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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

RATE ADJUSTMENT DUE	)	
TO EXTRAORDINARY OR	)	Docket No. R2010-4
EXECPTIONAL CIRCUMSTANCES	)	

COMMENTS OF THE NATIONAL ASSOCIATION OF PRESORT MAILERS ON THE RATE ADJUSTMENTS REQUESTED BY THE UNITED STATES POSTAL SERVICE DUE TO EXTRAORDINARY OR EXCEPTIONAL CIRCUMSTANCES

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The National Association of Presort Mailers respectfully submits these comments on the request the United States Postal Service submitted to the Postal Regulatory Commission to increase rates above the statutorily authorized price cap due to extraordinary or exceptional circumstances. The comments relate almost entirely to the request by the Postal Service top increase the rates for what it now calls "First-Class Mail Commercial Letters and Cards.[1]

First and foremost, the NAPM believes that the Postal Service is correct that "[a] loss of presort First-Class Mail volume, or even a relatively minor portion of it, would be

[1] The terms "presort First-Class Mail," "Presort Mail," "First-Class Presort Mail," and even "commercial First-Class Mail" are ambiguous. The terms "Presort Mail," and "First-Class Presort Mail" sometimes refers only to Nonautomation, Presorted First-Class Letters and Cards (a very small subcategory [2.8% based on the "Hybrid Billing Determinants Q3&Q4, FY09 plus Q1&Q2, FY10" submitted by the USPS as part of USPS-LR-1 FirstClassMailWorksheets R2010-4.xls.] of First-Class Mail, Commercial Letters), but sometimes these terms refer to (i.e., are used to include) all of First-Class Mail mailpieces other than Single-Piece. See "Mailing Services (Market Dominant Products) Final Revenue, Pieces, and Weight by Classes of Mail and Special Services for Fiscal Year 2009). In these comments we will use the term "First-Class Mail, Commercial Letters and Cards to refer to all First-Class Letters and Cards other than Retail Single Piece, First-Class Mail Letters and Cards. This usage is consistent with the current United States Postal Service Price List and thus includes everything sent at the rates for First-Class Mail Commercial Letters and Cards. See page 10 of the current United States Postal Service Price List, Notice 123, Effective May 11, 2009.

devastating to the Postal Service's financial health."[2] Accordingly, any proposed pricing adjustment must be designed to preserve and grow the volume of First-Class Mail Commercial Letters, Cards and Flats. But the rate adjustments requested by the Postal Service fall short in this regard.

First-Class Mail remains the Postal Service's most important class of mail. In FY 2009, it had the largest volume of any class – 84.2 billion pieces out of 177.1 billion total mail pieces, with Standard Mail second at 82.7 billion pieces.[3] First-Class Mail contributed 78 percent of the total contribution of market dominant products, far more than any other class of mail.[4]

Of the six products within First-Class mail, two comprise a huge share of both total mail volume and contribution: (1) Retail Single-Piece First-Class Mail Letters and Cards and (2) First-Class Mail, Commercial Letters and Cards. Together these products accounted for 45.1 percent of total Postal Service mail and a staggering 65.1 percent of total contribution for all products.[5] Within First-Class Mail, First Class Mail Commercial Letters and Cards make almost twice the contribution ($10.8 billion) of Retail Single-Piece Mail ($5.5 billion).[6] On a unit basis, First-Class Mail, Commercial Letters contributed 22.5 cents per piece with a cost coverage of 299.2 percent, while Retail Single Piece Letters contributed only 17.3 cents per piece with a coverage of 176.8 percent, only slightly higher than the system wide average of 173.6 percent.[7]

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[2] Kiefer Statement at 13.
[3] See, Table IV-5, pages 29 and 30, of the Postal Regulatory Commission's Annual Compliance Determination of the U.S. Postal Service's Performance for Fiscal Year 2009 ("ADC 2009") in which Commercial First-Class Mail Letters and Cards are referred to as "Presort Letters and Cards," see note 1 above.)
[4] Kiefer Statement at 12.
[5] Percentages derived from ACD 2009, Table IV-5, supra, note 2.
[6] ACD 2009, supra, note 2
[7] Masse Statement, Attachment 10, Total Domestic Market Dominant Mail.

First-Class Mail, Commercial Letters contributed approximately a nickel more per piece than Retail Single-Piece First-Class Letters because the average discount from Retail Single-Piece First-Class Letters is less than the average cost difference.[8] Finally, available data shows First-Class Mail Commercial Letters are more price sensitive than Retail Single Piece First-Class Letters with a price elasticity of -0.402, as compared to -0.184.[9]

As discussed by witness Kiefer, the current elasticity data may not adequately reflect how fragile the current environment is for First-Class Mail, Commercial Letters and Cards: "…[I]f prices increase too much, these customers may decide not just to scale back their mailings, but to leave the system altogether. Current econometric estimates of price elasticity may not adequately predict such 'tipping point' movements."[10] The mailing community is very concerned that the above-average pricing increases proposed for First-Class Mail Commercial Letters, Cards and Flats unwisely moves closer to, if not over, that "tipping point."

We also note that while the prices requested by the USPS in this case were requested in time for most companies to use the requested rates when developing their 2011 budgets, any further increases in these prices would come too late to adjust 2011 budgets. Thus, such further increases could only be absorbed by reducing the volume of mail. The primary means of doing that would be to initiate or accelerate conversion to alternative (electronic) information delivery systems which implies an acceleration of

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[8] *See* Statement of Maura Robinson, Vice President, Pricing, Before the Subcommittee on Federal Workforce, Postal Service and the District of Columbia of the Committee on Oversight and Government Reform, United States House of Representatives (May 12, 2010), at 5 ("More simply, for each dollar the Postal Service spends to process, transport, and deliver workshared First-Class Mail letters, we receive almost three dollars in revenue. In comparison, for each dollar in cost for single-piece First-Class Mail, we receive only $1.67 in revenue.").

[9] USPS-LR-8, Domestic Market Dominant Demand Equations, March 2010.doc at 1, 6.

[10] Kiefer Statement at 13.

the ongoing shift and a likely permanent loss of even more of the Postal Service's most profitable product.

It is also noteworthy that the Postal Service's ability to develop an optimal First-Class Mail rate design has been severely constrained by the on-going debate regarding the appropriate methodology for estimating workshare-related cost avoidances. The Postal Service, supported by NAPM and many others, contends that Retail First-Class Mail Single-Piece Letters and First-Class Mail Commercial Letters and Cards are separate products because they have distinct cost and market characteristics. As separate products the PAEA's statutory limitations on workshared discounts in 39 U.S.C 3622(e)(2) would not apply to the difference between First-Class Single-piece mail and First-Class Mail Commercial Letters and Cards.

The issues regarding "linking" Retail Single Piece First-Class Mail and Commercial First-Class Mail remain unresolved. It is, of course, the subject of a separate proceeding, Docket No. RM2009-3, which is still pending before this Commission despite the fact that the resolution of the issue has an important bearing on the rates proposed in the instant proceeding and beyond.

Comments filed by the Direct Marketing Association in RM2009-3 demonstrate that under a CPI price cap a delinked rate design that optimizes pricing for First-Class Mail Commercial Letters and Cards could increase the total contribution by nearly $400 million.[11] The converse also applies; the Postal Service would suffer substantial financial harm by reducing presort discounts and moving towards "relinked" rates.

[11] Comments of the Direct Marketing Association, at pages 4-5, submitted in PRC Docket RM2009-3 on September 11, 2009.

The Postal Service proposes an average price increase of 5.4 percent for First-Class Mail. The percentage increase proposed for Single-Piece Letters is 4.7 percent. The percentage increase proposed for First-Class Mail, Commercial Letters is 5.9 percent. The Postal Service explained the proposed increases as follows:

> Deciding the appropriate prices for First-Class Mail is not just a regulatory exercise, it is a business decision based on an evaluation of what will be in the best long term interests of the Postal Service. Pricing First-Class Mail therefore involves balancing three important considerations: 1) the impact of the price change on customers and the volumes they choose to mail; 2) the need for additional revenue and contribution to replace what was lost by the volume decline; and 3) the extent to which mail volumes will continue to decline, regardless of pricing actions taken by the Postal Service.[12]

The prices requested by the Postal Service reduce the discount between Single-Piece Letters and Mixed AADC Automation Letters, thereby decreasing the passthrough from 126 percent to 120 percent, and partially "relinking" the rates for Retail Single Piece Letters with the rates for First-Class Mail Single-Piece with Presort. As explained by witness Kiefer:

> we are proposing prices that (consistent with the Commission's direction in the 2009 ACD) move to narrow the gap between presort and single piece pricing, but that do not, we hope, pass the tipping points for many of our customers. We believe that the worksharing provisions of the law were not intended to force the Postal Service into potentially dangerous and self-destructive pricing decisions solely to meet a rigid regulatory requirement.[13]

Table 1, below, shows current and USPS proposed prices for the First-Class Letter products and the attendant passthroughs.

[12] Kiefer Statement at 13-14.
[13] Kiefer Statement at 20.

Table 1: Current and Proposed First-Class Mail Letter Prices / Passthroughs

	Current Price	Proposed Price	Current Passthrough	Proposed Passthrough
Single-Piece	$0.440	$0.460		
Nonautomation Presort	$0.414	$0.433	50%	52%
Mixed AADC Automation	$0.382	$0.405	126%	120%
AADC Automation	$0.360	$0.381	110%	120%
3-Digit Automation	$0.357	$0.378	100%	100%
5-Digit Automation	$0.335	$0.356	85%	85%

As the table shows, with one exception, the passthroughs for automation letters either remain unchanged from those at current prices (AADC to 3- Digit, 3-Digit to 5-Digit) and are currently at or under 100 percent, or move closer to 100 percent (Single-Piece to MAADC). In the case of the passthrough between Mixed AADC to AADC, however, the pass through, currently 110 percent, increases to 120 percent.

Setting rates on the basis of a purely hypothetical category of mail (Bulk Metered Mail) is bad enough, but deriving the rates for 43.5 billion pieces of First-Class Mail Commercial Letters by subtracting an estimate of the unit costs avoided by a category of that mail that represents only a small fraction-- 6/100^{ths} – of First-Class Mail Commercial Letters amounts to letting the tail wag the dog.

According to the USPS, it handled only 2.7 billion pieces of Automation Mixed AADC First-Class Letters in FY 2009. But if current estimates of the unit costs avoided by this rate category are used to increase all other First-Class Mail Commercial Letter rates some very curious prices could result.

According to the Commission's ACD2009, the estimated unit cost avoidance for First-Class Non-automation Presort letters is 5.2 cents. Thus, if the prices were to pass through 100% of the unit costs avoidance the rate for the first ounce of a First-Class Non-automation Presort letter would be 40.8 cents (46¢ – 5.2¢= 40.8¢) while the rate for the first ounce of a Mixed AADC First-Class Automation Letter would be 41.4 cents (46¢ – 4.6¢= 41.4¢). This simply does not make sense and mechanically setting prices for First-Class Mail Commercial Letters on the basis of an estimate of cost avoidance for a very small residual category of that mail, does not make sense either.

Witness Kiefer's statement discusses the interconnected nature of the First-Class Mail "presort ladder" and why strict compliance with a "relinked" rate design would result in the dramatic price increases for AADC mail, 3-Digit Mail, and 5-Digit mail - effective price increases that in percentage terms would be nearly twice the average percentage increase proposed for all products.[14] Price increases of this magnitude would be reckless and could easily drive large volumes of highly-profitable First-Class Mail Commercial Letter volume from the system.

In filings connected with the Annual Compliance Determination (ACD), the Postal Service has explained why the passthroughs in excess of 100 percent are justified under the relevant exceptions under sections 3622(e)(2). NAPM believes the Postal Service has made an adequate showing to claim the exception. Yet in the most recent ACD the Commission held that:

> [t]he automation mixed AADC and AADC presort discounts for letters . . . exceed avoided costs and do not qualify for any of the exceptions. *Therefore the Commission finds that the appropriate action is for the Postal Service to align the discounts with avoided costs when it files its next general market dominant price adjustment. If, at that time, any of the discounts are subject to one of the exceptions in section 3622(e), the Postal Service may present arguments to that effect.*[15]

[14] Kiefer Statement at 25.
[15] ACD 2009, supra, at 73 (emphasis in original).

The Postal Service has come forward with additional, persuasive arguments as to why complete alignment of the mixed AADC and AADC discounts with the avoided costs would be imprudent in context of the present filing.[16] As noted above, the rate shock that would ripple through all of the First-Class Mail Commercial letter rates in response to a sudden adjustment of the MAADC or AADC rate are significant and must be taken into consideration. However, NAPM offers the following alternative rate design in the event that the Commission remains unpersuaded or takes the position that while these discounts may remain at prior levels it cannot countenance an expansion of the discounts.

This alternative rate design reflects two goals: (1) incremental alignment of discounts with costs avoided that result in passthroughs that move closer to 100 percent of the costs avoided or stay at current levels, and (2) revenue generated by any rate modifications that is equal to that produced by the original proposal.

Table 2, Alternative First-Class Mail Letter Prices / Passthroughs

	Current Price	Alternative Price	Current Passthrough	Alternative Passthrough
Single-Piece	0.44	0.46		
Nonautomation Presort	0.414	0.433	50%	52%
Mixed AADC Automation	0.382	0.405	126%	120%
AADC Automation	0.36	0.383	110%	110%
3-Digit Automation	0.357	0.38	100%	100%
5-Digit Automation	0.335	0.354	85%	100%

This alternative rate design holds or improves the mixed AADC and AADC presort discounts with the modeled avoided costs, while generating essentially the same amount of revenue as the Postal Service's proposal. The increased discount

[16] Kiefer Statement at 24-26.

between the 3-Digit Automation and 5-Digit Automation prices serves as an off-setting adjustment to prevent rate shock down the "presort ladder." As the Commission noted in the most recent ACD:

> While the PAEA does not impose a minimum passthrough of avoided costs for workshare discounts, parts of the PAEA (including section 3622(b)(1) on incentives to increase efficiency and section 3622(c)(5) on reflecting the degree of mail preparation) do provide a rationale for promoting efficient mailing choices by mailers. Setting workshare discounts as close as feasible to 100 percent of avoided costs helps to promote these goals.[17]

For the reasons set forth above, we recommend that the Commission approve either (a) the rates requested by the USPS or (b) the Alternative prices set out in the Table 2 above.

Respectfully Submitted,

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[17] ACD 2009, supra, at 73.