Postal Regulatory Commission
Submitted 3/3/2008 4:23:35 pm
Filing ID: 59156
Accepted 3/3/2008

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

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

VALPAK DIRECT MARKETING SYSTEMS, INC. AND VALPAK DEALERS' ASSOCIATION, INC. COMMENTS ON THE UNITED STATES POSTAL SERVICE NOTICE OF PRICE ADJUSTMENT
(March 3, 2008)

Background

On February 11, 2008, the U.S. Postal Service filed a Notice of Market-Dominant Price Adjustment ("Postal Service Notice") with the Postal Regulatory Commission ("Commission") pursuant to the Postal Accountability and Enhancement Act, Public Law 109-435 ("PAEA") (*see* 39 U.S.C. § 3622), and the Commission's rules promulgated thereunder (*see* 39 CFR 3010.1, *et seq.*). The Commission issued Order No. 59 on February 14, 2008, opening this docket and setting March 3, 2008 as the deadline for public comment.

These comments are filed jointly on behalf of Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. (hereinafter "Valpak").

I. ADEQUACY OF THE POSTAL SERVICE'S NOTICE OF MARKET-DOMINANT PRICE ADJUSTMENT UNDER COMMISSION REGULATIONS

PAEA was enacted on December 20, 2006, and this is the first market dominant price change under the new ratemaking regime. Further, this is the first use of Commission rules with respect to ratemaking for market dominant products, which rules went into effect on December 10, 2007. 72 *Fed. Reg*. 63662 (Nov. 9, 2007).

Commission rules specify the contents of a public notice of a market dominant rate adjustment. 39 CFR 3010.14. The Appendix to these comments (Docket No. R2008-1: Comparison of Commission Rules and Postal Service Notice of Market-dominant Price Adjustment) sets out each Commission requirement for Postal Service public notices, and then identifies where that requirement is addressed in the Postal Service Notice and related appendices. The Appendix indicates that the Postal Service undertook to address all Commission requirements in its Notice.

Further, as of this date, the Commission has submitted only one "Commission Information Request" (Feb. 26, 2008), with responses due no later than Tuesday, March 4, the day after these comments are due. With the possible exception of certain issues related to matters raised in this Information Request, the Postal Service Notice appears to have complied with the Commission's requirements.

Commission rules provide mailers only 20 days (21 days in this docket, due to the fact that the 20th day fell on a Sunday) to review the Postal Service filing and submit comments, and Valpak submits the following for consideration by the Commission.

II. THE POSTAL SERVICE'S RATE ADJUSTMENT FOR THE SATURATION AND HIGH-DENSITY LETTER PRODUCT MAKES SENSE

Valpak makes extensive use of Standard commercial saturation letter rates, entering trayed mail at destination Sectional Center Facilities ("SCFs"). These mailings are required to be pre-barcoded and also sequenced in carriers' line-of-travel ("LOT"). As such, these letters not only are well-suited to being inducted directly into the Postal Service's Delivery Point Sequencing ("DPS") equipment, but also can be taken to the street by the carrier as an extra bundle, or even cased rapidly, due to LOT preparation.

Until the recent categorization of products under PAEA, saturation letters were part of the Standard Enhanced Carrier Route ("ECR") subclass, which also included flats and parcels. The current rates for all ECR mail, established in Docket No. R2006-1, had an estimated cost coverage of 206.3 percent (Docket No. R2006-1, *Op. & Rec. Dec.*, Appendix G, Schedule 1). However, the cost coverage on commercial saturation letters is higher than this, for two reasons. First, the coverage of 206.3 percent is an average that includes both commercial and nonprofit categories. Since the nonprofit categories are charged rates with an average per-piece revenue that is only 60 percent of their commercial counterpart, it is clear that coverage for the commercial category is higher than the subclass average. Second, the former ECR subclass included other rate categories with higher costs, such as Basic and High-Density letters and flats.[1]

For the purpose of setting rates, much has now changed under PAEA. In particular, the Postal Service has identified High-Density and Saturation Letters as a separate product,

[1] When pieces in a subclass with varying unit costs are subjected to an equal per-piece markup, as recommended by the Commission in Docket No. R2006-1 for the ECR subclass (as well as other subclasses), an implication of the math is that application of the equal per-piece markup to the lower-cost categories results in a cost coverage that is higher than (i) the coverage on more costly pieces in the subclass, and (ii) the subclass average coverage. For discussion of this effect, with a numerical example, *see* Docket No. MC95-1, *Op. & Rec. Dec.*, ¶¶ 3065-3073.

including a nonprofit counterpart. This is an important change that should allow improved costing as well as better focus on rates that: (i) are economically efficient (specified in 39 U.S.C. § 3622(b)(1)); (ii) satisfy the requirement to consider the efficiency of the postal sector (specified in 39 U.S.C. § 3622(c)(12)); and also (iii) take into account market factors and net financial outcomes (including the focus on retained earnings specified in 39 U.S.C. § 3622(b)(5)). A good deal of the averaging which may have impeded this type of focus is now gone.

For newly-defined products, such as High-Density and Saturation Letters, detailed costs and cost coverages are unavailable. However, two factors relating to saturation letter costs may be noted.

First, it appears that about 35 percent of saturation letters on city routes are being cased.[2] In contrast, 90.28 percent of Standard Regular 5-digit letters are DPS'd, leaving a much smaller percentage to be cased.[3] The purpose of the DPS investment is to avoid costly casing. It can be anticipated that the costs of saturation letters will decline as more are either DPS'd or taken as an extra bundle.

Second, for some reason, it appears that the city carrier costing method for street activities is not recognizing low street costs for DPS'd letters. Handling these letters in a low-

---

[2] *See* VOLAdj071211.xls, tab SaturationVols, Docket No. ACR2007, USPS-FY07-19.

[3] *See* UDCInputs071211.xls, tab DPS%, USPS-FY07-19, Docket No. ACR2007, USPS-FY07-19.

cost way is central to the benefits associated with the DPS investment. The Postal Service should ascertain that these costs are being recognized appropriately.

A separate elasticity measure for High-Density and Saturation Letters is also not available at this time. Nevertheless, in this docket the Postal Service has taken a meaningful step in the direction of recognizing more appropriately the very high cost coverage of commercial saturation letters, as well as the high elasticity known to exist for all saturation mail. This is entirely consistent with PAEA's emphasis on setting rates in a way designed to improve the Postal Service's finances. The proposed rate increase also is in line with further movement that should be made in future annual rate adjustments, as better and more focused costs and demand information become available.

As a general concept, saturation letters, delivered in bulk to SCF facilities with DPS equipment, should be a model of low-cost operation. The letters are prepared for induction into the machines. Trays of DPS'd letters are moved in limited steps to carrier vehicles. Carriers then put groups of letters into mailboxes. The even less costly alternative of handling saturation letters as an extra bundle on the street is always available. Saturation letters are the most versatile mail handled by the Postal Service, as they can be processed in the way which is optimum for the Postal Service in any given situation. As such, their rates should reflect their favorable operational characteristics.

By way of contrast, in Docket No. R2006-1, DDU-entered on-piece addressed saturation flats had no rate increase whatsoever.[4] This special benefit apparently correlated

[4] *Compare* Docket No. R2006-1 rates (18.7 cents saturation flats minus 5.1 cents DDU entry discount = **13.6 cents**), *Op. & Rec. Dec.*, Appendix One, p. 17, with Docket No.

with representations of certain flats mailers that they were incurring significant one-time expense in converting from Detached Address Labels ("DALs") to on-piece addressing.[5] Regardless, this special benefit in current rates had the effect of closing the rate gap between letters and flats, and, if continued, would send undesirable price signals. In this docket, the Postal Service Notice explains that "[t]he Postal Service also widens the gap between saturation letters and flats brought to the Destination Sectional Center Facility (DSCF). This change will reduce the incentive for some mailers to convert letter-size mail pieces to flats, which are not as efficient to process and deliver." Postal Service Notice, p. 17.

III. FURTHER PROGRESS IS NEEDED ON PRICING OF DETACHED ADDRESS LABELS

Detached Address Labels originally were conceived as a technique for reducing the costs of delivering mailings of saturation or near-saturation parcels weighing under 16 ounces, but they also have been authorized for use with flats for some years.

One difficulty uncovered recently was that many of the costs of DALs were being attributed as letter costs. In Docket No. R2005-1, in order to fix this problem, the Postal

---

R2005-1 rates (16.9 cents saturation flats minus 3.3 cents DDU entry discount = **13.6 cents**), Docket No. R2006-1, Request of the United States Postal Service for a Recommended Decision on Changes in Rates of Postage and Fees for Postal Service, Attachment A, p. 19.

[5] *See* Saturation Mailers Coalition witness Pete Gorman's testimony, SMC-T-1, section entitled "The Difficult Transition From DALs to On-Piece Addressing," pp. 9-12. On a related point, the Commission cited witness Gorman as describing the "high cost, difficulty, and lead time involved in converting to on-piece addressing." Docket No. R2006-1, *Op. & Rec. Dec.*, p. 269.

Service made an adjustment to its cost analysis.[6] *See* Docket No. R2005-1, *Op. & Rec. Dec.*, pp. 137-38. In the end, the Commission said: "Because the Commission recommends the rates resulting from an across-the-board approach, the lower unit cost of saturation letter mail does not affect the rate in this instance. However, in future rate cases the revised unit costs should be reflected in rates." *Id.*, ¶ 6080.

Although a good estimate of the number of DALs in the postal system remained unavailable, in Docket No. R2006-1, the Postal Service presented costs for saturation letters that reflected improved accuracy, and went a step further, proposing that DALs be an added-cost option, relative to the on-piece-address alternative, and that a surcharge of **1.5 cents** should be instituted for their use.

In proposing the DAL surcharge, the Postal Service apparently understood that it was significantly below cost, but was considered adequate as an initial step for moving mailers toward on-piece addressing. *See* Docket No. R2006-1, Testimony of Postal Service witness James M. Kiefer, p. 32. Valpak argued that the DAL surcharge should reflect the costs of handling DALs and raised questions about who should finance any shortfall associated with the surcharge being below cost. The Commission, in approving the 1.5 cent surcharge for DALs, explained:

> The Commission also agrees … that the DAL costs, to the extent that any exist that are not recouped by the DAL surcharge, should not be paid by saturation flat mailers. The appropriate way to deal with this situation is for the entire subclass to make up any

---

[6] Discovery conducted by Valpak in Docket No. R2005-1 revealed that the Postal Service's estimate of the volume of DALs was significantly understated. *See* Docket No. R2005-1, *Op. & Rec. Dec.*, ¶ 6080.

> potential shortfall. This conclusion is buttressed by the fact that DALs currently are being used with high-density mailings. [Docket No. R2006-1, *Op. & Rec. Dec.*, ¶ 5566.[7]]

In the instant docket, relying on costs provided by the Postal Service in its Annual Compliance Report (Docket No. ACR2007), the extra cost associated with use of a DAL, relative to the cost of an addressed piece, appears to be 2.72 cents.[8] As a step forward, the Postal Service proposes to increase the DAL surcharge from 1.5 cents to 1.7 cents, a 13.3 percent increase. Viewed as a passthrough of the extra costs associated with DALs, this equates to about 62.5 percent. In calculating a rate index for comparison with the cap, the Postal Service shows a volume of just over 1.6 billion DALs.[9] A rough approximation of the difference between the cost and revenue of DALs will be about $16.3 million ((2.72 cents - 1.7 cents) x 1.6 billion DALs).

Although the proposal to increase the surcharge by 0.2 cents results in an above-cap increase of 13.3 percent, it remains less than the increase proposed for many of the parcel

---

[7] The backdrop for the Commission's reasoning that "DALs currently are being used with high-density mailings" is a paradoxical observation it made earlier: "Witness Kiefer confirms that the Postal Service does not currently allow high-density flats to use DALs. *See* Tr. 5/903. However, witness Kiefer also confirms that 7.7 percent of high-density mail that is dropshipped to DDUs use DALs. Tr. 18D/6666." Docket No. R2006-1, *Op. & Rec. Dec.*, ¶ 5430, footnote omitted.

[8] In file UDCmodel071211.xls, tab 11.SummaryBY of attachment USPS-FY07-19 to the Postal Service's FY 2007 Annual Compliance Report, 2.72 cents is the cost of a saturation host piece plus the cost of a DAL minus the cost of an attached-label saturation flat.

[9] CAPCALC-STD-FY2008.xls, Postal Service Notice, Attachment USPS-R2008-1/2.

categories. Further steps are needed in the near future because, at the current pace (of 0.2 cents increase per year), the surcharge will not be compensatory for another five years.

IV. PROPOSED RATES MAY RESULT IN SOME CLASSES OF MAIL FAILING TO COVER THEIR ATTRIBUTABLE COSTS

When revenues from any class of mail fail to cover attributable costs, a cross-subsidy from other mailers is required. The necessity to subsidize a money-losing class of mail makes it more difficult for the Postal Service to be financially self-sustaining in a rate cap environment. Should the Postal Service fail to be financially self-sustaining under the new rate cap environment and be forced to file an exigent rate case, all mailers will feel the pain of prior losses. However, a review of rate increases under PAEA is focused on ascertaining whether they conform with the cap, and is not, in the first instance, designed to ensure that there are no cross-subsidies after the pending rate adjustment takes effect.[10]

By way of illustration, the Cost and Revenue Analysis ("CRA") submitted by the Postal Service in its Annual Compliance Report for FY 2007 indicates a cost coverage for the Periodicals class of approximately **83 percent**.[11] In its submission in this docket, the Postal Service makes a retroactive adjustment to reflect the effect of the rate increase from Docket No. R2006-1 as though those rates had been in effect all year. On a *pro forma* basis, this

---

[10] *See generally* Frank A. Wolak, "Implementing a Modern System of Regulation for the Postal Service Under the Postal Accountability and Enhancement Act," testimony presented to the House Subcommittee on Federal Workforce, Postal Service, and the District of Columbia, February 28, 2008.

[11] Docket No. ACR2007, USPS-FY07-1.

increases Periodicals coverage to **89.59 percent**.[12] The rate increase for Periodicals proposed in this docket, applied to the same FY 2007 billing determinants used to adjust revenues upward to account for the higher rates that went into effect in July, would further increase the coverage of FY 2007 costs to **92.02 percent**.[13]

In this docket, the Postal Service has asserted that cost reductions should result from the restructuring of rates:

> The new price structure is expected to have cost-savings benefits as mailers respond to the incentives it creates. An increase in May of this year, in conjunction with the increase of last July and with increased mailer response to the incentives created by the new structure, should help move Periodicals towards cost-compensatory status.... The Postal Service is also working to further understand and reduce Periodicals costs, and has assembled a task force for that purpose, consistent with section 708 of the PAEA. [Postal Service Notice, p. 18.]

If the new rate structure in fact elicits an overwhelming response from Periodicals mailers and reduces costs by an amount sufficient to result in a coverage of at least 100 percent, that would be a most welcome outcome.[14] However, the jury is still out.

---

[12] Periodicals Cap Compliance, USPS-R2008-1/4, Summary spreadsheet.

[13] *Id.*

[14] Valpak has said it would welcome this achievement. "[I]f the cost of handling periodicals in fact were to be reduced through some combination of the different ways mentioned in ANM/MPA's Comments — *e.g.*, improved preparation, co-mailing, sortation on the FSS, various cost initiatives, etc. — that would help reduce and possibly eliminate the annual shortfall and resulting cross-subsidy. **Such an outcome would be the most desirable and least contentious way to resolve this issue**." Docket No. ACR2007, Valpak Reply Comments, p. 9 (emphasis added).

Although the Postal Service filing acknowledges that coverage of the Periodicals class has been less than 100 percent, it is Valpak's understanding of the Commission's new rules that the matter of compliance with 39 U.S.C. section 3622(c) is only before the Commission on a "provisional" basis, is "subject to subsequent review," and is not now before the Commission "on the merits" 39 CFR 3010.13(j).[15] Therefore, it appears that the Commission rules anticipate deferring final action on compliance with 39 U.S.C. section 3622(c)(2) until its compliance review for FY 2008. Accordingly, Valpak will await the next compliance review for any problem of under-priced Periodicals to be addressed when the Commission will make an after-the-fact determination as to whether rates promulgated under PAEA have complied with the requirement in section 3622(c)(2) that revenues from each class of mail cover its attributable costs, thereby eliminating cross-subsidies between classes of mail.

Respectfully submitted,

____

William J. Olson
John S. Miles
Jeremiah L. Morgan
WILLIAM J. OLSON, P.C.
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
(703) 356-5070
Counsel for:
Valpak Direct Marketing Systems, Inc. and
Valpak Dealers' Association, Inc.

---

[15] "For purposes of subsequent Commission proceedings, findings that a planned Type 1 rate adjustment is in compliance with the annual limitation set forth in § 3010.11 [CPI cap]; the limitations set forth in § 3010.28 [use of previously unused cap]; and 39 U.S.C. 3626, 3627, and 3629 **are decided on the merits**. A Commission finding that a planned Type 1 rate adjustment does not contravene **other policies** of 39 U.S.C. chapter 36, subchapter 1 is **provisional and subject to subsequent review**." 39 CFR 3010.13(j) (emphasis added).

**DOCKET NO. R2008-1:
COMPARISON OF COMMISSION RULES AND
POSTAL SERVICE NOTICE OF MARKET-DOMINANT PRICE ADJUSTMENT**

Commission Rule (39 CFR)	Requirement	USPS Notice (2/11/08)
Rule 3010.14(a)(1)	A schedule of the proposed rates	Appendix A
Rule 3010.14(a)(2)	The planned **effective date(s)** of the proposed rates	page 1 (May 12, 2008)
Rule 3010.14(a)(3)	A representation or evidence that **public notice of the planned changes** has been issued or will be issued at least 45 days before the effective date(s) for the proposed new rates	page 1 (publication of notice on USPS.com, pe.usps.com, the *DMM Advisory*, and *P&C Weekly* and issuance of a press release; 90 days prior)
Rule 3010.14(a)(4)	The identity of a responsible **Postal Service official** who will be available to provide prompt responses to requests for clarification from the Commission	page 2 (Mr. Joseph D. Moeller)
Rule 3010.14(b)(1)	The **amount of the applicable change in CPI–U** calculated as required by rule 3010.21 or 3010.22, as appropriate. This information must be supported by workpapers in which all calculations are shown, and all input values including all relevant CPI–U values are listed with citations to the original sources	page 3 (2.9 percent), Appendix D and worksheet
Rule 3010.14(b)(2)	A schedule showing **unused rate authority available** for each class of mail displayed by class and available amount for each of the preceding 5 years. This information must be supported by workpapers in which all calculations are shown	page 5 (no previous rate change involving cap)

Rule 3010.14(b)(3)	The **percentage change** in rates for each **class of mail** calculated as required by § 3010.23. This information must be supported by workpapers in which all calculations are shown, and all input values including current rates, new rates, and billing determinants are listed with citations to the original sources	pages 4-5, 13 (First-Class), 15 (Standard), 17 (Periodicals), 19 (Package Services); Library References USPS-R2008-1-1 – 5
Rule 3010.14(b)(4)	The amount of **new unused rate authority**, if any, that will be generated by the rate adjustment calculated as required by § 3010.26. All calculations are to be shown with citations to the original sources. If new unused rate authority will be generated for a class of mail that is **not expected to cover its attributable costs**, the Postal Service must provide the rationale underlying this rate adjustment	page 5 (unused pricing authority), page 18 (rationale for Periodicals not covering its costs)
Rule 3010.14(b)(5)	A schedule of the workshare discounts included in the proposed rates, and a companion schedule listing the avoided costs that underlie each such discount. The avoided cost figures must be developed from the most recent PRC Annual Compliance Report. This information must be supported by workpapers in which all calculations are shown, and all input values are listed with citations to the original sources	pages 26-37 (discussion); Appendix B and worksheet (schedules)

Rule 3010.14(b)(6)	Separate **justification** for all proposed workshare **discounts that exceed avoided costs**. Each such justification shall reference applicable reasons identified in 39 U.S.C. 3622(e)(2) or (3). The Postal Service shall also identify and explain discounts that are set substantially below avoided costs and explain any relationship between discounts that are above and those that are below avoided costs	pages 26-37
Rule 3010.14(b)(7)	A **discussion** that demonstrates how the planned rate adjustments are designed to help achieve the **objectives** listed in 39 U.S.C. 3622(b) and properly take into account the **factors** listed in 39 U.S.C. 3622(c)	pages 6-12 (generally), 13-15 (First-Class), 15-17 (Standard), 17-18 (Periodicals), 18-21 (Packages Services), 21-23 (Special Services)
Rule 3010.14(b)(8)	A discussion that demonstrates the planned rate adjustments are consistent with 39 U.S.C. 3626 [nonprofit, other discounts], 3627 [free rates], and 3629 [nonprofit eligibility]	pages 24-25
Rule 3010.14(b)(9)	A schedule identifying every change to the Mail Classification Schedule that will be necessary to implement the planned rate adjustments	pages 37-38 (discussion); Appendix C (changes to proposed MCS)
Rule 3010.14(b)(10)	Such other information as the Postal Service believes will assist the Commission to issue a timely determination of whether the requested increases are consistent with applicable statutory policies	

Rule 3010.14(c)(1)	A statement explaining its reasons for establishing the [new worksharing] discount	N/A (no new worksharing discounts)
Rule 3010.14(c)(2)	All data, economic analyses, and other information relied on to justify the [new worksharing] discount	N/A
Rule 3010.14(c)(3)	A certification based on comprehensive, competent analyses that the discount will not adversely affect either the rates or the service levels of users of postal services who do not take advantage of the [new worksharing] discount	N/A
Rule 3010.14(d)	The notice of rate adjustment shall identify for each affected class how much **existing unused rate authority is used** in the proposed rates calculated as required by rule 3010.27. All calculations are to be shown, including citations to the original sources	N/A