

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

NOTICE OF PRICE ADJUSTMENT

Docket No. R2009-4

RESPONSE OF THE UNITED STATES
POSTAL SERVICE TO ORDER NO. 220
(June 22, 2009)

In Order No. 220, issued on June 4, 2009, the Commission posed four questions concerning the Postal Service's filing in the above-captioned docket, and requested responses from the Postal Service. Attached are the Postal Service's responses to Questions 1-4.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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Question 1

This is the first Postal Service request for a permanent rate decrease in rates of general applicability. The Postal Service states that it “proposes that the adjustments have no impact on price cap issues, but would welcome other views.” *Id.* at 3. Title 39 U.S.C. 3622(d)(1)(A) states that the Commission’s system of rate regulation must include regulations that include an annual limitation calculation from the last date that “the Postal Service files its notice of its intention to *increase* rates.” 39 U.S.C. 3622(d)(1)(A) (emphasis added). Does this provision suggest that permanent rate decreases in rates of general applicability do not require an analysis under section 3622(d)(1)(A)?

RESPONSE:

The Postal Service believes that this price adjustment does not require the conduct of a price cap compliance analysis, which would lead to a change to the Postal Service’s price adjustment authority for Standard Mail. The language of section 3622(d)(1)(A) clearly indicates that a price cap analysis is not *required* when a price decrease occurs. While this language does not foreclose the Commission from adjusting the Postal Service’s pricing authority due to a mid-cycle price decrease, the Commission should not do so here. This is due to the unique factual circumstance that the partial-year annual limitation applicable to this adjustment is negative, such that even the decreases being noticed here would require the Postal Service to utilize a large portion of its unused price adjustment authority for Standard Mail (authority that was intended by Congress to facilitate a measured approach to price *increases* by encouraging the Postal Service not to use all available pricing authority at any given time out of a fear of losing that unused authority). As such, the application of the price cap to this adjustment would create a perverse incentive for the Postal Service not to implement mid-year price decreases in order to respond to market conditions,

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during an environment of declining CPI-U. There is no reason to suggest that Congress would have intended the price cap structure of section 3622(d) to have such a result.

Applying the price cap to a price decrease is not required either under the language, or the purpose, of section 3622. First, as the Commission notes, section 3622(d)(1)(A) states that the Postal Service is subject to an “annual limitation on the percentage changes in rates...equal to change in [CPI-U] over the most recent available 12-month period preceding the date the Postal Service files notice of its intention to *increase* rates.” (emphasis added) This indicates that the price cap established by that section applies as a “limitation” on the Governors’ flexibility to “increase” prices, as opposed to their discretion to implement an isolated mid-year decrease in prices. See also Order No. 43 at 34 (noting that section 3622(d) sets forth “mandatory annual limitations on rate increases”); Order No. 26 at 33 (noting that section 3622(d) “requires that the system for regulating rates and classes for market dominant products include a limitation on the percentage increase in rates.”). Thus, while the Commission must apply the price cap structure of section 3622(d) to price adjustments that include increases to prices (i.e., either a price adjustment that consists solely of price increases, or a price adjustment that includes increases to some prices, and decreases to others), it is not required to do so with respect to a price adjustment consisting solely of a decrease in prices.

Furthermore, a reduction in prices does not implicate the concerns underlying Congress’ decision to establish a price cap. The legislative history

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indicates that Congress was concerned about capping the extent to which postal prices could *increase*. See H.R. REP. NO. 109-66, pt.1, at 43-44, 46-48 (2005); SEN. REP. NO. 108-318 at 33 (2004). This reflects a desire on the part of Congress to ensure that users of market-dominant postal products are protected from the Postal Service taking advantage of its market-dominance by maximizing revenue through the imposition of excessive prices. See 39 U.S.C. 3642(b)(1) (defining market-dominance in part by the ability of the Postal Service to “set the price of such product substantially above costs [or] raise prices significantly”). Such concerns about excessive price increases for products with limited or no directly-competitive alternatives are at the very least highly attenuated when the Postal Service is deciding to set forth a mid-year decrease of a few of its prices.

The Commission’s rules reflect the language and purpose of the price cap. Echoing the language of section 3622(d)(1)(A), the Rules speak to the price cap acting as a limitation on price “increases.” See 39 C.F.R. 3010.11(a); 3010.22(a). See also Order No. 43 at 34 (noting that the Commission will, in its pre-implementation review of a price adjustment, “address the statutory requirements related to the annual limitation on rate increases”). Rule 3010.11(a), for example, notes that, “Rate increases for each class of market dominant products in any 12 month period is limited.” The Commission’s Rules therefore do not appear to specifically contemplate a mid-year price adjustment that consists entirely of a decrease.

While the statute clearly does not *require* that the price cap structure established by section 3622(d) apply to a mid-year decrease, this does not mean

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that the statute affirmatively forecloses the Commission from deciding that the Postal Service's price adjustment authority may in certain circumstances be altered as a result of such a decrease. Section 3622(d)(1)(A) requires the application of the price cap in particular circumstances (i.e., where the Postal Service provides notice of a price adjustment that includes increases to prices). Nothing in that section suggests, however, that Congress intended that the Commission have no authority to also apply the price cap structure to mid-cycle decreases, when doing so is deemed necessary in order to effectuate the objectives of section 3622.

In the circumstances that are present here, application of the price cap does not seem appropriate. As the Postal Service discussed in its Response to Chairman's Information Request (CHIR) No. 1, the partial-year inflation limitation that would presumably apply to this adjustment is negative, due to the fact that the CPI-U trended steeply downward in the last five months of last year. However, this is a highly unusual circumstance, considering the history of the CPI-U: as set forth in the attached analysis (Rate Authority History.xls), this is the first time in decades that the partial-year limitation is negative. Certainly, there is nothing in the statute that suggests that Congress would have wanted to penalize the Postal Service for making a mid-cycle price decrease in order to respond to market conditions, by requiring that the Postal Service give up a large portion of its unused price adjustment authority. This would create a perverse incentive for the Postal Service not to implement mid-cycle price decreases in such circumstances, to the detriment of mailers, even though Congress was clearly

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concerned about price increases, not decreases.¹ As such, considering the highly unique circumstances of the current negative partial-year limitation, and the perverse incentives that would be created by applying the price cap to this decrease, the Commission should treat this price decrease as having no effect on the Postal Service's price adjustment authority.

In contrast, the application of the price cap to a mid-cycle decrease would seem appropriate when that decrease is implemented in different circumstances, such as in the normal situation where the partial-year limitation is positive rather than negative. Again, the same reasoning discussed above applies: the price cap structure of section 3622(d) should be applied in such a way so as to avoid perverse incentives. If the Postal Service cannot acquire additional unused price adjustment authority from a mid-year decrease (similar to what occurs in the context of an omnibus change, in which a decrease in certain categories either gives the Postal Service additional room under the cap to raise other prices in the class, or additional "banked" pricing authority), then the Postal Service would have much less incentive to provide such a decrease to mailers. Considering the purposes behind the price cap, it does not appear that Congress would have intended this result.

Considering that the Commission's Rules do not appear to specifically contemplate a mid-year price adjustment that consists entirely of a decrease, the

¹ Furthermore, the downward trend in inflation will eventually accrue to the benefit of mailers, because it will be taken into account as part of the price cap calculation the next time the Postal Service provides notice of its intent to raise prices for the class. Thus, it is not necessary to account for the decline in inflation at the time of a mid-year price decrease.

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Commission may wish to consider the need for additional rules concerning the effect of such decreases on the Postal Service's price adjustment authority. In the meantime, the Commission should recognize that the price cap should not be applied to this price adjustment.

Finally, even if a mid-year decrease implemented during a period of declining CPI-U does not implicate the Postal Service's price adjustment authority, the other provisions of section 3622, such as sections 3622(b), (c), and (e), of course still apply. The Commission's current price adjustment notice rules require a discussion of these elements (Rule 3010.14(b)(5)-(8)), and also leaves open the possibility of a Commission determination on such issues (Rule 3010.13(j)).

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Question 2

If the price cap under section 3622(d)(1)(A) does not apply to this case, is an analysis under section 3622(d)(2)(C) (relating to unused rate adjustment authority) also not required?

RESPONSE:

The Postal Service's price adjustment authority derives from two related sources: the change in the CPI-U, and the existence of banked amounts. As discussed in the Response to Question 1, the Postal Service believes that this price adjustment should have no affect whatsoever on the Postal Service's price adjustment authority. The Postal Service therefore believes that this change does not require an analysis under any element of the price cap structure established by section 3622(d).

Furthermore, in the context of a price decrease, it does not seem possible to apply section 3622(d)(2)(C) without also determining the relevant price cap. The Postal Service derives banked authority if it chooses not to raise the prices in a class to the full extent of the cap. See 39 U.S.C. 3622(d)(2)(C)(i). As such, determining how much banked authority is utilized (or generated) in a given price adjustment normally depends on the calculation of the price cap, because the extent to which the price adjustment for a class exceeds (or falls below) the price cap applicable to that class determines the extent to which available banked authority is used (or generated). This does not mean that the Postal Service can only use its existing banked authority when the price cap itself also applies to a particular price adjustment; as Rule 3010.25 notes, the Postal Service may increase prices using its banked authority even when an inflation-based price

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adjustment is “not possible.” In fact, in the context of a price *increase*, utilizing banked price adjustment authority independent of inflation-based price adjustment authority seems quite straight-forward. However, a price *decrease* would not normally be viewed as eliminating any of the Postal Service’s pricing authority (as discussed in the response to Question 1, such a situation is highly unusual), and the effect of such a decrease on banked authority can only be determined by calculating the relevant price cap.

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Question 3

Notwithstanding the potential application of section 3622(d)(2)(C) to this case, can the Postal Service waive some or part of its unused rate adjustment authority? Can the Commission enforce such a waiver?

RESPONSE:

The Postal Service does not view a price adjustment that is outside of the price cap structure of section 3622(d) as raising a question as to whether the Postal Service can “waive” price adjustment authority, because in such a circumstance there is no authority that is being generated and subsequently “waived.” As discussed in the Postal Service’s response to Question 1, the banking provisions of the statute should apply in the case of a price increase. Furthermore, under some circumstances, it seems reasonable that a price decrease might generate additional banked authority. However, in this unique situation, Congress would likely not have desired that the Postal Service be penalized for giving mailers a mid-cycle decrease in prices. The Postal Service therefore feels that the most straight-forward approach for this mid-year price decrease is to not adjust the Postal Service’s banked pricing authority.

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Question 4

The Notice states that “the Postal Service is not claiming any new unused rate adjustment authority as a result of this price decrease.” *Id.* at 3. Should this statement be construed as an intention by the Postal Service to waive any resulting additional unused rate adjustment authority that may result due to the rate decreases from the instant rate adjustment?

RESPONSE:

No, please see the response to Question 3. For the reasons set forth in the response to Question 1 above, the Postal Service believes that this mid-year price adjustment should not implicate the Postal Service’s price adjustment authority for Standard Mail.