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

NOTICE OF PRICE ADJUSTMENT

Docket No. R2009-2

RESPONSE OF THE UNITED STATES POSTAL SERVICE
TO CHAIRMAN'S INFORMATION REQUEST NO. 1
(February 20, 2009)

Chairman's Information Request (CIR) No. 1 was issued on February 13, 2009. The request sought an answer no later than February 20, 2009. Attached is the Postal Service's response. The restated question has been distilled from the three page request, and is followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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Q. In the instant docket, the Postal Service does not evaluate First-Class Mail workshare discounts using established cost avoidance methodology. Instead, the Postal Service employs a new methodology that effectively de-links single-piece from workshare rates within First-Class Mail. … In the instant docket, the Postal Service does not provide a rationale for not using the established cost avoidance methodology. Please provide the Commission with a rationale explaining why the established cost avoidance methodology is not used and why the Postal Service chose to employ a new methodology at this time considering the limited time frame and scope of this rate adjustment review. The rationale should include an explanation of any changed circumstances over the last year requiring such change and a discussion of why it would not be more appropriate to consider these methodological issues in a separate rulemaking where public comment could be fully evaluated.

RESPONSE:

In the view of the Postal Service, the issue raised in this question is not one of cost avoidance methodology. As the Postal Service has explained in the past, it has *not* changed the methodology used in calculating the cost avoidances between Bulk Metered Mail (BMM) and Presort First-Class Mail. In both the FY 2007 and FY 2008 Annual Compliance Reports (ACRs), the Postal Service provided estimates of these cost avoidances, based on the Commission-approved cost methodology, in USPS-FY07-10 and USPS-FY08-10. Thus, because the cost avoidance methodology has not changed, there was no need to include this issue with the thirteen methodological changes proposed by the Postal Service in the prior fiscal year, or to provide a rationale for changing that methodology in the instant docket.

Rather, the issue that appears to have motivated this CIR is legal and definitional: whether the relationship between two distinct Mail Classification Schedule (MCS) products constitutes "worksharing," such that the provisions of section 3622(e) apply to that relationship. In its MCS proposal, the Postal

Service was responsive to the Commission's observation that the old subclass structure did not translate directly to the new framework of "products," and proposed that Single-Piece First Class Mail and Presort First-Class Mail be considered separate products due to their clear cost and market differences. See Docket No. RM2007-1, United States Postal Service Submission of Initial Mail Classification Schedule in Response to Order No. 26, at 11-12 (September 24, 2007). The Commission agreed that these types of mail constitute different products in Order No. 43. The Postal Service believes that this decision governs the application of section 3622(e), because that provision must be read in a manner consistent with section 3652(b).

The Commission cites its 2007 ACD to the effect that the assumption that worksharing relationships do not cross product boundaries is "not necessarily valid." However, in the 2007 ACD, the Commission also said:

> The logic of restricting worksharing analysis to intra-subclass rates does not necessarily translate directly into restricting analysis to intra-product rates. Whereas subclasses under the PRA were defined as having distinct cost *and* demand characteristics, products are defined in the PAEA as having distinct cost *or* demand characteristics. Whether or not a rate differential is a worksharing discount may depend, in part, on whether the categories in question have substantially similar demand characteristics.

FY 2008 Annual Compliance Determination at 63-64 (footnote omitted).

The Postal Service believes that presort First-Class Mail has both distinct cost *and* market characteristics from single-piece First-Class Mail (including BMM).[1] Therefore, while the Postal Service is mindful of cost and price relationships between presorted First-Class Mail and single-piece First-Class

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[1] See, e.g., United States Postal Service Submission of Initial Mail Classification Schedule at 11-12

Mail when making pricing decisions, it does not believe that this relationship constitutes a worksharing relationship for the purposes of applying the provisions of section 3622(e).

Moreover, the Commission has not instituted a proceeding to resolve this issue. The Postal Service respects the Commission's concerns over changing methodologies, and appreciates its decision not to make these price adjustment proceedings a venue for evaluating new methodologies. Yet, as stated above, the issue here is not a methodological one—that is, the issue is not what is the correct, or the approved, way to calculate the BMM-Presort cost avoidance. The Postal Service has not deviated from that methodology. The issue is whether the BMM-Presort relationship is worksharing that triggers the provisions of 3622(e). The Postal Service believes it is not, and has consistently maintained that position, while at the same publishing the data necessary for "avoided costs" and a related "passthrough" to be computed in both the 2007 ACR and 2008 ACR.[2]

The Postal Service's pricing decisions for the First-Class Mail single-piece first-ounce price (i.e., the "stamp" price) and the presorted letters price are based on a series of decisions beginning with the determination of what the stamp price should be. Once the decision was made to increase the stamp price to 44 cents (a 4.8 percent increase), it was obvious that presort prices would have to increase by less than the cap of 3.8 percent to keep the First-Class Mail class as a whole within the cap. This implied a passthrough of greater than 100 percent for the BMM and Mixed AADC Automation Letters cost difference. The effect of

[2] At the Commission's request (Order No. 169), the Postal Service provided an additional tab in Docket No. ACR 2008 to show these cost differences and resulting "passthroughs.".

the one-ounce single piece price of 44 cents was discussed in the Postal Service's Notice of Market-Dominant Price Adjustment on page 12:

> The First-Class Mail, first ounce letter price is a major driver of the overall increase for First-Class Mail; the Postal Service increases this price by two cents (4.8 percent). For simplicity, prices used by the general public are in whole cents (Factor 6). The integer constraint on the single-piece price generally results in some deviation from the average increase implied by the cap. To meet the cap average increase for First-Class Mail as a whole, the average percentage price increase for presorted mail is lower than the cap. This is a reverse of last year, when the presort grouping received a larger-than-the-cap increase. [Footnote 8: In 2008, Presorted Letters and Cards had an increase of 3.6%, which was above the cap of 2.9%. The one-cent stamp increase was 2.4%.]

In Docket No. R2008-1, the ratio of the price difference to cost difference between BMM and Mixed AADC letters turned out to be approximately 100 percent, given the price cap and the choice of 42 cents for the First-Class Mail stamp. The Docket No. R2009-2 ratio is approximately 129 percent for a similar measured cost difference.[3] This is a necessary result of (a) the size of the cap, (b) the First-Class Mail stamp price, which was rounded to a full cent under the integer constraint,[4] and (c) the relative size of these two mail categories within First-Class Mail. In future years, because of the sensitivity of the ratio to these three factors, the ratio could be larger than 100 percent or even shrink to less than 100 percent. Under just the right conditions, it may be possible to achieve a 100 percent ratio (or one that is not substantially below 100 percent) while observing the integer constraint on the stamp price, by making minor adjustments to other prices, such as the additional ounce price. But these

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[3] The 129 percent figure will be fully documented in the Postal Service's response to Question 6 of CIR No. 2, which is still under preparation but will be filed shortly.
[4] See 39 USC 3622(d)(2)(B).

circumstances should not be viewed as the norm. Adjusting the prices of the smaller First-Class Mail categories to in order to achieve a 100 ratio between BMM and Presort in every year would likely require large swings in the prices of these categories unrelated to their costs or market characteristics. In the Postal Service's view, this would be disruptive both to customers and to maintaining the efficient operations of the Postal Service. As such, if the BMM-Presort relationship were to be considered worksharing subject to section 3622(e), section 3622(e)(2)(D) would justify the deviation from 100 percent since, as described above, hitting the 100 percent target would most likely require large swings in other, non-workshare related, prices.

The Postal Service recognizes that, as this CIR suggests, the Commission wishes to deal with this issue outside of the time pressures attendant to this review. The Postal Service believes that this is appropriate, considering the significant and wide-ranging impacts of a Commission decision on this issue. The Commission will have a basis, based on this response, and the response of the Postal Service to CIR No. 2, Question 6, to issue a decision in this proceeding using whatever approach it considers appropriate at this time, while deferring final resolution of this issue. The Commission must understand, however, that applying the 100 percent standard of section 3622(e) to the BMM-Presort relationship in its decision in this docket, in a way that requires a change to any of the prices set forth in the Notice, is not appropriate, for, among other things, the reasons discussed above.