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

NOTICE OF PRICE ADJUSTMENT

Docket No. R2009-2

RESPONSES OF THE UNITED STATES POSTAL SERVICE
TO QUESTIONS 1-12 OF CHAIRMAN'S INFORMATION REQUEST NO. 4
(March 4, 2009)

Chairman's Information Request (ChIR) No. 4 was issued on February 25, 2009. The request sought answers no later than March 4, 2009. Attached are the Postal Service's responses to questions 1-12.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

R. Andrew German
Managing Counsel, Pricing and
Product Development

Daniel J. Foucheaux, Jr.
Chief Counsel, Pricing and Product
Support

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Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260-1137
(202) 268-2992, FAX: -5402
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1. The following question refers to the avoided cost, discount, and passthrough associated with Automation Mixed AADC Letters.

   a. The Commission's approved methodology for estimating avoided costs is identified in Order 169, question 5. Also, in its Response to Commission Information Request (CIR) No. 3, Questions 2 and 3, in Docket No. ACR2008, the Postal Service made two corrections. Please confirm that using the approved methodology with the corrections stated above, results in an avoided cost differential of $.016 between Automation Mixed AADC Letters and Automation AADC Letters. If not confirmed, please explain, provide the correct cost differential, and show all calculations.

   b. Please confirm that the resulting passthrough for Automation Mixed AADC Letters is 106 percent (0.017 / 0.016). If not confirmed, please explain.

   c. If subparts a. and b. above are confirmed, please provide a justification for why the discount for Automation Mixed AADC Letters exceeds 100 percent of avoided cost by reference to one or more of the exceptions specified in Section 3622(e).

RESPONSE:

For the purposes of responding to this question the Postal Service assumes that the question refers to Standard Mail.

a. Confirmed.

b. Confirmed.

c. The prices for Mixed AADC and AADC letters were developed to reflect 100 percent of avoided costs as filed in the FY2008 ACR as directed by the Commission's rule 3010.14(b)(5). The Postal Service is aware that the Commission issued Order No. 169 subsequent to the filing of the ACR, directing the Postal Service to provide alternate estimates of certain costs (including some of the costs that are used to calculate the Mixed AADC—AADC avoided costs) "[t]o enable the Commission (and interested persons) to assess the impact" of the cost estimating methodologies used in the ACR. The Commission has not yet issued its Determination on the ACR, including the methodologies used therein. Therefore, the Postal Service maintains that the discounts cited in this question comply with 3622(e) and the Commission's rules.

The Postal Service observes that the deviation from the Order 169-based avoided cost estimates is small, 0.1 cent. In the Postal Service's view, it would not be practical to change an announced price difference of this size (except to correct some serious error) without causing confusion and adding major uncertainty to the price adjustment process for little purpose and gain. Making changes in the announced prices that mailers have already incorporated into their planning would, at this stage (again, absent the discovery of major error), be an inefficient way to run a business.

2. The following question refers to Standard Mail Parcels and NFMs, Carrier Route Parcels, and High Density and Saturation Parcels. In its response to CIR No. 1 in Docket No. R2008-1, the Postal Service stated that a passthrough exceeding 100 percent for the DDU dropship discount is "intended to induce mailers to move parcels and NFMs out of the BMCs and into the DDUs." In R2009-2, the Postal Service increases the passthrough for DSCF parcels from 92.8 percent to 179.8 percent. This would seem to diminish somewhat the incentive to mailers to dropship parcels at DDUs. Please discuss the Postal Service's apparent shift in its incentive strategy for parcels.

RESPONSE:

The Postal Service does not agree with the inference that the changes in dropship discounts suggest an apparent shift in its incentive strategy. To be sure, these prices show an increase in the incentive to move parcels out of BMCs, but the incentive to move them into DDUs is not thereby diminished. In the Docket No. R2008-1 prices, the incentive to move the parcels described in the question out of the DBMCs and into DSCFs was 5.0 cents; the incentive to move parcels from DBMCs to DDUs was 17.2 cents. In the Docket No. R2009-2 prices these incentives are, respectively, 25.9 cents and 40.4 cents. Clearly the incentive to move parcels out of BMCs to <u>both</u> DSCFs or DDUs has been greatly increased. This is consistent with the Postal Service's policy statement quoted in the question. In Docket No. R2008-1, the incentive to further move parcels from DSCFs to DDUs was 12.2 cents; in the current docket this incentive has <u>increased</u>, to 14.5 cents. So, while the prices signal mailers to "move parcels and NFMs out of the BMCs," they unambiguously also signal mailers to move their parcels, even deeper—"into the DDUs," if possible.

The Postal Service continues to believe that it is advantageous to have parcels entered at the DDU rather than the DBMC. The incentive for moving parcels out of DBMCs and into DDUs was significantly enlarged in the Docket No. R2009-2 pricing. This presented the question of where the DSCF price should be set: should it be closer to the DBMC price, or the DDU price? The Postal Service believes that setting the DSCF price closer to the DDU price (while still widening the DSCF-DDU price gap) will encourage more parcels to move from DBMCs and will thus provide more consistent support to the overall strategic goal than the alternative—keeping the DBMC-DSCF incentive closer to its current value.

3. This question concerns the discount for 5-digit presorted parcels. The current discount of 39.9 cents is based on a passthrough of 116 percent. *See* R2008-1, Postal Service Notice, Appendix B. According to the Postal Service, the proposed discount of 43.9 cents, an increase of 3.9 cents, reflects primarily the 3.1 cent increase in avoided unit cost between FY 2007 and FY 2008. See R2009-1, Postal Service Notice, page 39. The planned 43.9 cent discount reflects a passthrough of 117 percent which is an increase compared with the R2008-1 passthrough percentage.

a. What were the other factors the Postal Service considered in deciding to increase the discount by more than the increase in unit avoidable cost?

b. Please show how the, albeit marginal, increase in the percentage passthrough is consistent with 3622(e).

c. What evidence does the Postal Service have that "Standard Mail parcels mailers might not undertake the investments necessary to prepare parcels to avoid BMC parcel sorting and move them quicker to delivery units." *Id.*

RESPONSE:

a. Postal Service product managers assessed costing information from other package offerings and, based on this information and their knowledge of Standard Mail parcels characteristics, believe that the costs avoided by 5-digit parcels were likely higher than reflected in the ACR data.

b. The Postal Service product managers for ground parcels have developed the price differences for BMC and 5-digit Standard Mail machinable parcels based upon the business needs of the Postal Service, their knowledge of mail processing and delivery operations and their familiarity with mailer behaviors. These price differences therefore represent the best informed judgments of the Postal Service officers responsible for the profit and loss of these products.

The Postal Service acknowledges that these price differences exceed the avoided costs developed from the cost estimates presented in the FY 2008 ACR. These cost estimates are the best data the Postal Service has been able to develop to date, but they are still evolving, and the Postal Service believes that they must still only be viewed as approximations to the true costs. At this stage in their development, the Postal Service is concerned that it would be unwise, and a poor business decision to force price differentials to rigidly adhere to these approximate cost differences, particularly when doing so would run counter to the informed judgment of the responsible Postal Service officers. The Postal Service believes that forcing rigid adherence to approximate avoided costs in the face of the countervailing judgment of its responsible managers would introduce risks significant enough to impede the efficient operation of the Postal Service. Therefore the Postal Service justifies these discounts under section 3622(e)(2)(D).

c. The Postal Service believes that, absent larger incentives to prepare parcels to avoid BMC parcel sorting, mailers would not perform the additional work. The best evidence of this is the FY 2008 volume profile which shows 74% of machinable pieces do not avoid BMC parcel sorting, so meaningful price incentives did not exist for this volume. To assist lower volume mailers to take advantage of these presort opportunities, Postal Service partners are also potential resources.

4 Please refer to United States Postal Service Notice of Market-Dominant Price Adjustment, pages 38-39. With regard to the discount between machinable Mixed BMC presorted and BMC presorted parcels, the Postal Service states, "The Postal Service is concerned that reducing the discount below what it proposes in this price adjustment will slow the movement toward finer presort levels and impede the efficient operation of the Postal Service."

a. Please explain what evidence the Postal Service has for believing that a smaller discount would slow the movement toward finer presort levels.

b. Please explain in what way a slow movement toward finer presort levels would impede the efficient operation of the Postal Service.

c. Please confirm that the cost savings from "bypassing the primary parcel sorters" is reflected in the avoided cost. If not confirmed, please explain.

d. Please explain how increasing the passthrough for BMC Machinable parcels will improve the cost coverage of the product.

RESPONSE:

a. Evidence for a slower movement toward finer presort levels comes through Postal Service management experience in the marketplace. This experience includes direct discussions with customers that explored their propensities to perform additional work at different relative price points. The price schedule in this notice reflects management's best information and judgment regarding customer willingness to change behaviors, while cognizant of our operational environment.

b. A slower movement toward finer presort levels would impede the efficient operation of the Postal Service by causing the Postal Service to continue to absorb costs of mail processing which are not recovered.

c. Not confirmed. The costs used to develop the "avoided costs" for Mixed BMC / BMC presort have some primary parcel sorting costs at each level.

d. The BMC-presort machinable parcel volume is dispatch-ready and, in many cases, is a simple transfer from one truck to another, thereby bypassing much of the mail processing activity associated with Mixed BMC parcels.

5. Please reference the tables below.

Table A			
Current Drop Ship Discounts for Standard Mail (Commercial and Nonprofit) and Standard Mail Carrier Route Letters, Flats, Parcels (Commercial and Nonprofit)			
	Letters	**Flats**	**Machinable Parcels/IPPs/NFMs**
DBMC	.159	.159	.159
DSCF	.203	.203	.209
DDU	-	-	.331

Table B							
Planned Drop Ship Discounts (Docket No. R2009-2)							
	Standard Mail (Commercial and Nonprofit)				**Standard Mail Carrier Route Letters, Flats, Parcels (Commercial and Nonprofit)**		
	Letters	**Flats**	**IPPs/NFMs**	**Machinable Parcels**	**Letters**	**Flats**	**Parcels**
DBMC	.163	.163	.215	.215	.163	.163	.221
DSCF	.208	.208	.466	.424	.208	.208	.480
DDU	-	-	.701	.620	-	.253	.625

In Docket No. R2009-2, the Postal Service plans, for the first time, differential drop ship discounts by product. Please provide a rationale for the differential discounts, given that the unit avoided costs do not vary by product.

RESPONSE:

The Postal Service has proposed different dropship discounts for different categories of Standard Mail since Docket No. R2006-1, when it proposed higher discounts for parcel-shaped mail pieces. And, as Table A demonstrates, the current dropship discounts for the Parcels and NFMs product differ from the dropship discounts for letters and flats.

The different dropship discounts for different categories of mail shown in Table B continues, rather than inaugurates, this process of price differentiation. While the current prices have larger incentives for parcels to dropship more deeply into the Postal Service's network, they are not dramatically higher than the incentives for letters and flats. In the set of prices that are the subject of Docket No. R2009-2, the Postal Service has offered much stronger incentives to move parcels out of BMCs and into both DSCFs and DDUs (see the response to ChIR 4, Question 2 for further discussion of this point).

Table B shows that in this round of pricing adjustments the Postal Serivce is offering differentiated dropship incentives within products also. For example, within the Parcels and NFMs product, machinable parcels have a slightly different set of dropship incentives than irregular parcels and NFMs. This, again, is not a new development. In the current pricing design for Standard Mail, the High Density and Saturation Flats and Parcels product and the Carrier Route product both have different dropship discounts for different categories within their respective products.

In the FY 2008 ACR, the Postal Service presented two sets of dropship cost avoidances for Standard Mail. The first, developed using the traditional methodology, estimated avoided costs for Standard Mail as a whole. The Postal Service also, for the first time, presented estimates of Standard Mail dropship avoided costs by mail processing shape. All of the passthroughs in the Notice's Appendix B were calculated using the aggregate Standard Mail cost avoidances, although the Postal Service's discussion of worksharing discounts and cost avoidances pointed out that none of the Standard Mail dropship discounts exceeded 100 percent of the avoided costs by shape for the predominant shape in each pricing category. This means, for example, that all of the discounts for the parcel-based price categories (including NFMs) fall well within the respective parcel shaped dropship avoided cost estimates in the FY 2008 ACR. Variations in the pattern of discounts between pricing categories within the same product and across products reflect the Postal Service's exercise of its pricing flexibility (Objective 4) to tailor prices to discrete groups and categories of mail based on the business needs of the Postal Service, its understanding of the cost and market characteristics of different subgroups of mail within and across products, and what discounts are appropriate to encourage desired mailer behaviors.

6. Please refer to Library Reference USPS-R2009-2/2, Standard Mail Cap Compliance, and the Word file, "Standard Mail Attachment Preface FINAL.doc," where the Postal Service states, "The migration patterns adopted in worksheet 'Parcels Migration Distributions' reflect the experience and judgment of Postal Service parcels managers." The Postal Service also states that, "management believes that it is reasonable for machinable parcels now paying 5-digit Origin prices to migrate to the BMC Origin, 5-digit DBMC, 5-digit DSCF and 5-digit DDU pricing categories roughly in the same proportions as total Standard pieces and pounds were distributed to those same categories in the FY 2008 billing determinants." Please explain in detail the reasoning behind management's conclusion that it is reasonable for machinable parcels now paying 5-digit Origin prices to migrate as described above.

RESPONSE:

The Postal Service believes that its choice of the words "migrate" and "migration" to describe its "reasonable adjustments" to the billing determinants under rule 3010.23(d) was inapposite. The pattern of adjustments should, in theory, reflect the FY 2008 distribution of volumes had the eliminated pricing cells not existed. The adjustments are not intended as a forecast of volumes in response to pricing changes. The Postal Service believes that the term "assignment" more appropriately reflects the kind of adjustment made, whereas "migration" inappropriately suggests a forecast of volume responses.

The Postal Service parcels management based its volume adjustment pattern on its experience with Standard Mail parcels and parcels mailers. Its judgment, based on this experience, was that customers who have sufficient volume to make up 5-digit containers would reasonably have efficiencies in transporting volume for entry at locations, such as BMCs, rather than at origin, and would have done so, had the origin option not existed in the pricing charts.

7. Please refer to the Postal Service's Notice at 31-40 and Appendix B.

   d. Please provide a revised version of Appendix B which shows the discounts, avoided costs, and percentage passthroughs by shape (letters, flats, parcels) between (1) Basic and High Density, and (2) High Density and Saturation.

   e. Based on the response to subpart (a), please discuss how the proposed presort discounts for Standard Mail Carrier Route Letters, Flats, Parcels comply with the worksharing requirements in section 3622(e) of title 39.

   f. Based on the response to subpart (a), for each discount in excess of the avoided cost, please identify the specific statutory exemption claimed and provide a complete explanation of how the discount satisfies that exemption.

RESPONSE:

While providing the calculations requested, the Postal Service does not accept the premise that either shape or density can be defined as worksharing. In its broadest sense, worksharing occurs when customers undertake activity that the Postal Service would otherwise do. Clearly customers can make decisions that affect shape or density; however, this is not an activity that the Postal Service could undertake once mail is presented. A flat cannot be transformed into a letter; a parcel cannot be transformed into a flat; and a letter cannot be transformed into a letter. Similarily, the Postal Service cannot change the density of mailing from high-density (125 pieces per carrier route) to saturation (75 percent of all addresses on the route). More fundamentally, the statute defines worksharing very explicitly as presorting, prebarcoding, handling and transportation of the mail. None of these is changing shape or changing density.

a. Please see the Excel file ChIR4.Q7.Appendix.B.xls, which is attached electronically to this response.

b. Please see the Postal Service's response to Order No. 169, Item 6. In that response the Postal Service explained its position that density differences such as those between Carrier Route (what the question refers to as Basic) and High Density, and between High Density and Saturation mail are not worksharing. Therefore the worksharing requirements in section 3622(e) of title 39 do not apply.

Nevertheless the Postal Service acknowledges that the Commission has exhibited an interest in knowing how the Postal Service would treat these price and cost relationships in the counterfactual case that the differences were worksharing. While continuing to maintain that these differences are not worksharing, the Postal Service is willing to assist the Commission in its review of its noticed price changes by responding to the Commission's inquiries as if these relationships were worksharing.

Worksheet "ChIR4-Q7 Resp." in workbook ChIR4.Q7.Appendix.B.xls shows that three of the price differences are larger than their corresponding mail processing plus delivery unit cost differences. All other price differences would be in compliance with section 3622(e) were they, in fact, worksharing. The three differences where the price differences exceed the cost differences are the differences between Saturation and High Density Letters, between Saturation and High Density Flats, and High Density and Carrier Route parcels.

c. If the Postal Service were to treat address density differences as worksharing, it would justify the High Density letters / Saturation letters and Carrier Route parcels / High Density parcels price differences using section 3622(e)(2)(D). The price differences between these pairs of categories exceed the estimated cost differences because the estimated cost differences are negative. That is, the sum of the estimated mail processing plus delivery costs for Saturation letters is higher than the corresponding sum of costs for High Density letters and the sum of the estimated mail processing plus delivery costs for Carrier Route parcels is higher than the corresponding sum of costs for High Density parcels. The Postal Service believes that these estimated cost relationships are anomalous in that they do not represent the true cost differences that are attributable, ceteris paribus, to the address density differences between these categories of mail. Because of this, they should not be used as the bases for establishing reasonable pricing relationships between these categories. If the Postal Service were to attempt to set prices for these pairs of categories so as to achieve 100 percent "passthroughs" of the cost differences, it would have to price Saturation letters higher than High Density letters and High Density parcels higher than Carrier Route parcels, contrary to what has always been believed to be the underlying cost relationships between these categories. If later estimates uphold the Postal Service's longstanding belief about the cost relationships of these mail categories, the Postal Service would then have to reverse the pricing relationships and once again adopt the former ordering. To say the least, this kind of vacillating pricing would run contrary to the PAEA's goal of stable and predictable pricing. Moreover, it would send confusing signals to mailers, leading to unpredictable behaviors and mail flows and undermine the Postal Service's efforts to conduct its operations in the most efficient way possible.

Further, the Postal Service took the current price relationships between High Density and Saturation flats into account when setting prices. Discouraging potential migration from Saturation to High Density and non-mail alternatives was a consideration in setting the two respective pound rates as well as in determining the density tier price differences, which in this hypothetical are considered "worksharing passthroughs." The Postal Service understands that the boundary between these two categories of mail is porous and mail moves both ways between them. The Postal Service is concerned that narrowing the gap between High Density and Saturation flats prices might lead significant volumes of Saturation flats to switch to products which deliver geographically targeted flats mainly using private carriers, with the residual typically being mailed using the Postal Service's High Density flats category. This could lead to a significant loss of contribution from Saturation flats. The Postal Service would therefore justify the price difference between High Density and Saturation flats using sections 3622(e)(3)(A).and 3622(e)(2)(D).

As with the Standard Mail Flats product, the Postal Service has attempted to address the potential loss of Saturation flats by moderating the price changes for Saturation flats by holding the line on the pound price element for the great majority of Saturation flats (i.e., DSCF and DDU entered Saturation flats). The pound price element for Saturation flats is also moderated in order to encourage Saturation mail to stay and to grow higher weight volume in the Saturation category, as well as to discourage migration of pieces from the mail altogether.

The Postal Service is concerned that reducing the price gap between High Density and Saturation flats may lead enough mailers to switch from Saturation mail going to 100 percent of residential households to other products where the Postal Service would deliver to a much smaller percentage of residential addresses formerly covered. A large loss in volume like this would lead to a reduction in the aggregate contribution from Saturation mail below what it would have been if the gap had not been narrowed (and ultimately drive up other Standard Mail prices). While such an outcome is not certain, narrowing the gap would expose the Postal Service to the risk of a serious loss in contribution. Running risks of serious contribution losses unnecessarily would certainly undermine the efficient operation of the Postal Service.

8. Please refer to the Postal Service's Notice at 16. Please provide the specific standards, including identifying the time period in which volume growth is to be measured, that apply to the new incentive targeted at increasing saturation mail volumes.

RESPONSE:

The standards for the saturation incentive program are contained in DMM 243.1.9 (for letters) and 343.1.7, reproduced below.

200 Commercial Mail Letters and Cards

240 Standard Mail

243 Prices and Eligibility

1.0 Prices and Fees for Standard Mail

1.9 Saturation Mail Volume Incentive Program

1.9.1 Basic Program Eligibility

Mailers of Regular and Nonprofit Standard Mail saturation letters under 243.6.5 that demonstrate a verified increase in mailing volume from the prior year (May 11, 2008 to May 10, 2009), qualify for a per-piece credit to postage paid on the incremental volume, recorded during the established program period, under the following conditions:

a. Qualifying mailers may request a credit to the postage paid on the incremental saturation mailing volume under either of the following conditions:

    1. Based on an overall increase in the mailer's total saturation mailing volume.

    2. Based on an increase in the volume of saturation mailpieces destinating to ZIP Codes within a specific sectional center facility (SCF) (or group of SCFs) identified by the mailer.

b. Mailers must be able to demonstrate saturation mail volume in both the 2007 and 2008 calendar years. Mailers applying for a credit to the postage paid on saturation mailpieces within a specific SCF must be able to demonstrate saturation mail volume to ZIP Codes within the specified SCF in both the 2007 and 2008 calendar years.

c. Mailers must be able to demonstrate a minimum of six saturation mailings (or six saturation mailings to a specified SCF) in the 2008 calendar year.

d. Mailers must pay saturation postage through a permit imprint advance deposit account at the time of application and must have a functioning Centralized Account Payment System (CAPS) account prior to the close of the program period.

e. Each permit imprint advance deposit account used for the payment of postage for saturation mailings must be established at a Postal facility having *PostalOne!* capability.

f. Mailers presenting saturation mailpieces within a Negotiated Service Agreement (NSA) or through another Postal Service-sponsored incentive program are not eligible for the saturation mail volume incentive program.

g. Letter-size mailpieces that are not automation-compatible or not barcoded and are mailed at flat-size saturation prices are not eligible for the saturation mail volume incentive program.

1.9.2 Application

Mailers wishing to participate in the saturation mail volume incentive program must submit a letter requesting participation to their district Manager, Business Mail Entry (see the postal locator link on Postal Explorer at http://pe.usps.com for contact information).

a. Mailers must specify their intent to apply for consideration for an overall volume increase under 1.9.1.a1, or for a volume increase to a specific SCF (or group of SCFs) under 1.9.1.a2.

b. Applications must include historical mailing activity demonstrating eligibility for the program as specified under 1.9.1.

c. Applications must specify the mailer's Permit Imprint advance deposit account(s) and Centralized Account Payment System (CAPS) account(s) number(s). Mailers applying for CAPS accounts within the program period must provide their CAPS account number to their district Manager, Business Mail Entry before the end of program period.

d. Applications may be submitted after February 11, 2009, and must be received by the district Manager, Business Mail Entry no later than June 11, 2009.

e. Applications must be completed and submitted by an official of the business or nonprofit entity that owns the mail. For the purposes of participation in this program, an entity that owns the mail is defined as the parent organization. Franchisees that are not separate business entities may not apply for the incentive independently of the parent organization. Printers and mailing agents may not apply for external entities for which they prepare the mail.

1.9.3 Additional Eligibility Standards

Mailers requesting eligibility for a volume increase to a specific SCF (or group of SCFs) under 1.9.1.a2 must submit mailing documentation electronically to the Postal Service using an approved method (e.g. Mail.dat) at the time of application and for the duration of their participation in the program.

1.9.4 Saturation Mail Volume Incentive Credits

Approved program participants demonstrating an increase in saturation mail volume under 1.9 qualify for a per-piece credit to the postage paid on the incremental volume, recorded during the established program period as follows:

a. Standard Mail saturation letters: $ 0.037 per piece.

b. Nonprofit Standard Mail saturation letters: $ 0.022 per piece.

1.9.5 Incentive Program Period

The program period is annual and begins May 11, 2009. Approved participants demonstrating an increase in saturation mail volume in accordance with 1.9.0 and otherwise in compliance with the terms of this program, receive a credit to their specified CAPS account after the close of the annual program period.

300 Commercial Mail Flats

340 Standard Mail

343 Prices and Eligibility

1.0 Prices and Fees for Standard Mail

1.7 Saturation Mail Volume Incentive Program

1.7.1 Basic Eligibility

Mailers of Regular and Nonprofit Standard Mail flats under 343.6.5 that demonstrate a verified increase in mailing volume from the prior year (May 11, 2008 to May 10, 2009) qualify for a per-piece credit to postage paid on the incremental volume, recorded during the established program period, under the following conditions:

a. Qualifying mailers may apply for a credit to the postage paid on the incremental saturation mailing volume under either of the following conditions:

    1. Based on an overall increase in the mailer's total saturation mailing volume.

    2. Based on an increase in the volume of saturation mailpieces destinating to ZIP Codes within a specific sectional center facility (SCF) (or group of SCFs) identified by the mailer.

b. Mailers must be able to demonstrate saturation mail volume in both the 2007 and 2008 calendar years. Mailers requesting a credit to the postage paid on saturation mailpieces within a specific SCF must be able to demonstrate saturation mail volume to ZIP Codes within the specified SCF in both the 2007 and 2008 calendar years.

c. Mailers must be able to demonstrate a minimum of six saturation mailings (or six saturation mailings to a specified SCF) in the 2008 calendar year.

d. Mailers must pay saturation postage through a permit imprint advance deposit account at the time of application and must have a functioning Centralized Account Payment System (CAPS) account prior to the close of the program period.

e. Each permit imprint advance deposit account used for the payment of postage for saturation mailings must be established at a Postal facility having *PostalOne!* capability.

f. Mailers presenting saturation mailpieces within a Negotiated Service Agreement (NSA) or through another Postal Service-sponsored incentive program are not eligible for the saturation mail volume incentive program.

1.7.2 Application

Mailers wishing to participate in the saturation mail volume incentive program must submit a letter requesting participation to their district Manager, Business Mail Entry (see the postal locator link on the Postal Explorer at http://pe.usps.com for contact information).

a. Mailers must specify their intent to apply for consideration for an overall volume increase under 1.7.1.a1, or for a volume increase to a specific SCF (or group of SCFs) under 1.7.1.a2.

b. Applications must include historical mailing activity demonstrating eligibility for the program as specified under 1.7.1.

c. Applications must specify the mailer's Permit Imprint advance deposit account(s) and Centralized Account Payment System (CAPS) account(s) number(s). Mailers applying for CAPS accounts within the program period must provide their CAPS account number to their district Manager, Business Mail Entry before the end of program period.

d. Applications may be submitted after February 11, 2009 and must be received by the District Manager, Business Mail Entry no later than June 11, 2009.

e. Applications must be completed and submitted by an official of the business or nonprofit entity that owns the mail. For the purposes of participation in this program, an entity that owns the mail is defined as the parent organization. Franchisees that are not separate business entities may not apply for the incentive independently of the parent organization. Printers and mailing agents may not apply for external entities for which they prepare the mail.

1.7.3 Additional Eligibility Standards

Mailers requesting eligibility for a volume increase to a specific SCF (or group of SCFs) under 1.7.1.a2 must submit mailing documentation electronically to the Postal Service using an approved method (e.g. Mail.dat) at the time of application and for the duration of their participation in the program.

1.7.4 Saturation Mail Volume Incentive Credits

Approved program participants demonstrating an increase in saturation mail volume, within the area selected and approved under 1.7.1.a, qualify for a per-piece credit to the postage paid on the incremental volume, recorded during the established program period as follows:

a. Standard Mail saturation flats $0.04 per piece.

b. Nonprofit Standard Mail saturation flats $0.024 per piece.

1.7.5 Incentive Program Period

The program period is annual and begins on May 11, 2009. Approved participants demonstrating an increase in saturation mail volume in accordance with 1.7.0 and otherwise in compliance with the terms of this program, receive a credit to their specified CAPS account after the close of the annual program period.

9. In Docket No. MC2008-3 the Commission approved a classification change for Bound Printed Matter Flats and Bound Printed Matter Parcels (BPM), which required mailers to pay postage by permit imprint only. This classification change may have caused mailers that became ineligible to mail BPM pieces to shift former BPM volumes to other mail products because of the new requirement. This shift in volume may have caused adverse affects on the price cap compliance calculations. *See* Order No. 89 at 14. In order to comply with rule 3010.23(d) please provide adjusted FY 2008 billing determinants for Bound Printed Matter Flats and Bound Printed Matter Parcels to reflect this classification change. Please include all information relied upon to develop the adjustment and an explanation of why the adjustment is reasonable and appropriate.

RESPONSE:

The Postal Service does not have the information required to make reasonable adjustments to the BPM billing determinants as requested. Because the two BPM products have significantly different characteristics, separate adjustments would have to be made for each product. The following discussion, therefore, addresses each product separately.

<u>BPM Flats</u>

The Postal Service's BPM Flats product is mainly catalogs that are too heavy to qualify as Standard Mail. It is the Postal Service's belief that BPM Flats—including Nonpresorted (single piece) BPM Flats is overwhelmingly a commercial product. BPM Flats mailers are likely to have permits and are likely to pay Nonpresorted BPM prices to mail individual catalogs to requesters who were not on the mailing list for one of their earlier bulk catalog mailings.

The Postal Service expects that BPM Flats mailers who formerly brought single piece catalogs to the retail window would respond to the permit indicia requirement in one or more of the following ways:

1. Continue to mail at Nonpresorted prices, and pay postage using a permit. The Postal Service's new rules allow permits to be used with no minimum quantity to pay Nonpresorted BPM postage. Mailers would use their existing permits, or if they do not have a permit at the office they customarily use to send out single piece catalogs, they would acquire one.
2. Mail single piece catalogs using Parcel Post or Priority Mail. It is possible that some mailers, when given the choice between Parcel Post and Priority Mail pricing and service levels, might opt for Priority Mail service, even though it has a higher price. The mailer's decision to "buy up" should not be counted in figuring any price impact on Package Services,

however, since Parcel Post is available and offers comparable service to BPM. These pieces, presumably, should be treated for billing determinants adjustment purposes as if they had mapped to Parcel Post.

3. Postpone mailing catalogs until the next bulk mailing. The mailer may decide to not send out a catalog as single piece mail, but rather to include the recipient on the mailing list for the next bulk catalog mailing.
4. Cease mailing individual catalogs via the Postal Service. The mailer may choose an alternate carrier for its single piece catalogs or may forego mailing catalogs as single piece mail altogether. This latter possibility only makes sense for very small volume catalog mailers who never mail out enough catalogs at any one time to qualify as bulk mail. These mailers may decide, rather than acquire a permit, to drop out of the mail entirely, switching, for example, to an online only format for their catalogs. In either of these cases, there is no mapping of volume from single piece to bulk mail. Indeed there is no shift of this volume to any USPS mail category.

To make the adjustments requested in the question, the Postal Service would have to make reasonable estimates of the volume of retail window Nonpresorted BPM Flats mail that would map to each of these four possibilities. Without performing an extensive and expensive survey, the Postal Service does not know how to reasonably estimate the volumes in any of these four categories, except possibly for category 1, where Postal Service estimates of volume by mail category and indicia might be employed. With no other data available, the Postal Service could assign an arbitrary share of one-third of the assumed balance no longer in the Nonpresorted BPM Flats to each of the three remaining categories, although, from a business perspective, category 3 would appear to have a much larger probability than either 2 or 4.[1]

Once the volumes (albeit arbitrary) in each category are selected, the billing determinants for Nonpresorted BPM Flats and the destination product / category have to be adjusted to reflect their assigned volumes. The Postal Service has no data on the weight and zone distribution of the pieces that no longer use its products. Presumably the assumption could be made that the weight and zone of those pieces leaving Nonpresorted BPM Flats are the same as the weight and zone of the remaining pieces.

For making adjustments to the destination billing determinants, category 2 pieces pose the least problems. The pieces leaving BPM Flats could be assigned to the

[1] Catalog mailings typically operate on a tight margin and the expected net return from each catalog mailed is small and may become marginal or negative (i.e., a loss-leader) even at Nonpresorted (single piece) BPM Flats prices. If a mailer is faced with the choice of paying Parcel Post or nonpostal carrier prices, or purchasing another permit, the Postal Service believes that many catalog mailers would simply decide to add the requester to its mailing list and send the requester a catalog at the next bulk mailing.

corresponding Single Piece Parcel Post price cells, since the two pricing designs are reasonably similar.

Category 3 pieces are more challenging. The Postal Service would have to assign Nonpresorted volumes by zone and weight to bulk BPM Flats price categories. This raises a broad constellation of additional issues. For one, there is no single set of presorted prices: bulk BPM can be sent as either Basic Presort or Carrier Route Presort. Moreover, bulk BPM offers dropship pricing and (as the Postal Service has testified on multiple occasions under the former rate case regime), there is no direct correspondence between dropship zones and non-dropship zones.[2] Although there are no data to support it. perhaps an assumption can be made that the profile of the Nonpresorted BPM Flats in category 3 would match the profile of the presorted BPM Flats it is mapped to. Then the category 3 pieces could be added to each bulk BPM Flats pricing category on a pro-rata basis.

Pieces that drop out of the mail altogether pose an entirely different problem. There is no billing determinants category to assign these pieces to. The Parcel Post prices are obviously too high (since the mailers were clearly unwilling to pay them). And the number of pieces that will use alternate carriers would be totally a guess. Moreover, alternate carriers do not offer a bundle of services comparable to the Postal Service's BPM, leaving aside the question why it would be reasonable to use a competitor's price at all.[3] Although it is not above criticism, the only way to treat departing pieces that do not end up in other Postal Service products without piling up layers of arbitrary assumptions to unreasonable levels would be to eliminate these pieces from the Nonpresorted BPM Flats billing determinants and leave the matter at that.

BPM Parcels

BPM Parcels are mainly books sent by companies in fulfillment of mail orders or by book clubs to regular members. Nonpresorted BPM Parcels does include a number of individual single book transactions, but also contains large numbers of returns to book clubs (that is, parcels returned and refused by addressees for which the original shipper has agreed to pay return postage at Nonpresorted prices).

[2] In other words, a non-dropship zone 3 should not be compared to a DBMC zone 3. The former measures the distance between the mailer's origin postal facility and the addressee, whereas a DBMC zone 3 measures the distance between the destination BMC and the addressee. A single piece zone 3 catalog will only by chance happen to translate into a DBMC zone 3 catalog when dropshipped.

[3] Assuming, for the sake of argument that it were, that still doesn't reveal the actual prices charged by the competitor, rather than their undiscounted public "list" prices.

The Postal Service expects that BPM Parcels mailers who formerly brought single piece parcels to the retail window would respond to the permit indicia requirement in one or more of the following ways:

1. Continue to mail at Nonpresorted prices and pay postage using a permit. The Postal Service's new rules allow permits to be used with no minimum quantity to pay Nonpresorted BPM postage. Mailers would use their existing permits, or if they do not have a permit at the office they customarily use to send out single piece parcels, they would acquire one.
2. Mail single piece books using Media Mail if they do not contain any advertising and would otherwise meet the Media Mail eligibility standards.
3. Mail parcels that would not qualify as Media Mail using Parcel Post or Priority Mail. Some parcels are catalogs that are too thick to qualify as flats. These and other parcels that contain advertising would not qualify as Media Mail and so would go via Parcel Post or Priority Mail. It is possible that some mailers, when given the choice between Parcel Post and Priority Mail pricing and service levels, might opt for Priority Mail service, even though it has a higher price. The mailer's decision to "buy up" should not be counted in figuring any price impact on Package Services, however, since Parcel Post is available and offers comparable service to BPM. These pieces, presumably, should be treated for billing determinants adjustment purposes as if they mapped to Parcel Post.
4. Postpone mailing books until there are enough parcels to qualify as a bulk mailing. BPM Parcels mailers typically have a regular stream of incoming orders. If the orders are too small to qualify as a bulk BPM mailing, the mailer can hold onto the parcels until there are enough pieces to qualify; Alternatively, smaller mailers can use consolidators to gain some of the advantage of bulk mailing without holding onto orders until they have accumulated enough to make up a bulk mailing themselves. Mailers of catalogs that are too thick to qualify as BPM Flats might also opt for the category 3 response described in the BPM Flats section.
5. Cease mailing individual parcels via the Postal Service. The mailer may choose an alternate carrier for its single piece parcels or may forego mailing book parcels altogether. This latter possibility would probably only be chosen by (i) BPM Parcels mailers who are mailing catalogs and who might switch to an online-only format for their catalogs, or by (ii) certain private mailers who might mail out books, for example, as gifts, and who might decide to send another gift or gift certificate instead.

To make the adjustments requested in the question, the Postal Service would have to make reasonable estimates of the volume of retail window Nonpresorted BPM Parcels mail that would no longer be entered throughfrom retail sales channels, and how much should be mapped into each of these five categories. As discussed in the BPM Flats section above, the only volumes that the Postal Service might have data to base a reasonable estimate would be for category 1. Without a large survey to develop estimates for the other four categories, the Postal Service could arbitrarily assume that one-fourth of the mail that does not fall into category 1 would go to each of the remaining four categories. Alternatively, the Postal Service might assume that a greater proportion of parcels to be remapped would fall into category 2, based on the assumption that most Nonpresorted BPM parcels are books and most books would qualify for Media Mail. In addition, single piece Media Mail prices do not differ much from BPM prices. What share of pieces might pay Media Mail prices would have to be an educated guess. It is likely that relatively fewer of the remapped pieces would fall into categories 3 to 5, although just how many would also be a guess.

In adjusting the billing determinants, the process and issues describe in the BPM Flats section would also apply to the BPM Parcels. Media Mail does not have zones, so the zone distribution of the remapped Nonpresorted BPM would not matter. The Parcel Post and bulk BPM procedures and issues would be the same. And the closest thing to a reasonable adjustment for parcels that leave the Postal Service would be to remove their volumes from the BPM billing determinants without placing them anywhere else.

The foregoing discussion outlines the amounts and kinds of guesswork and arbitrary assumptions that the Postal Service would have to make to perform the requested adjustments to the billing determinants since there is almost no data to work with. The Commission's rules require that the Postal Service make reasonable adjustments to billing determinants when classification changes occur. While some assumptions are necessary in almost any analysis and adjustment to billing determinants, the inordinate amount of guesswork and arbitrary assumptions needed to produce these adjustments would render and adjustments so produced highly suspect and place them well beyond the pale of reasonability.

10. Please refer to USPS-R2009-2/3 Periodicals Cap Compliance, File: CAPCALC-PER-FY2009.xls, Sheet: Nonprofit BD08.

a. Please explain why the following cells were left blank: H79:I80, H85:I86, H92:I93, G101:I102, and H107:I108.

b. If they were left blank in error, please file a revised version of the excel file.

RESPONSE:

a. They were left blank in error.

b. The revised spreadsheet, ChIR4_Qu.10.11 CAPCALC-PER-FY2009.xls, is attached. As a result of this correction, the correction that results from the response to question 11, and the correction discussed in the response to question 4 of Chairman's Information Request No. 5, the overall increase for Periodicals changes from 3.966 percent to 3.961 percent. The 'Unused Pricing Authority Available Following this Price Change' changes from 0.010 percent to 0.015 percent.

11. Please refer to USPS-R2009-2/3 Periodicals Cap Compliance, File: CAPCALC-PER-FY2009.xls, Sheet: Classroom BD08, and United States Postal Service Notice of Market-Dominant Price Adjustment, Appendix B.xls, Table 1310.

    a. Please explain the reason why the following cells CAPCALC-PER-FY2009.xls, Sheet: Classroom BD08 do not match the corresponding rates in Appendix B.xls, Table 1310: H79:H80, H85:H86, H92:H93, and H101:H102.

    b. If the cells identified are in error, please file a revised version of the excel file.

RESPONSE:

a. Assuming that the question refers to Table 1310 in the Word document in Appendix A, the cells referred to in CAPCALC-PER-FY2009.xls, Sheet: Classroom BD08 are in error. Besides the cells referred to in the question, Cells H107:H108 and H114:H115 also are in error.

b. Please see the response to question 10, part b.

12. Please refer to USPS-R2009-2/3 Periodicals Cap Compliance, File: CAPCALC-PER-FY2009.xls, Sheet: Price % of Cst-Bundle-Contnr., and ACR2008-LR-FY208-11, File: Per OC Flts.xls, Sheet: Summary.

a. Please reconcile the differences between the non-weight related unit bundle costs of sacks on ADC, SCF/3-D, and 5-Digit containers in the above-mentioned sheet in file Per OC Flts.xls, and cells D13:D17, D20:D22, and D25:D26 in the above-mentioned sheet in file CACPCALC-PER-FY2009.xls.

b. If the cells identified in either file are in error, please file a revised version(s) of the excel file(s).

RESPONSE:

a. As was the case in Docket Nos. R2006-1 and ACR 2007, the bundle costs used in both pricing and the cap calculation are the weighted costs of sacked and palletized bundles. Separate prices for palletized bundles and sacked bundles are not applied. The weighted costs used in CAPCALC-PER-FY2009.xls, Sheet: Price % of Cst-Bundle-Contnr., and ACR2008-LR-FY208-11, File: Per OC Flts.xls, Sheet: Summary are the same. The below mapping applies:

Price % of Cst-Bundle-Contnr	Summary
D13:D17	V45:V49
D20:D22	W46:W49
D25:D26	X48:X49

b. Not applicable.

CERTIFICATE OF SERVICE

I hereby certify that I have this date served the foregoing document in accordance with Section 12 of the Rules of Practice and Procedure.

Eric P. Koetting

475 L'Enfant Plaza West, S.W.
Washington, D.C. 20260–1137
(202) 268-2992, FAX: -5402
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