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

Consideration of Workshare Discount Methodologies | **Docket No. RM2009-3**

INITIAL COMMENTS OF THE BANK OF AMERICA CORPORATION, DISCOVER FINANCIAL SERVICES, J.P. MORGAN CHASE & CO., AND THE AMERICAN BANKERS ASSOCIATION (May 27, 2009)

By Order No. 192, dated March 16, 2009, the Postal Regulatory Commission (Commission) initiated the above-captioned proceeding to afford interested parties the opportunity to address the costing methodologies used by the Postal Service to develop its proposed First-Class Mail and Standard Mail rates in connection with the most recent Market Dominant pricing adjustment (PRC Docket No. R2009-2). *See* Order No. 192 at 3. Order No. 192 further invited interested parties to submit alternative rate design proposals. *See id*. The Bank of America Corporation, Discover Financial Services, J.P. Morgan Chase & Co., and the American Bankers Association[1] (the Joint Commenters) respectfully submits these comments in response to Order No. 192.

I. First-Class Mail

The instant proceeding was initiated, in large part, because the Commission found that the Postal Service deviated from the Commission's established methodology for calculating First-Class Mail workshare cost avoidances. *See id.,* at 1-2. Under the Commission's established methodology workshare-related cost differences are measured

[1] The American Bankers Association represents the interests of both large and small banks. The issues raised in these comments would benefit banks of all sizes.

between a bulk metered mail (BMM) proxy and Automation mixed AADC First-Class Mail letters; that difference is multiplied by a pass-through and then subtracted from the price of Single-Piece First-Class Mail letters to calculate the rate for Automation mixed AADC First-Class Mail Presort letters. The Commission states that the Postal Service did not use the existing methodology, but rather effectively "de-linked" the costs of Single-Piece First-Class Mail letters from First-Class Mail Presort letters. *See id.*, at 1.

In its filings in PRC Docket No. R2009-2, the Postal Service disagrees that it has changed the methodology used to calculate the relevant cost avoidances. *See* USPS Response to CIR No. 1 (PRC Dkt. No. R2009-2), at 1-2. The Postal Service contends that under the Postal Accountability and Enhancement Act (PAEA) First-Class Presort letters are not a workshare variant of Single-Piece First-Class Mail letters, but rather are a unique and distinct product. *See id.*

The Joint Commenters agree with the Postal Service that First-Class Mail Presort letters are a distinct product from Single-Piece First-Class Mail Letters. First-Class Mail Presort letters and Single-Piece First-Class Mail letters have distinct cost differences and are perceived by mailers as distinctive products; they are listed as separate products under the Mail Classification Schedule. The Joint Commenters certainly perceive them as different products. In the Joint Commenters' view, Standard Mail letters are closer substitutes than Single-Piece letters for marketing mail and electronic options are closer substitutes for statements.

The Joint Commenters are also concerned that to the extent the Commission requires workshare-related cost avoidances to be measured across distinct products, it will unnecessarily restrict the Postal Service's pricing flexibility and needlessly threaten the Postal Service's financial viability by imposing a disproportionate burden on one of the Postal Service's most profitable products.

A. Treating First-Class Mail Presort Letters as a Distinct Product from Single-Piece Letters Promotes the Efficiency and Pricing Flexibility Goals of the PAEA Without Unreasonably Disadvantaging Single-Piece Mail Letters

Efficiency and pricing flexibility are two of the fundamental policy objectives of the PAEA. *See* 39 U.S.C. §§ 3622(b)(1) and (4). Both of these statutory goals are promoted by treating First-Class Mail Presort letters as a distinct product from Single-Piece letters. In contrast, both of these goals are diminished under a "linked" rate design that requires the Postal Service to measure workshare-related cost avoidances across distinct products. The Postal Service's pricing flexibility is restricted under a "linked" rate design because all of the prices for Presort letters are measured, either directly or indirectly, from and defined by their relationship to a proxy for a separate, distinct product. As discussed below, a "linked" rate design also frustrates efficiency because the Postal Service cannot use its pricing flexibility to stem declines and encourage growth in more profitable Presort letter mail volumes.

Restrictions on the Postal Service's pricing flexibility under a "linked" rate design are further compounded by the integer constraint on Single-Piece letters and the mechanics of the price cap, applied at the class level for all First-Class Mail products. As discussed in the Postal Service's February 10, 2009, Notice of Market Dominant Price Adjustments:

> 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%.].

USPS Notice, at 12.

By treating Presort letters and Single-Piece letters as distinct products, the Postal Service retains the pricing flexibility to balance the relative burden of above-average increases over time. If the workshare-related cost avoidances of these distinct products are “linked,” the Postal Service loses the flexibility to equitably allocate this burden. With linking, the integer constraint and the price cap mechanics create a systematic bias in favor of Single-Piece letters, which will produce below-average increases for Single-Piece letters and above-average increases for Presort letters.

If the concern for Single-Piece prices is motivated by concerns for individual mailers, it is important to note that households mail less than half of the Single-Piece First-Class Mail. The average household mails only 179 letters in a year, therefore, a rate increase for Single-Piece mail of a penny more than it might have received costs the average household $1.79 annually. And Single-Piece mailers can mitigate or avoid the impact of future rate increases by purchasing Forever stamps.

To the extent that proponents of the “linked” rate design are concerned that absent the linking of these two distinct products, that Single-Piece mailers would be unreasonably disadvantaged, the concern is unfounded. After two successive pricing adjustments under the new law, no party has alleged that Single-Piece letters have been unreasonably disadvantaged. *See* GCA Comments at 1-2 (observing that the above-the-cap increases have alternated between Presort letters and Single-Piece letters over the last two cycles). Comments submitted on behalf of Single-Piece mailers have expressly identified the statutory protections inherent in the "just and reasonable" requirement under the PAEA. *See* GCA Comments at 2 (noting that a "consistent tilt in favor of Presort may signal an infringement of the statutory requirement of a "just and reasonable scheduled of rates and classifications."). Setting aside the issue of whether a "consistent tilt" in favor of Single-Piece rates is violative of the "just and reasonable" requirement, the Joint Commenters contend that while a "linked" rate design unreasonably constrains the Postal Service's pricing flexibility and ultimately will hurt postal finances, the Postal Service should not be given unfettered flexibility. The statutory objective of a "just and reasonable" rate design serves as an important check on the Postal Service's pricing flexibility. The statutory "just and reasonable" standard contemplates a relative standard with reference to other prices and products. For example, with respect to Presort and Single-Piece letters, referential pricing could require that the unit contribution of Presort Letters be no less than that of Single-Piece letters.

Accordingly, the "just and reasonable" statutory objective should be read in concert with the efficiency and pricing flexibility objectives of the PAEA to provide the Postal Service with the pricing flexibility necessary to grow Presort letter volume while ensuring that Single-Piece letters are not unreasonably disadvantaged.

B. Treating First-Class Mail Presort Letters as a Distinct Product from Single-Piece Letters Protects the Financial Viability of the Postal Service

In view of the tremendous financial pressures currently facing the Postal Service, the rate preference for Single-Piece Mail Letters associated with a "linked" rate design is also potentially self-defeating. The unit contribution and cost coverage data for First-

Class Mail published in the Commission's FY 2008 Annual Compliance Determination (ACD) establish that the price difference between Single-Piece and Presort First-Class Mail letters is only a fraction of the actual cost difference between these products. *See* FY2008 ACD, at 48, Table VI-1. The unit contribution of the average Presort First-Class Mail letter (23 cents) is approximately five cents more than the unit contribution of the average Single-Piece First-Class Mail letter (18 cents). *See id*. Thus, First-Class Mail Presort letters are much more "profitable" for the Postal Service than Single-Piece letters.

Similarly, notwithstanding similar own-price elasticities between Single-Piece and Presort First-Class Mail letters, *see* United States Postal Service FY 2008 Demand Analysis Materials Market Dominant - USPS Econometric Demand Equation Tables for Market Dominant Products as of November 2008 (filed Jan. 16, 2009) <http://www.prc.gov/prc-pages/library/usps-periodic-reports/default.aspx?gridpart=periodic>, the cost coverage of Presort letters (302 percent) is nearly double the cost coverage of Single-Piece letters (171 percent). *See* FY2008 ACD, at 48, Table VI-1.

A "linked" rate design will also aggravate the existing disparity in profitability and contribution between Single-Piece and Presort letters. For example, reducing the current Single-Piece letter first-ounce rate by one cent to 43 cents, would necessitate an increase in the Presort letter first-ounce rate of as much as 0.7 cents to offset the revenue loss; thus, increasing the current unit contribution disparity by approximately 2 cents. Further pricing increases on Presort letters threaten to accelerate the decline in mail volumes and thus, increase the revenue shortfalls experienced by the Postal Service.

Recurring, disproportionate pricing increases for First-Class Mail Presort letters will also work to the long-term disadvantage of the entire postal system, including Single-Piece mailers. In the current economic environment banks of all sizes and other business mailers are increasingly sensitive to the relative cost of postage. For a significant portion of the Joint Commenters' mail volume, electronic substitution is the primary means to manage postage pricing increases. For every Presort letter that is diverted to an electronic communication the Postal Service loses 23 cents in contribution. Within the physical mail channel, for every marketing piece that is converted from a First-Class Mail Presort letter to a Standard Mail letter, the Postal Service loses 14 cents.

Accordingly, increasing the price of Presort letters to conform with a "linked" rate design between distinct products, would not only harm business mailers who are already forced to bear a disproportionate share of institutional costs, it would also harm the Postal Service by driving away low-cost, highly profitable mail volume. Ultimately, Single-Piece mailers, in the face of declining First-Class Mail presort letter volume, will be disadvantaged, including small banks that are more likely to be Single-Piece mailers, as they are left with a larger and larger share of the institutional costs of the postal system. In the current economic climate, the Postal Service simply cannot afford to perpetuate, much less expand, the traditional rate preference for Single-Piece First-Class Mail letters at the expense of retaining highly profitable First-Class Mail Presort letters.

C. Even Assuming the BMM-Presort Relationship is Deemed to be Worksharing, the Statutory Workshare Exceptions Preclude Any Rate Design Changes

Section 3652(b) of the PAEA requires the Postal Service to report information relating to workshare discounts "with respect to each market-dominant product for which a workshare discount was in effect during the period covered by such report[.]" 39 U.S.C. § 3652(b). Because Presort First-Class Mail and Single-Piece First Class Mail have distinct cost differences and are perceived by mailers as distinctive products, they are listed as separate products under the Mail Classification Schedule. *See* PRC Dkt. No. RM2007-1, United States Postal Service Submission of Initial Classification Schedule in Response to Order No. 26 (September 24, 2007). Accordingly, if section 3622(e) is read in concert with section 3652(b), which requires workshare reporting on a product-by-product basis, Presort letters are not properly construed as a worksharing variant of Single-Piece letters or, by extension, the BMM proxy.

Alternatively, even assuming the BMM-Presort relationship is properly construed as a worksharing relationship, the statutory worksharing exceptions in section 3622(e)(2) and the limitation of section 3622(e)(3) preclude changes under a "linked" rated design. Section 3622(e)(2)(D) provides an exception to the general workshare limitation where the "reduction or elimination of the discount would impede the efficient operation of the Postal Service." 39 U.S.C. § 3622(e)(2)(D). The combination of a "linked" rate design and a 100 percent passthrough of the BMM-Automation mixed AADC letter cost avoidance would reduce the price differential between the two products. Because the percentage markups on the two products are already unequal, such a rate adjustment would be inefficient from an economic perspective. A reduction in the price differential between the two products, by means of a price increase on more profitable Presort First-Class Mail letters, would likely also lead to reduced volume of Presort letters and, therefore, a reduced aggregate contribution to the institutional costs of the Postal Service from First-Class Mail as a whole. Accordingly, the Postal Service could also claim an exemption from the general workshare limitation under section 3622(e)(3)(A). *See* 39 U.S.C. § 3622(e)(3)(A).

D. Highly Disruptive, "Out-of-Cycle" Rate Changes Should be Avoided

Regardless of the Commission's ultimate disposition on the "linking" issue, the Joint Commenters strongly urge that any proposed changes to the First-Class Mail rate design should await the next regularly scheduled notice of pricing adjustment. In light of the continuing and significant financial challenges faced by the Postal Service and the mailing community, an "out-of-cycle" pricing adjustment for First-Class Mail would be highly disruptive and, therefore, should be avoided if at all possible.

II. Standard Mail

A. Incremental Changes to Standard Mail Rate Design are Necessary to Ensure Compliance with the PAEA

In the FY 2008 ACD the Commission observes that recent below-average increases for Standard Mail flats and above-average increases for Standard Mail letters have had the effect of placing a disproportionate burden of institutional costs on Standard Mail letter mailers. FY2008 ACD, at 62. The ACD also observes that in FY 2008, Standard Mail (non-Carrier Route) flats' attributable costs exceeded their associated revenues, yielding a unit "contribution" of <u>negative</u> 2.2 cents, while Standard Mail Letters yielded a unit contribution of 9.0 cents. *See id.*, at 60. Thus the average unit contribution of Standard Mail letters is more than 11 cents greater than the average unit contribution of Standard Mail flats. *See id.*, at 59-60, Figure VI-1.

The Commission further observed that the failure of Standard Mail flats to cover their costs is inconsistent with section 3622(c)(2) of the PAEA which requires that each class of mail or type of mail service cover attributable costs and make a reasonable contribution to institutional costs. *See id*., at 61; 39 U.S.C. § 3622(c)(2). Similarly, the Commission stated that the lack of a sufficiently high cost coverage may be inconsistent with the sections 101(d) and 3622(b)(5) of the PAEA which direct to Postal Service to apportion costs equitably and to establish rates that ensure adequate revenues to maintain financial stability. *See id*.; 39 U.S.C. §§ 101(d) and 3622(b)(5).

The Commission also raises the concern that because the Postal Service has failed to present any empirical evidence that Standard Mail letters and flats have different market characteristics or other non-cost factors that justify disparate treatment, continued, unjustified rate preferences for below-cost Standard Mail flats relative to Standard Mail letters may raise issues of unreasonable discrimination under section 403(c). *See id*., at 62; 39 U.S.C. § 403(c).

Notwithstanding these findings, the Postal Service's most recent pricing adjustments exacerbate the disparity between Standard Mail flats and letters. Under the recently implemented pricing adjustments, prices for Standard Mail flats were raised only 2.3 percent, whereas the prices for Standard Mail letters increased by 3.8 percent. This is, as the Commission observed, inconsistent with the PAEA. The Joint Commenters agree with the Commission that the Postal Service should be required to either (1) incrementally decrease the disparity between letters and flats in future pricing adjustments or (2) provide the Commission with empirical evidence that the market characteristics of Standard Mail letters and Standard Mail flats or other non-cost factors justify the disparate difference in per piece contributions and percentage markups between letters and flats.

To date, the Postal Service has offered no evidence regarding market characteristics or other non-cost factors to support the disparate treatment, but rather has asserted a general concern regarding the need to "moderate increases for catalog mailers," in the context of the current economic challenges. USPS Notice at 15 (citing 39 U.S.C. § 3622(c)(3)). The Joint Commenters are sensitive to the economic difficulties catalog mailers are facing, but these challenges are generally applicable to all mailers and cannot, alone, justify the undue preference afforded Standard Mail flats.

Closing the contribution gap between letters and flats in future pricing adjustments by imposing larger increases on Standard Mail flats than on higher profit Standard Mail letters would bring Standard Mail rate design into compliance with the PAEA. Incremental changes to Standard Mail rate design will also address the Postal Service's business imperative to grow more profitable mail volumes.

III. CONCLUSION

The Joint Commenters appreciate the Commission's consideration of these comments.

Respectfully submitted,

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