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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

NOTICE OF PRICE ADJUSTMENT	))	Docket No. R2008-1

COMMENTS OF
NATIONAL POSTAL POLICY COUNCIL
(March 3, 2008)

The National Postal Policy Council ("NPPC") respectfully submits these comments on the rate changes proposed by the Postal Service on February 11, 2008, and noticed for comment by the Commission in Order No. 59 (published at 73 Fed. Reg. 9363 (2008)).

In submitting these comments, NPPC is mindful of the limited scope of the Commission's review of the rate adjustments, and the equally limited scope of the comments authorized by 39 C.F.R. § 3010.13. The rules established by the Commission in Docket No. RM2007-1, *Regulations Establishing A System of Ratemaking*, state that public comments on a proposed rate adjustment of general applicability "should focus primarily on whether [the] adjustments comply with" the "annual limitation established in rule 3010.11" (the CPI-based cap) and "the limitations established in rule 3010.28" (the application of previously unused rate adjustment authority). 39 C.F.R. §§ 3010.13(b)(1) through (2) (quoted in Order No. 59, 73 Fed. Reg. at 9364 col. 2). Because this is the first rate adjustment under 39 U.S.C. § 3622(d) since the enactment of the Postal Accountability and Enhancement Act ("PAEA"), the only real issue before the Commission in this docket is whether the overall percentage rate increase proposed for each class complies with the CPI-based cap.

The limited scope of pre-implementation review of proposed rate changes under Rule 3010 is consistent with the policies underlying 39 U.S.C. § 3622 and PAEA generally. "[O]ne of Congress's main motives in enacting the PAEA was to simplify and expedite the setting of postal rates. . . . Congress expected that a modern system for regulating rates and classes would afford the public and the Commission only a limited period of pre-implementation comment and review." Order No. 43, Docket No. RM2007-1, *Regulations Establishing A System Of Ratemaking* (Oct. 29, 2007) at ¶¶ 2025-2026. In light of these policies, and the 45-day period of advance notice of proposed rate changes referenced in 39 U.S.C. ¶ 3622(d)(1)(C), "the inference is strong that Congress contemplated that complicated or subjective compliance issues would be addressed during the annual compliance review, or through the complaint procedures of section 3662." *Id*. at ¶ 2026. The limited scope of pre-implementation review of proposed rate changes does not prejudice the rights of persons aggrieved by the rates, because a Commission finding that a proposed rate adjustment "does not contravene other policies of" 39 U.S.C. §§ 3621 *et seq*. "is provisional and subject to subsequent review." 39 C.F.R. § 3010.13(j).

As noted in the remainder of these comments, NPPC and its members have a number of concerns about the changes in rate design proposed by the Postal Service for First-Class, Standard Mail and certain Special Services. NPPC intends to discuss these issues directly with the Postal Service, and reserves the right to seek appropriate relief for any unresolved issues in future proceedings under 39 U.S.C. §§ 3651-3653 and 3662. NPPC also reserves the right to seek similar relief from any other aspect of the proposed rate changes that further analysis reveals to be problematic.

None of these issues, however, appears to provide a basis under PAEA or the Commission's rules for the Commission to prevent the proposed rate changes from taking effect as proposed by the Postal Service. The only relevant question here is whether the overall rate increase proposed for any of these classes of service exceeds the CPI cap. Because the aggregate increase for the class as a whole appears to be less than the CPI, NPPC has found no basis for objecting to the proposed rate changes under 39 C.F.R. § 3010.13.

I. FIRST-CLASS MAIL

The average rate increase proposed for First-Class Mail is 2.886 percent, slightly less than the 2.9 percent increase authorized by the CPI cap. USPS Notice at 5. Accordingly, NPPC has found no basis for objecting to the proposed rate changes under 39 C.F.R. § 3010.13.

The Commission has requested further explanation from the Postal Service on the economic justification for proposed worksharing passthroughs that exceed 100 percent of cost differences. Commission Information Request No. 1 (Feb. 26, 2008). While the Commission's desire for more information is entirely reasonable, the Commission should refrain from modifying the proposed rate changes in this proceeding, let alone preventing them from taking effect, on this ground. Determining presort passthroughs requires accurate and current estimates of presort cost avoidances. As the Commission has recognized, this is too complex a task to complete within the short period available for pre-implementation review of proposed rates:

> The merits of one attribution methodology relative to another is an example of an issue that is too complex to be re-evaluated in a pre-implementation context. Cost attribution methods should be reviewed in other rulemaking proceedings. Whether rates properly reflect costs will be judged using the most recently approved attribution methodologies.

Docket No. RM2007-1, Order No. 43, *supra*, at ¶ 2031.

Consistent with this rule, the Postal Service has calculated the presort cost avoidances of its proposed rates by comparing the proposed presort rate differentials with the cost avoidance estimates presented in Docket No. ACR2007. USPS Notice at 26 & n. 21. This simplifying step, however, clearly overstates the presort passthroughs within Presort First-Class Mail. The cost avoidance estimates presented in Docket No. ACR2007 were for FY 2007—i.e., the period from October 2006 through September 2007. The rates now proposed by the Postal Service, however, are expected to be in effect during the 12-month period beginning in May 2008—almost two years later. A timing mismatch of this magnitude means that the Postal Service's presort cost avoidances are understated by amount equal to nearly two years of cost inflation. This error produces the illusion that AADC-to-3 digit and 3 digit-to-5 digit presort passthroughs for First-Class automation letters exceed 100 percent,[1] when they do not.

Certain aspects of the rate changes proposed for First-Class Mail are troubling, however. First, the proposed rate changes would preserve, and even expand, the existing rate preference for Single-Piece vis-à-vis Presort First-Class Mail. According to

[1] *See* USPS Request, App. B at 1.

the data relied on by the Postal Service in Docket No. ACR2007, the average Presort letter still pays approximately 3.4 cents more in unit contribution under the rates set in R2006-1 than does the average Single-Piece letter. *See* FY 2007 CRA (PRC version) at 2. The same CRA data show that Presort letters have only 38 percent of the unit attributable cost of Single-Piece letters (11.8 cents vs. 31.2 cents), and that the cost coverages of the two kinds of First-Class Mail are 279 percent and 157 percent, respectively. *Id*. These cost coverages equate to percentage markups of 179 percent and 57 percent, respectively.

The rates now proposed by the Postal Service would exacerbate these preferences. The following table shows the percentage increases proposed for one, two, three and 3.5-ounce letters entered, respectively, at single-piece, 5-digit automation, 3-digit automation, AADC and mixed AADC automation rates:

Percentage Rate Increases: Single-Piece Vs. Presort First-Class Letters				
	1 ounce	2 ounces	3 ounces	3.5 ounces
Single Piece	2.44%	1.72%	1.33%	1.09%
Mixed AADC	2.50%	1.86%	1.48%	1.22%
AADC	2.93%	2.15%	1.69%	1.40%
3-digit	3.59%	2.61%	2.05%	1.69%
5-digit	3.85%	2.75%	2.14%	1.75%

Second, the proposed rate changes *within* Presort First-Class Mail are also anomalous. While rates for the coarser presort categories increase less than the CPI, rates for one-ounce 3-digit and 5-digit automation letters will receive increases considerably above the CPI (3.59% and 3.85% for 3-digit and 5-digit, respectively, vs. 2.9% for the CPI). The changes in presort rate relationships for automation postcards are inverted in a similar way. The disproportionate increases imposed on the most finely presorted lightweight automation letters directly increase the risk of diversion of some of the Postal Service's most profitable and high-volume mail categories to non-postal channels. And this is set against a backdrop of a United States economy in difficulty, if not in recession.

This anomalous pattern of rate changes cannot be defended on the theory that the presort passthroughs established in Docket No. R2006-1 between AADC and 3-digit categories, and the 3-digit and 5-digit categories, exceeded 100 percent of cost savings. The PAEA specifically allows above-100 percent passthroughs where "reduction or elimination of the discount would impede the efficient operation of the Postal Service" (39 U.S.C. § 3622(e)(2)(D)) or lead to a reduced aggregate contribution to institutional costs (*id*., § 3622(e)(3)). Moreover, the PAEA requires that the elimination of above-100 percent passthroughs, even if otherwise required by law, shall be phased out over time to mitigate rate shock. 39 U.S.C. § 3622(e)(2)(B).

Third, First-Class automation letters will receive significantly larger rate increases than First-Class automation flats. Indeed, while many letter rate categories will receive increases above 2.9 percent, the majority of the automation flats categories are receiving outright decreases. The effect of this disparity is to compress letter-flat differentials, and thus to reduce the rate recognition of the shape-related cost differences between letters and flats. For the reasons discussed in connection with the letter/flat differential for Standard Mail, this shift is an unfortunate move away from full cost recognition.

II. STANDARD MAIL

The average rate increase proposed for Standard Mail is 2.875 percent, slightly less than the 2.9 percent increase authorized by the CPI cap. USPS Notice at 5. Because the aggregate increase for the class as a whole appears to be less than the CPI, NPPC has found no basis for objecting to the proposed rate changes under 39 C.F.R. § 3010.13.

In at least one major respect, however, the proposed rate design for Standard Mail is a step backwards. The average rate increase proposed for regular Standard letters is 3.39 percent, while the average increase proposed for regular Standard flats is only 0.86 percent. USPS Notice at 15. The effect of this disparity is to compress letter-flat differentials, and thus to *reduce* the rate recognition of the shape-related cost differences between letters and flats—thereby undoing part of the hard-won progress achieved in Docket No. R2006-1 toward full cost recognition.[2]

This is an unfortunate development. Even the rates set in Docket No. R2006-1 did not achieve full recognition of the cost effects of shape. In its recent Annual Compliance Report, the Postal Service estimated that the unit attributable cost of processing and delivering an average Standard Regular flat was 21.3 cents greater in FY 2007 than for a comparable Standard letter.[3] This disparity exceeds by almost four cents the letter/flat cost differential estimated in Docket R2006-1 for Standard Regular

[2] *See* PRC R2006-1 Op. & Rec. Decis. ¶ 5593 (February 26, 2007); PRC R2006-1 Second Op. & Rec. Decis. on Reconsideration (May 25, 2007).

[3] Mail processing costs are reported in USPS-LR-FY07-26, shp07prc.xls, “PAGE I-3”, cells B30 and C30. Delivery costs are reported in USPS-LR-FY07-19, UDCmodel071211.xls, “1.Table 1”, cells C71 and C72.

mail in FY 2008.[4] Moreover, the 21.3 cent differential exceeds by approximately 20 percent the difference in unit revenue between Standard Regular letters and flats produced by the R2006-1 rates.[5]

The defenders of rate preferences for flat-shaped Standard Regular Mail have asserted that rate preferences for flat-shaped mail are justified by the assertedly more elastic demand for this mail. This claim is unfounded. Even assuming *arguendo* that Ramsey pricing theory were to establish the benchmark for setting markups under PAEA, the disparities in markups between the two mail categories far exceed their differences (if any) in demand elasticities. The R2006-1 rates produce an average percentage markup over mail processing and delivery costs for Standard letters that is approximately *5.6 times* the markup for Standard Regular flats.[6] No evidence has been offered that the demand for Standard Regular flats is substantially more price elastic than the demand for Standard Regular letters—let alone that the former is 5.6 times more elastic than the latter.

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[4] *See* R2006-1, PRC-LR-9, shp08prc PRCFinal.xls, "Page I-3", cells B30 and C30 (mail processing costs); *id*., PRC-LR-11, UDCmodel.PRC.xls, "1.Table1", cells C71 and C72 (delivery costs).

[5] Average revenues per piece under Docket No. R2006-1 rates for Standard Regular (including Nonprofit) letters (18.5 cents) and flats (36.1 cents) were derived from Tables 2-A and 2-B of the Postal Service's FY 2007, Quarter 4, Quarterly Statistics Report. http://www.usps.com/financials/_qsr/QSR_Quarter_4.pdf. Note that R2006-1 rates were in effect for all of FY 2007, Quarter 4. Further, the 21.3 cent figure does not include differences in transportation costs.

[6] The markups for Standard Regular flats and letters were calculated using the mail processing and delivery cost per piece data cited in footnote 3 and the revenue per piece data cited in footnote 5. Including the remaining attributable cost segments would reduce somewhat the average percentage markup of each category, but the wide disparity in markups between the two categories would remain.

Another anomaly in the proposed Standard Mail rate design is the freeze on dropship discounts. Nearly all of the proposed passthroughs are below 100 percent, even according to the ACR2007 cost avoidance estimates on which the Postal Service relies. Given the likelihood that rising fuel costs have substantially increased unit transportation costs since FY 2007, the effective passthroughs are likely to be even lower. The failure to increase dropship discounts when the costs avoided by the Postal Service from destination entry are clearly rising sends poor price signals and is at odds with the Efficient Component Pricing Rule.

III. SPECIAL SERVICES

The average rate increase proposed for Special Services is 2.848 percent, slightly less than the 2.9 percent increase authorized by the CPI cap. USPS Notice at 5. Because the aggregate increase for the class as a whole appears to be less than the CPI, NPPC has found no basis for objecting to the proposed rate changes under 39 C.F.R. § 3010.13.

Several of the proposed fee changes are problematic, however. These include the fee for electronic Address Correction Service (increased by 33.3 percent), the Certificate of Mailing fee for a firm book mailing (increased by 14.3 percent), and several Confirm fees (increased by as much as 25 percent), These increases do not appear to be justified by cost increases or any other appropriate ratemaking factor.

CONCLUSION

For the foregoing reasons, NPPC does not ask the Commission to modify or disallow the proposed rate changes before they take effect. As noted above, however, several aspects of the proposed changes in rate design are troublesome, and may require further Commission attention in future proceedings under 39 U.S.C. §§ 3651-3653 or 3662.

Respectfully submitted,

/s/

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