

S. Rep. No. 108-318, 108th Cong., 2d Sess., at 16 (Aug. 25, 2004).

The average increase for Standard Mail Parcels and NFMs is 9.66 percent. Adjustment Notice at 15. This increase is more than three times the applicable price cap and more than twice the average increase for any other mail product.[5] While we recognize that price increases for market dominant products may vary above and below the price cap, and support this aspect of pricing flexibility, mailers of market dominant products should be able to plan for increases that are generally consistent with the price cap and, certainly, no mailer of any product should expect that increases for that product will be dramatically higher than those for other products. An increase for one product that is so far divergent from those for all other products, does not foster stability nor is it likely to be predictable.

PSA supports pricing flexibility for the Postal Service. It is necessary if the Service is to survive and thrive. Pricing flexibility, however, should be exercised to "encourage increased mail volume," not drive it away as we fear the proposed price increases for Standard Mail Parcels and NFMs will do. *See 39 U.S.C.* § *3622(c)(7).* In fact, we believe these prices are so out of line that *if* th ey are challenged by complaint pursuant to § 3662 or *when* they are reviewed through the annual compliance procedure pursuant to § 3652, the Commission should determine that they result in a system that does not achieve another important objective under the PAEA—"[t]o establish and maintain a just and reasonable schedule of rates and classifications. . ." 39 U.S.C. § 3622(b)(8).

[5] The "price cap" is 2.9 percent. Adjustment Notice at 3. The next largest price increase is that for Media Mail and Library Mail, 4.54 percent.

We reiterate, this increase is more than three times the applicable price cap and more than twice the average increase for any other mail product. This is not reasonable.

Table 1 shows the Postal Service's announced price changes for the 18 market dominant mail products. It does not require sophisticated analysis to conclude that the increases for Standard Mail Parcels and NFMs are out of line.

Table 1. Average Rate Increase by Product

Product	Percent Change
Bound Printed Matter Flats	0.42%
Standard Mail Flats	0.86%
Standard Mail High Density/Saturation Letters	1.66%
First-Class Mail Flats	1.93%
Standard Mail High Density/Saturation Flats and Parcels	2.09%
Bound Printed Matter Parcels	2.10%
First-Class Mail Parcels	2.18%
First-Class Mail Single-Piece Letters and Cards	2.50%
Inbound Surface Parcel Post	2.62%
Periodicals Within County	2.63%
Periodicals Outside County	2.71%
PRICE CAP	**2.90%**
Standard Mail Carrier Route Letters, Flats, and Parcels	2.99%
First-Class Mail International	3.09%
Single-Piece Parcel Post	3.30%
Standard Mail Letters	3.39%
First-Class Mail Presort Letters and Cards	3.55%
Media Mail and Library Mail	4.54%
Standard Mail Parcels and NFMs	9.66%

Adding to the unreasonableness of the magnitude of this increase is the fact that this increase is not necessary. We estimate that in FY 2007, there were approximately 1.09 billion Standard Regular (including both Commercial and Nonprofit) parcels and NFMs. The mailers of this product constitute one very small slice of the Postal Service customer base. The 9.66 percent average price increase for these parcels and NFMs will raise only $84 million in additional revenue at FY 2007 volume levels. Reducing the average price increase for these parcels and NFMs from 9.66 percent to a reasonable increase of five percent would reduce Postal Service revenue (at the proposed prices) only by approximately $40 million. This is certainly not pocket change especially to the small segment of the mailing community so burdened. However, it is not appreciably significant to the Postal Service as it amounts to less than 0.1 percent of the total $71 billion annual revenue the Postal Service expects from market dominant products as a result of these price increases. The Postal Service describes the Standard Mail Parcel and NFM price increases as "relatively large." Adjustment Notice at 16. To the affected mailers these increases are not "relatively large." They are unreasonably and unjustifiably large.

The Postal Service also says the increases for these products "will help bolster their contribution." *Ibid.* Our best efforts to determine the cost coverage for this product (there are no cost data available for NFMs) suggest that a reasonable five percent increase would be sufficient to "move toward providing [these] parcels with better cost coverage" which the Postal Service says is its goal. *Ibid.* To the extent the Postal Service believes it needs to increase the cost coverage, it should do so on a more gradual and incremental basis. We note the Postal Service's observation that ". . . a price cap allows prices to be changed more efficiently, and thus in a more gradual, incremental, and market-friendly manner." Adjustment Notice at 9. It should practice what it preaches.

Five percent is a reasonable, gradual, and incremental increase even though it still would constitute the highest average price increase proposed for anymail product.

A rate and classification schedule resulting from an increase that so disproportionately burdens one product, as demonstrated by Table 1, is not "just and reasonable." *See* 39 U.S.C. §3622(b)(8). It is not just. And it does not promote rate predictability and stability. *See* 39 U.S.C. §3622(b)(2). Upon the filing of a complaint or in the course of its annual compliance review the Commission should conclude that these rates achieve neither a just and reasonable schedule nor rate stability and predictability.

We provide these comments to alert the Commission, the mailing community, and the Postal Service to our concerns[6]. We believe the Postal Service should correct this situation on its own, by revising its proposed prices for Standard Mail Parcels and NFMs downward or through the issuance of temporary prices. Since the Postal Service filed its Adjustment Notice well in advance of the implementation date, there remains time for the Postal Service to

[6] PSA forecast these in its initial comments in the Docket No. RM2007-1 rulemaking :

> Finally, PSA members make substantial use of Standard Mail and First-Class Mail, which are market dominant products. The extraordinarily and exceptionally large rate increases for First-Class Mail parcels and Standard Mail packages proposed by the Postal Service in the most recent omnibus postal rate case, Docket No. R2006-1,are very problematic. To ensure the predictability and stability in the ratemaking system envisioned by the PAEA where annual rate increases are expected to be the norm, the Postal Service should be required to provide the Commission with written, on the record, justification for any market dominant rate increases that *substantially* exceed inflation.

Comments of the Parcel Shippers Association (Docket No. RM2007-1)(April 6, 2007) at 4-5.

adjust its proposed prices downward and still provide the statutorily required 45-day notice before a May 12th implementation. *See 39* U.S.C. § 3622(d)(1)(C). Alternatively, the Commission's regulations contemplate temporary price changes.[7] Temporary price *reductions* should be fairly straightforward as price cap issues should be minimal. *See* 39 U.S.C. §3622(7); 39 CFR § 3010.23. If it does not revise its proposed prices downward in advance of the implementation date, the Postal Service should afford itself of the opportunities it has under the law and Commission Rules to correct these prices on a temporary basis (until the next general rate increases).

Standard Mail Parcel and NFM Discounts

In addition to the unreasonably large average increase for this product, we are concerned that several worksharing discounts for this product appear to pass through far less than the full costs avoided, in some cases passing through only about 25 percent of estimated avoided costs.

PSA is hopeful that the very low passthroughs proposed in this filing for some discounts and the greater-than-100 percent passthroughs underlying others are, as suggested in the Adjustment Notice (at 31-33), the result of judgmental adjustments to the discounts based upon Postal Service knowledge of how actual costs avoided are likely to compare to the cost avoidances estimated by the FY 2007 cost models. Given the newness of the parcel/NFM-specific Standard Mail rate design and the lack of high-quality data on parcel and

[7] *See, e.g.,* 39 CFR 3010.23(a) ("seasonal or temporary rates , for example, shall be identified as rate cells separate and distinct from the corresponding non-seasonal or permanent rates"); *see also* PRC Order No. 43 at 50 ("The Commission also believes that its clarification of the treatment of rates of limited duration (*e.g.*, seasonal or temporary) in rule 3010.23 may address some of the concerns of commenters who urge the use of average revenue in the application of the cap")

NFM costs, PSA recommends that the Commission allow the Postal Service flexibility in this proceeding to deviate from 100 percent passthroughs (on both the upside and downside) for Standard Mail Parcel and NFM discounts.

Judgmentally adjusting discounts in this manner is far from optimal. In the future, the Postal Service should develop more accurate estimates of Standard Mail Parcel and NFM cost avoidances and move in the direction of full passthroughs of those accurately-estimated cost avoidances.

Destination Delivery Unit Discount for Bound Printed Matter Parcels

PSA respectfully submits that, when properly measured, the Bound Printed Matter (BPM) destination delivery unit (DDU) discount for parcels does not exceed 100 percent of cost avoided. The greater-than-100 percent passthrough results from the Postal Service inappropriately calculating the DDU passthrough relative to origin-entered parcels and simply reflects the cumulative effect of the greater-than-100 percent passthrough proposed for destination bulk mail center (DBMC) parcels. While the Postal Service should (and, as the Commission recognized in Commission Information Request No. 1 in its Adjustment Notice) provide a justification of the greater-than-100 percent passthrough underlying the DBMC discount, no further justification is necessary for the DDU passthrough.

Consistent with the "marginal passthrough" approach generally accepted for presort and automation discounts[8], the passthrough of the BPM DDU dropship discounts should be estimated using destination sectional center facility

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[8] *See, e.g.,* the passthrough calculations on the First-Class Mail Letters, Flats, and Parcels sheet in Appendix B of the Adjustment Notice.

(DSCF) parcels as the benchmark. Calculated in this manner, the BPM DDU discount for parcels (17.1 cents per piece)[9] is equal to FY 2007 costs avoided and would be less than costs avoided if inflated to the time period (May 2008 through May 2009) during which the rates will be in effect.

CONCLUSION

For the foregoing reasons PSA concludes the following:

1. The proposed price increases appear to comply with the law on "price caps."

2. The Commission should not make any modifications, so far as prices are concerned in this proceeding. This is not a mini-rate case. Review should be confined to price cap compliance.

3. The 9.66 percent average increase for Standard Mail Parcels and NFMs, which is three times the cap and twice the increase of any other mail product, is inconsistent with the objectives and factors of the PAEA. We believe this will have to be addressed by the Postal Service or in future proceedings.

4. The USPS should use its pricing flexibility to reduce the 9.66 percent average increase to no more than 5 percent.

[9] The 17.1 cent discount and cost avoidance figures can be calculated by subtracting the DSCF cost avoidance and discount figures from the Bound Printed Matter Parcels sheet of Appendix B of the Adjustment Notice from the DDU cost avoidance and discount figures on that sheet. Similarly, the DSCF passthrough calculated relative to DBMC parcels is slightly less than 100 percent. Thus, no justification of the DSCF discount is necessary either.

5. What is most unfair about the Standard Mail Parcel and NFM increases is that they are not necessary. A reduction to a 5 percent increase would at most cause a revenue loss of $40 million, 1/10th of one percent of the total annual revenue expected from these proposed rates.

6. The Postal Service justification for these harmful Parcel and NFM increases is that it needs to improve the cost coverage of this product. There is no PAEA requirement to improve the coverages and certainly no financial need. Any increase in coverage should be achieved incrementally.

7. Some of the workshare discounts for the Standard Mail Parcel and NFM product pass through less than full avoided costs, in some cases less than 25 percent. This balances the passthrough of more than 100 percent of costs for other discounts. This is acceptable for this first proceeding, but not for the future. The Postal Service should develop more accurate estimates of Standard Mail Parcel and NFM avoided costs, and move toward a goal of full passthroughs.

8. The BPM DDU discount for parcels (17.1 cents per piece) is equal to FY 2007 costs avoided and would be less than costs avoided if inflated to the time period (May 2008 through May 2009) during which the rates will be in effect.

9. This is a good but somewhat flawed first effort for the Postal Service to provide optimal use of the flexibility afforded to it and the responsibility imposed upon it by the PAEA.

Respectfully submitted,

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