

**Before the
POSTAL REGULATORY COMMISSION
Washington, DC 20268-0001**

**Rate Adjustment Due to Extraordinary
Or Exceptional Circumstances**

Docket No. R2010-4

**COMMENTS OF THE PARCEL SHIPPERS ASSOCIATION
(August 17, 2010)**

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COMMENTS OF THE PARCEL SHIPPERS ASSOCIATION

(August 17, 2010)

INTRODUCTION

This is the first instance involving the "exigency" provision of the PAEA¹. As we read the PAEA, if extraordinary or exceptional circumstances occur (exigency) the Postal Service may propose price adjustments notwithstanding certain limitations in the PAEA, including the price cap. The Postal Regulatory Commission (Commission) has the responsibility to determine (1) whether extraordinary or exceptional circumstances exist and if they do, (2) whether the adjustments proposed are "reasonable and equitable and necessary to enable the Postal Service, under best practices of honest, efficient, and economic management, to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States." 39 U.S.C. § 3622(d)(1)(E).

The question of whether exigent circumstances exist has been briefed by others and awaits Commission decision.² As the Postal Service points out, if extraordinary or exceptional circumstances do exist, the Commission then must "proceed to a consideration of whether the Postal Service's requested rate increases are 'reasonable

¹ See Pub. L. 109-435, 120 Stat. 3198 (Dec. 20, 2006). The PAEA amends various sections of title 39 of the United States Code. Unless otherwise noted, section references in these comments are to sections of title 39. The "exigency provision" is found at 39 U.S.C. § 3622(d)(1)(E).

² See Motion of the Affordable Mail Alliance to Dismiss Request (July 26, 2010) ("AMA Motion"); Public Representative Answer to Motion of the Affordable Mail Alliance to Dismiss Request (August 2, 2010); Response of the National Rural Letter Carriers' Association to Affordable Mail Alliance's Motion to Dismiss (August 2, 2010); Statement of the National Postal Mail Handlers Union In Response to Motion to Dismiss Filed by the Affordable Mail Alliance (August 2, 2010); Response of Intervenor National Association of Letter Carriers, AFL-CIO to Motion to Dismiss of Affordable Mail Alliance (August 2, 2010); Answer of the Saturation Mailers Coalition, Valassis Direct Mail, Inc., Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association to Motion of the Affordable Mail Alliance to Dismiss Request (August 2, 2010).

and equitable and necessary.” Postal Service Response to AMA Motion at 1-2. These comments address only the narrow, but very important question of whether the price adjustments proposed for Standard Mail parcels and not flat-machinables (NFMs/Parcels) meet the statutory requirements for adjustments in exigent circumstances. As we explain below, they do not. These proposed adjustments are not reasonable. They are not equitable. And they are not necessary. They are based on data that inspires no confidence they achieve their stated goals. And, finally, when judged against the objectives and factors of the PAEA, as we believe they must be, these adjustments cannot stand.

SUMMARY OF POSITION

In this case the Postal Service makes a serious miscalculation visiting excessive “rate shock” on mailers of NFMs/Parcels by unexpectedly increasing prices in an unreasonable and inequitable manner. It professes a “cautious approach”³ with respect to Standard Mail Flats prices, but abandons all caution when it comes to increases for NFMs/Parcels.

The huge, disproportionate, unexpected increases for NFMs/Parcels are unnecessary, will not materially improve the Postal Service’s financial position, and will cause significant economic harm to its customers.⁴

³ Kiefer Statement at 27.

⁴ The expedited nature of this proceeding denies mailers the opportunity to submit evidence with respect to the harm that will result from these proposed exigent increases. However, the unprecedented breadth of opposition to these increases, which except for NFMs/Parcels, fall in the “moderate” range of 5-8 percent, demonstrates that mailers fear substantial economic harm if the increases are approved. In the case of the proposed NFMs/Parcels increases, which are more than three times the “moderate” increases proposed for other mail, the harm is multiplied three-fold. The unexpected nature of these exorbitant

The Postal Service has enjoyed a unique market niche with respect to the delivery of lightweight parcels; its universal delivery network is especially suited to servicing shippers of this product. Yet, with these proposed price increases, it acts as if it is either (1) a monopolist that can hike prices with no fear of losing business, or (2) a competitor with no interest in continuing in this business.

Allowing these proposed prices to stand will test which is true. But, in discharging its responsibilities in this proceeding, the Commission should not permit the Postal Service to conduct this experiment. Under the law as it exists today,⁵ NFM/Parcels are market dominant products, the Postal Service is subject to the requirements and restrictions of the PAEA, and mailers are entitled to the protections, including the assurance of rate predictability and stability, afforded by the Act.

As a result, the Commission should not approve the proposed price increases. Rather it should order the Postal Service to resubmit a reasonable and equitable price schedule with an average increase no more than the largest average “moderate” increase for other products. If the other proposed prices are approved, that would be eight percent. See Table 2.

proposed increases is discussed below, but at an August 10 Parcel Shippers Association meeting, when asked if an increase in excess of 20 percent was expected, only one member raised his hand.

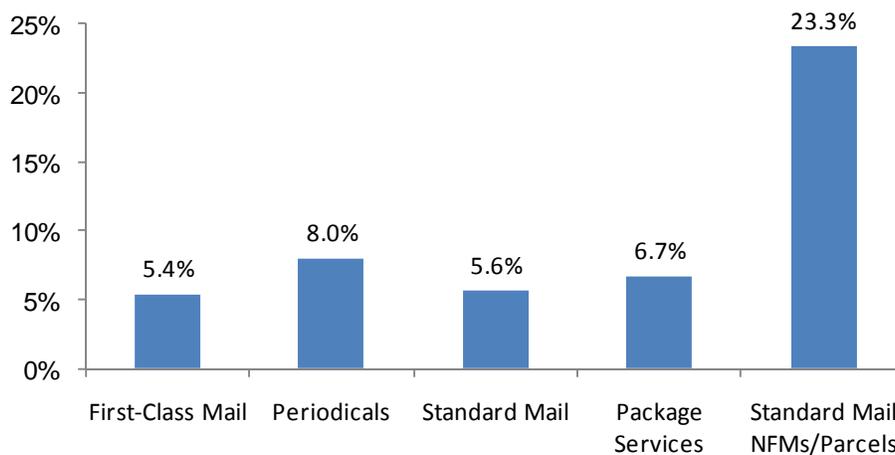
⁵ Late yesterday, the Postal Service filed a Request of the United States Postal Service to Transfer Commercial Standard Mail Parcels to the Competitive Product List (“Standard Parcel Request”). In our view, that Request should have no bearing on this pending rate proceeding. In any event, based on our initial review of that pleading, we remain of the opinion that the possibility that the Commission may at some future date approve transfer of a portion of Standard Mail NFM/Parcels to the competitive product list, does not justify the huge rate increases proposed in this docket.

I. The Price Increases Proposed For Standard Mail NFMs/Parcels Are Not Reasonable.

Reasonable is rational, in accord with common sense, not exorbitant. The average price increase proposed by the Postal Service is 5.6 percent. The average increase for NFMs/Parcels is exorbitant.

The average increases for all but one product fall in the range of 4 to 8 percent. One outlier – the 23.3 percent average increase for Standard Mail NFMs/ Parcels – stands out. See Figure 1. The next largest increase – that being proposed for Periodicals – is only one-third the size. Kiefer Statement at 10.

Figure 1. Proposed Rate Increases

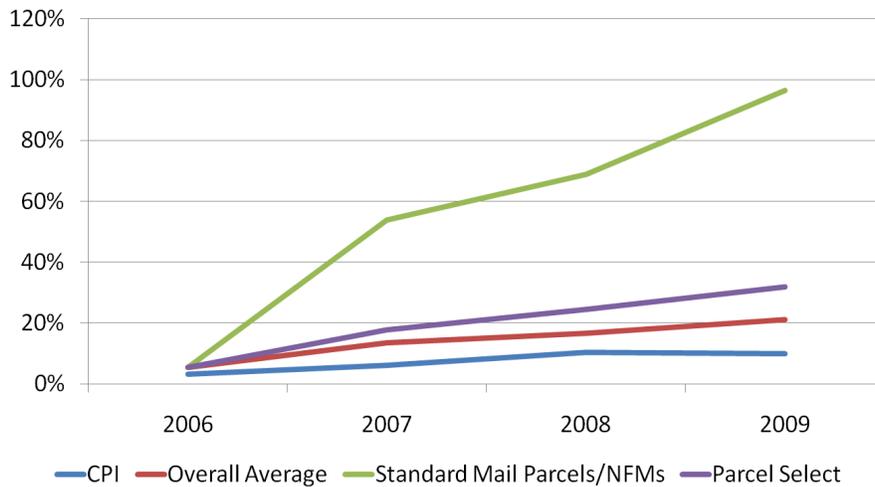


Some NFMs/Parcels shippers will face much larger increases: the largest proposed increase within this product is nearly eighty percent.⁶ On its face, the proposed price increase for the Standard Mail NFMs/Parcels product is not just unreasonable, it is outrageous.

⁶ This rate increase is for minimum-per-piece, DSCF-entered, SCF presort irregular NFMs.

Making these price increases even worse is that they come on top of the near-doubling of NFM/Parcels prices that occurred between FY 2006 and FY 2009. See Figure 2.

Figure 2. FY 2006 to FY 2009 Price Increases



The size of the instant proposed increase was completely unexpected. Based upon the statements of postal officials and the “phasing in” approach recommended by the Commission (and endorsed by Postal Service officials, see below), NFM/Parcels shippers had every reason to expect a respite from past outsized increases. As a result, these mailers will have little, if any, opportunity to adjust budgets or mailing plans to compensate for the increase. Imposing increases of this magnitude with little or even misleading notice is unreasonable.

On March 2 of this year, the Postmaster General announced the Postal Service’s intention to propose increases through the exigency procedure, but stressed the fact that the increases would be moderate. While he cautioned that underwater products would receive above-average increases, he again stressed moderation. Then, in its FY 2009 Annual Compliance Determination (March 29, 2010)(“FY 2009 ACD”), the

Commission expressed concern that several products including NFM/Parcels were estimated to be underwater. It, however, directed the Postal Service to address the problem by providing a plan (that could include operational and mail preparation changes,⁷ not just price increases) for making these products profitable, and also recommended a “phasing in” approach for NFM/Parcels.

Although the Commission finds the rates and revenues for NFM/Parcels neither recover attributable cost nor make a reasonable contribution to institutional cost, the Commission supports the Postal Service’s “phasing-in” approach to increasing the rates for Standard Mail NFM/Parcels. The Commission finds that the appropriate action is for the Postal Service to devise a plan to improve the cost coverage of the Standard Mail NFM/Parcels product. This plan should include any operational or mail preparation changes that the Postal Service deems necessary, as well as a timeline for achieving a positive contribution for the NFM/Parcels product. The plan shall be included in the next ACR or the next general market dominant price adjustment, if it precedes the ACR.

FY 2009 ACD at 87.

Finally, the postal official in charge of preparing the exigent price proposal, the Vice President for Pricing, testified before Congress that price increases for underwater products would be phased so as not to drive away business:

Improving the financial contribution of money-losing products requires focus on both the revenues generated by the product (through the prices charged), as well as the costs of providing the product. In addition, if we raise the price on money-losing products to a degree that mailers reduce their volumes significantly, it is not likely that we could reduce costs quickly enough to account for the volume decline. Thus, a *moderate* approach is the best way to address these types of issues. The Postal Service recently announced that it intends to increase prices *moderately* in early 2011 using the exigent price change mechanism. However, as we develop price recommendations for the Postal Service Governors' consideration, we are working to strike a balance between addressing cost coverage issues and maintaining our customer base. It is easy to suggest

⁷ The Postal Service has proposed implementing a number of cost reduction strategies, many of which would also reduce parcel costs, to help improve the cost coverage for flats. Not taking the same approach for parcels is clearly unreasonable and inequitable.

"just close the gap with prices," if you do not need to live with the consequences of that pricing prescription. "Just closing the gap" would require price increases of 20 to 30 percent for some customers.

Inherently, price increases are a double-edged sword. While they may improve contribution from the mail pieces that remain in the system, a substantial price increase has the potential to cause a devastating volume reduction. This potential may be exacerbated by current economic conditions. For example, over the past two years retail spending has retrenched and consumers have not purchased as many goods and services. Retail catalog merchants (who mail Standard Mail Flats) have made tough decisions on the number of catalogs they will mail based on the expected return on the cost of a catalog. If they do not expect to sell enough merchandise to justify the cost of mailing one more catalog, that catalog will not be mailed. From a postal perspective, we saw a 22 percent decline in Standard Mail Flats volume in FY2009. Unfortunately, mail volume may not be able to recover. If a cataloger goes out of business, they cannot mail when the economy rebounds. More insidiously, a cataloger who does not mail to a prospective customer faces a much more difficult and expensive challenge when it tries to regain that customer. Similarly, Periodicals publishers face market conditions that have changed the characteristics of the magazines and newspapers that are mailed. The general decline in advertising has put increased financial pressure on publishers. When you look at a magazine today, it is typically lighter than it was a few years ago. Because we charge postage based on weight, a reduction in advertising pages also decreases the per piece postage revenue from mailed Periodicals. In addition, the remaining higher share of editorial pages pay lower rates, reflecting Congressional policy decisions to grant preferred status for mailing editorial content.

There are no easy solutions. As noted above, if a sudden and dramatic volume reduction resulted from a significant price increase for money-losing products, the Postal Service would not be able to reduce costs quickly enough to account for the volume reduction. *Prices for below-cost products will be increased to address the cost challenges; however, we intend to do so in a judicious and measured way to improve financial performance over time. Accelerating volume declines may just exacerbate the cost coverage concerns, reducing efficiencies and increasing costs for the volume that is left. (Emphasis added.)*

Testimony of Maura Robinson before the House Subcommittee on Federal Workforce, Postal Service and the District of Columbia of the Committee on Oversight and Government Reform (May 12, 2010) at 3.

So, mailers, including mailers of NFMs/Parcels, reasonably expected moderate increases for 2011 and planned accordingly.

We leave it to others to argue whether the average 5.6 percent increase, or the vast majority of increases that fall within that 4-8 percent range are “reasonable.” But surely, under the circumstance here, a 23.3 percent average increase is by any measure unreasonable.

II. The Price Increases Proposed For Standard Mail NFMs/Parcels Are Not Equitable.

Is there an inequity in these proposed price increases?

Table 2 : Price Changes by Mail Class and Product

Class/Product	Price Change (Percent)
First-Class Mail	5.417
Single-Piece Letters/Postcards	4.652
Presorted Letters/Postcards	5.927
Flats	6.079
Parcels	5.415
Single-Piece First-Class Mail International	4.973
Standard Mail	5.616
Letters	5.011
Flats	5.134

Not Flat-Machinables/Parcels	23.331
High Density and Saturation Letters	4.808
High Density and Saturation Flats/Parcels	4.357
Carrier Route	4.920
Periodicals	8.035
Outside County	8.036
Within County	8.004
Package Services	6.700
Single-Piece Parcel Post	7.029
Bound Printed Matter Flats	5.040
Bound Printed Matter Parcels	7.024
Media Mail/Library Mail	7.010
Special Services	5.228

Source: Kiefer Statement at 10 (Highlight added).

Of course there is. Put another way, “which one of these increases is not like the others?”

III. The Price Increases Proposed For Standard Mail NFM/Parcels Are Not Necessary.

These huge increases are not necessary. They are not required by law. They are not necessary to prepare the product for transfer to the competitive product list. They

will not significantly improve the Postal Service's financial situation. They are based on data that inspires no confidence.

a. The PAEA does not require individual market dominant products to cover costs.

Although the Commission has urged the Postal Service to bring underwater postal rates up to full coverage, so far as we know, the Commission has never said that under the PAEA it is a legal requirement. In the normal course of considering market dominant rate adjustments, absent exigent circumstances, the Commission is directed by statute to establish a system to “take into account” a number of “objectives” and “factors,” including one factor that is stated as a “requirement that each class or type of mail bear the direct and indirect postal costs attributable to each class or type of mail.” See 39 U.S.C. §3622(b)(3). The Commission has not ruled whether, as it was under the Postal Reorganization Act, this “requirement” is an actual requirement or, whether under the PAEA, it simply requires the Commission's regulatory system to “take into account” whether a particular class or type of mail covers its costs. In any event, it is not a mandate governing NFM/Parcels because they are but one product in the Standard Mail Class, and the PAEA provision applies to entire classes, i.e., at the class level.⁸ The Postal Service clearly recognizes this is the case. While proposing a huge 23.3 percent average increase for NFM/Parcels, it proposes a “moderate” increase for another Standard Mail product, Flats. Its proposed prices even leave one entire class (Periodicals) “underwater.”

⁸ 39 U.S.C. § 3622(c)(2)

b. The proposed increases for Standard Mail NFMs/Parcels are not necessary to prepare the products for the possible transfer to the competitive product side as the Postal Service implies.

The Postal Service attempts to justify the large proposed increases as follows:

All parcel-shaped pieces face competition in the market place regardless of how they are classified in the MCS. Shortly, the Postal Service will be proposing to transfer Standard Mail parcels to the competitive category to reflect the realities of market place competition. Consequently, the proposed prices are designed to ensure that this product covers its costs, consistent with the statutory requirements for competitive products.

Kiefer Statement at 31.⁹

This is misleading at best. It is true that competitive products must cover costs. See 39 U.S.C. § 3633. But NFMs/Parcels may not be a separate product. They may not, and probably will not, be required to cover costs by themselves if transfer to the Competitive Product List is approved by the Commission. NFMs/Parcels could easily be included with Parcel Select, and the costs of all packages over one pound and one pound or under would be lumped together. Indeed, this is what the Postal Service proposed in yesterday's filing. See Standard Parcel Request at 1.

In any event, the Postal Service puts the cart before the horse. Unless and until the Commission approves a transfer of the Standard Mail NFMs/Parcels product to the competitive product list,¹⁰ this product is a market dominant product subject to the

⁹ Witness Kiefer also argued, "other parcel delivery companies charge much higher prices for one pound parcels and, on that basis, the market valuation of Standard Mail parcel delivery service far exceeds what we are asking our customers to pay, even incorporating the requested increase." Kiefer Statement at 31. This justification should be given absolutely no weight because the comparison is not meaningful. At the July 23rd technical conference, Dr. Kiefer conceded that the other delivery companies' one pound parcel prices to which his statement refers are published prices; these published prices are not comparable to Standard Mail rates because no worksharing is required to qualify for the published prices; parcel shippers actually negotiate prices that are lower than the published prices; and the Postal Service is not privy to the actual negotiated prices because they are confidential.

¹⁰ And it is, by no means, certain that Standard Mail NFMs/Parcels, or any portion thereof, meet the statutory requirements for such a transfer to be approved.

protections of an incentive price regulation system, a system which AMA points out provides “the primary line of defense established by Congress to protect mailers and the American public from abuse of the Postal Service’s market power.” AMA Motion at 5. “Thus, regulation is intended to prevent the regulated firm from exploiting its market power by earning excessive profits or recouping inefficiently high costs.” Stephen G. Breyer, *et al.*, *Administrative Law and Regulatory Policy: Problems, Text, and Cases* 228 (4th ed. 1999); Stephen G. Breyer, *Regulation and its Reform* (1982) at 37-38, 47-50; 1 Kahn, *Economics of Regulation*. (1970) at 17, 20-21; Kenneth E. Train, *Optimal Regulation 2* (1991). AMA at 6-7.

c. The proposed increase for Standard Mail NFM/Parcels will generate relatively little revenue and is not necessary to address the Postal Service’s financial dilemma.

AMA argues that “no financial relief is warranted under the exigent procedure if the Postal Service can continue providing necessary services without the exigent rate increase.” AMA at 15. Perhaps. But, the additional revenue that might result from the proposed price increases for Standard Mail NFM/Parcels, approximately \$125 million in FY 2011 for a \$70 billion business (or approximately 0.2 percent of total revenue)¹¹, is definitely not necessary for the Postal Service to continue providing necessary services. It will make little if any difference in the overall financial condition of the Postal Service. One hundred twenty million dollars, however, are big bucks to Standard Mail parcel mailers, and the unanticipated imposition of these costs will cause substantial harm.

¹¹ Compare Standard Mail NFM/Parcels revenue in Masse Statement, Attachments 10 and 11.

d. The data and methodology underlying the proposed increases inspire no confidence the proposed prices will achieve the stated goals.

As explained below, the data and methodology underlying the proposed increases inspire no confidence they are necessary to or will achieve the stated goals.

i. The Postal Service's roll forward for Standard Mail NFM/Parcels is flawed. Correcting this flaw would reduce Standard Mail NFM/Parcels costs by approximately \$125 million.

Between FY 2009 (the Base Year in this proceeding) and FY 2010, the amount of worksharing of Standard Mail NFM/Parcels has increased significantly. According to FY 2009 and FY 2010 (Year-To-Date through quarter 2) Billing Determinants --

- The percentage of Standard Mail NFM/Parcels pounds entered at the DSCF increased from 32 percent to 45 percent.
- The percentage of Standard Mail NFM/Parcels pounds entered at the DDU increased from 12 percent to 21 percent.
- The percentage of Standard Mail NFM/Parcels pieces presorted to 5-Digit increased from 39 percent to 55 percent.

The primary reason for the increased worksharing is that the May 2009 price increase included rules requiring mail pieces to be destination entered in order to qualify for the Sectional Center Facility (SCF)/3-Digit and 5-Digit Presort rates and also substantially increased destination entry discounts. Docket No. R2009-2, Notice of Market-Dominant Rate Adjustment (February 10, 2009) at 16-17.

In instances like this, where mail mix changes between the "Base Year" and "Test Year," the standard practice in past Omnibus Rate Case proceedings under the Postal Reorganization Act was to adjust costs to reflect the mail mix changes as part of

the roll forward's "Final Adjustment" process. See Docket No. R2006-1, USPS-T-23 (Page) at 23-24. The Postal Service did not make such an adjustment in this proceeding resulting in substantially overstated costs for the Standard Mail NFMs/Parcels product. See Masse Response to POIR No. 4, Question 3d.¹²

As calculated in Appendix A, the estimated cost of Standard Mail NFMs/Parcels should be reduced approximately \$125 million (about 15 percent) to reflect the significant increases in worksharing that occurred between FY 2009 and FY 2010. This figure was calculated using the following methodology –

1. Calculate total Standard Mail NFMs/Parcels workshare cost avoidances using FY 2009 volumes, mail mix and workshare cost avoidances.
2. Calculate total Standard Mail NFMs/Parcels workshare cost avoidances using FY 2009 volumes and workshare cost avoidances and FY 2010 (Year-To-Date) mail mix.
3. The cost reduction from increased worksharing is the difference between Standard Mail NFMs/Parcels workshare cost avoidances (using FY 2010 mail mix) and the Standard Mail NFMs/Parcels workshare cost avoidances (using FY 2009 mail mix).¹³ (See Appendix A).

¹² The Postal Service attempts to downplay this problem by questioning the size of the May 2009 rate increase. Masse Response to POIR No. 4, Question 3a. This argument should be given no weight. The Postal Service's calculations – which purport to show that the May 2009 price increase was less than one-fifth of the size that it had estimated in Docket No. R2009-2 – are incorrect because some of the May 2009 prices used in its calculations are wrong. For example, the calculations use a piece rate of \$0.622 for pound-rated AADC Irregular Parcels when the May 2009 piece rate for these pieces is actually \$1.022. The calculations use a \$1.022 piece rate for pound-rated Mixed BMC Machinable Parcels when the May 2009 piece rate for these pieces is actually \$1.279. The calculations use a \$0.563 piece rate for pound-rated BMC Machinable Parcels when the May 2009 piece rate for these pieces is actually \$0.879. Compare prices in PSA.FY09.BDs.xls (filed by the Postal Service on 8/13/2010), "Standard" cells BH20-22 with those in the Postal Service's current price list (Notice 123). Just correcting these three errors increases the average rate increase estimated by the Postal Service in response to POIR No. 4, Question 3a from three percent to more than 11 percent. Additionally, the spreadsheet provided on 8/13/2010 also appears incomplete, not including all Standard Mail NFMs/Parcels prices (e.g., the price for pound-rated 5-Digit Machinable Parcels). These mistakes are quite likely to infect the Standard Mail NFMs/Parcels revenue forecasts in Mr. Masse's appendices in addition to his response to the POIR.

¹³ Because the revenue per piece estimates are based in part on an FY 2009 mail mix, there may need to be a smaller downward adjustment to Standard Mail NFMs/Parcels revenue. This adjustment would be smaller for two reasons. First, the base period for the revenue forecast includes a portion of FY 2010 and the passthroughs (particularly for destination entry discounts where the largest increase in worksharing occurred) are generally below 100 percent, i.e., the impact of worksharing on revenue is much smaller than on cost. Masse Response to POIR No. 4, Question 3c; Kiefer Statement, Appendix B.

ii. By FY 2011, the Postal Service should be able to shed the excess labor (particularly in the delivery function) that has resulted in huge increases in Standard Mail NFM/Parcels costs in recent years.

Over the last two years, the Postal Service was unable to reduce workhours to fully adjust to the reduction in workload. As the Postal Service explained in a 2008 report, as mail volume declined, “it was impossible to adjust resources with sufficient speed.” FY 2008 Comprehensive Statement on Postal Operations at 54. The inability to fully adjust resources resulted in “some excess capacity in virtually all areas of operations” with “material excess capacity” in the Postal Service’s delivery networks in the Summer of 2009 and, most likely, for the entire year. Docket No. R2009-3, USPS Response to Chairman’s Information Request (CHIR) No. 1, Question 4. Further, in his response to POIR No. 4, Question 4, in this proceeding Masse explains the impact of this on Standard Mail NFM/Parcels costs:

- “[i]t is quite possible that the sharp decline in volume was accompanied by a decline in casing productivity. Such a productivity decline would lead to higher unit costs.”
- “[A]n environment with declining volumes and a stable number of delivery points reduces the number of pieces per delivery point which, in turn reduces, carrier street time productivity. This fall in productivity resulted in an average unit cost increase of sixteen percent for all products in CS/7 in FY09.”

This excess capacity contributed to very high NFM/Parcels unit costs in FY 2009, the “Base Year” in this proceeding, and thus similarly inflated FY 2010 and FY 2011 cost estimates. From FY 2008 to FY 2009, NFM/Parcels unit costs increased by 12 percent. One-third of the cost increase in dollar terms came from a *nearly thirty*

percent increase in city carrier costs, an area where the Postal Service had “material excess capacity.”

The rate of volume decline significantly decelerated in FY 2010 with volume growth projected in FY 2011. See Masse Statement at 5, Attachment 1. Going forward, as volume improves, the Postal Service should be able to shed the excess capacity built up in FY 2008 and FY 2009, bringing unit costs down.

The Postal Service attempts, without success, to explain away much of the cost increase between FY 2008 and FY 2009 as being the result of a “shift in mail mix toward a higher share of parcels vs. NFMs.” Response of Masse to POIR No. 4, Question 4.¹⁴ According to the Postal Service’s workshare calculations, NFMs are irregular parcels.¹⁵ As evidenced by the much larger workshare cost avoidance estimates for irregular parcels, they are, all else being equal, much more costly for the Postal Service to handle than machinable parcels, which comprise about half of Standard Mail parcels.

Moreover, from FY 2008 to FY 2009, the level of worksharing in the NFMs/Parcels product increased substantially, reducing unit costs. According to billing determinant data, the percentage of NFMs/Parcels that were destination entered increased from 55.0 percent to 69.8 percent in FY 2009 (with the entire increase being in the DSCF and DDU categories) and the percentage of NFMs/Parcels that were presorted to 5-Digit increased from 29.5 to 39.4 percent.

¹⁴ The Postal Service also attempts to explain away some of the cost increases as similar to that for all products. This comparison is of no import. It is not PSA’s position that Standard Mail NFMs/Parcels are the only product for which costs increased significantly between FY 2008 and FY 2009.

¹⁵ Kiefer Statement, Appendix B, Workshare Discounts and Benchmarks--Standard Mail Parcels and NFMs (Commercial and Nonprofit).

iii. Many of the strategies that the Postal Service has developed to reduce costs for handling flats will help reduce Standard Mail NFMs/Parcels costs.

Witness Kiefer explains that a major prong of the Postal Service's plan to improve the cost coverage of Periodicals and Standard Mail Flats is to reduce costs through a number of operational strategies (listed in USPS-LR-9) that will "result in substantial improvements in flats cost coverage." Kiefer Statement at 32, 41. PSA believes that reducing costs is the best approach for improving cost coverage for *all* products, including NFMs/Parcels, for which revenues may not cover attributable costs. While the Postal Service did not file a separate list of strategies for reducing parcel costs,¹⁶ most of the operational strategies identified for flats (including many identified as "large [cost reduction] opportunities") should similarly reduce costs for parcels. United States Postal Service Response to POIR No. 4, Question 5.

¹⁶ The disparate treatment of Standard Mail NFMs/Parcels is inequitable on its face. The Postal Service should be required to explore similar strategies for bringing down parcel costs before being allowed to implement the proposed massive increases. As noted above, the Postal Service attempts to justify the disparate treatment of Standard Mail NFMs/Parcels based upon a *future* proposal to transfer the Standard Mail NFMs/Parcels product to the competitive product list. This is, at a minimum, a premature justification.

Table 1. Flats Operational Strategies That Will Reduce Standard Mail NFM/Parcels Costs

Opportunity Name	Size of Opportunity
Transportation	
Improve Handling Unit/Container Density	Large
Eliminate Periodical and Standard Mail Flown	Small
Transportation Utilization	Large
Network Optimization	Medium
Mail Processing	
Facility Optimization	Large
Equipment Optimization -- APPS Utilization	Medium
Automated Package and Bundle Sorter	Medium
Material Handling	Large
Electronic Condition-Based Maintenance	Small
Distribution Compression	Large
Realign Operating and Transportation Plan to Improve Utilization	Medium
Refine Work Methods to Improve BMEU/Plant Load Handoff to Mail Processing	Large
Continuous Improvement	n/a
Post Office and Delivery Operations	
Business Plan Staffing and Scheduling Reviews	Large
Shifting Distribution from Post Office to Mail Processing Operations	Medium
Customer Service Unit Optimization	Medium
Route Adjustments JARAP/COR	Medium
Route Optimization 100 Percent Street Routes	Large
Facility Optimization	Small

iv. According to the Postal Service’s Chief Financial Officer, when volume declines suddenly, Postal Service costs are less variable than estimated by cost systems. In these situations, all products (whether estimated to be “underwater” or not) increase Postal Service profitability.

Finally, the Postal Service’s Chief Financial Officer made clear at the August 10 hearing that when volume declines significantly, the Postal Service can’t adjust its costs to the extent suggested by the Postal Service’s cost systems, i.e., the costing systems overstate the variability of postal costs. In such instances, cost systems substantially

overstate the attributable cost of individual products. Even at current rates, Standard Mail NFM/Parcels certainly cover the Postal Service's much lower marginal cost of handling NFM/Parcels during these times. Specifically, Witness Corbett stated, "We have...primarily a fixed-cost network when you really get down to it. The majority of our costs are in delivery...so...any volume loss actually will cause, all other things equal, will cause a decrease in our profits." Tr. 1, 77-78.

V. The proposed increases for Standard Mail NFM/Parcels are not designed to achieve important objectives, and fail to adequately take into account important factors of the PAEA.

a. The objectives and factors are relevant.

The Commission's rule § 3010.14 (7) provides that increases should demonstrate how they are "designed to help achieve the objectives listed in 39 U.S.C. § 3622 (b) and properly take into account the factors listed in 39 U.S.C. § 3662(c)." The Postal Service acknowledges this command and seems to suggest it applies in an exigency situation.¹⁷ Frankly, it seems incongruent to say that the Postal Service, in addition to busting the rate cap in an exigent case, may also ignore the "objectives" and "factors" of the PAEA. Congress certainly did not intend to give the Postal Service more discretion about particular prices in an exigent situation than it would have with a normal type 1 market dominant rate increase. Thus, we do think that, even though the statute does not explicitly say so, the prices proposed in an exigent case, among other things, must "be designed to achieve the statutory objectives, and take into account the statutory factors."

¹⁷ "As with any price change request, the pricing factors and objectives guide postal pricing decisions." Kiefer Statement at 3; On behalf of the Postal Service, Kiefer "discusses 1) how its planned prices 'help achieve' the objectives of section 3622(b) and 'properly take into account' the factors of section 3622(c)..." Kiefer Statement at 53.

The proposed increases for Standard Mail NFM/Parcels are not designed to achieve important objectives and fail to adequately take into account important factors of the of the PAEA.

b. Applicable objectives and factors of The PAEA argue against the lawfulness of the proposed NFM/Parcels increases.

Witness Kiefer's testimony is replete with reasons why the Commission should do all it can, indeed do more than the USPS has proposed, to mitigate the impact of the proposed price increases on users of the mail. His statement, for example, discussed "rate shock" in numerous instances.¹⁸

Factor 3, the effect on users, is a compelling guidepost for the Commission's judgment. The unexpectedly and disproportionately large increases proposed for NFM/Parcels surely brings this factor into play. As discussed above, price increases of this size will visit economic harm on NFM/Parcels users. Similarly, **Objective 2** calls for predictability and stability of rates. The unexpected, large increases proposed for NFM/Parcels are a contradiction of predictability and stability. The USPS proposal does not achieve this objective. **Objective 8** calls for a "just and reasonable" schedule. For reasons elsewhere discussed, we do not believe that the case can be made that these enormous increases are "just and reasonable".

IV. Relief Requested

For exigent rate increases the PAEA does not explicitly provide for Commission resolution should Postal Service proposals not comply with the law. However, the

¹⁸ See Kiefer Statement at 24-26, 49. Rate shock is used with respect to worksharing discounts, and most commonly in connection with assessing "the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters." See 39 U.S.C. § 3622(c)(3).

PAEA does provide a mechanism for type 1 rate proposals that do not comply. See 39 U.S.C. § 3622(d)(1)(C)(iii) and (iv). That section provides the Commission is to notify the Postal Service of any non-compliance of the adjustments with the limitation under section 3622(d)(1)(A) (The annual inflation limitation) and require it to respond to the notice and describe the actions it will take to comply with the limitations on annual increases.

There appears to be no statutory provision for a remedy should the Commission determine that rate adjustments under either regular or exigent circumstances fail to comply with the law, other than the cost of living limitation or the “circumstances” test for exigent increases.

Section 3010.13(d) and (e) of the Commission's rules provide that if planned rate adjustments are found consistent with applicable law by the Commission, they can take effect, and that if the adjustments are found to be inconsistent with applicable law, the Postal Service will submit an amended notice of rate adjustment and describe the modification to its planned rate adjustments that will bring them into compliance. Thus, it would appear that the Commission cannot itself fashion the remedy but must put it back to the Postal Service to provide the adjustments necessary to answer the Commission's findings of violation of the PAEA.

In this case, PSA urges the Commission to disapprove the price increases proposed for Standard Mail NFMs/Parcels and order the Postal Service to submit a reasonable and equitable and necessary price schedule for NFMs/Parcels with an

average increase no more than the largest average “moderate” increase for other products. In this instance, if other prices are approved, that would be eight percent.

Respectfully submitted,

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August 17, 2010

Appendix A. Cost Reductions From Increased Worksharing From FY 2009 to FY 2010

	FY 2009 [1]	FY 2010 (Q1 & Q2) [2]	FY 2010 (Q1 & Q2) Percentages [3]	FY 2009 (FY 2010 Mail Mix) [4]	Cumulative Cost Avoidance [5]
Presorting					
Parcels (Pieces)					
Machinable					
Mixed NDC	11,745,825	7,097,747	5.3%	14,074,375	
NDC	145,767,361	41,546,580	30.8%	82,384,189	\$0.218
5-digit	110,336,323	86,432,939	64.0%	171,390,945	\$0.631
TOTAL	267,849,509	135,077,266	100.0%	267,849,509	
Irregular					
Mixed NDC	15,344,358	7,133,733	4.5%	12,475,422	
NDC	14,136,175	4,679,073	3.0%	8,182,730	\$0.984
SCF	136,549,331	67,700,684	42.9%	118,394,476	\$1.968
5-digit	109,861,579	78,247,581	49.6%	136,838,815	\$2.150
TOTAL	275,891,443	157,761,071	100.0%	275,891,443	
NFMs (Pieces)					
Presorted					
Mixed NDC	14,590,607	6,871,233	13.4%	18,013,625	
NDC	39,344,569	9,923,259	19.4%	26,014,817	\$0.984
SCF	32,637,233	8,736,082	17.1%	22,902,513	\$1.968
5-digit	47,434,868	25,586,024	50.1%	67,076,322	\$2.150
TOTAL	134,007,277	51,116,598	100.0%	134,007,277	
Destination Entry (Pounds)					
Origin	108,408,127	21,929,208	14.3%	43,739,311	
DNDC	64,673,174	29,836,708	19.5%	59,511,363	\$0.770
DSCF	96,984,266	69,412,612	45.3%	138,448,221	\$1.060
DDU	35,388,022	31,964,151	20.9%	63,754,694	\$1.159
TOTAL	305,453,589	153,142,679	100.0%	305,453,589	

[6] FY 2009 Total Cost Avoidance	\$1,018,787,459
[7] FY 2009 (FY 2010 Mail Mix) Total Cost Avoidance	\$1,142,718,400
[8] Cost Reductions From Increased Worksharing	\$123,930,941

[1] Docket No. ACR 2009, USPS-FY09-4, 09 Standard Mail.xls (Excludes Pieces Paid at First-Class Rates)

[2] Market Dominant Products Billing Determinants (FY2010, Quarter 1), Filed 3/5/2010, Filing_Copy_Standard_BDs_2010Q1--MCS--WP.xls (Excludes Pieces Paid at First-Class Rates);
Market Dominant Products Billing Determinants (FY2010, Quarter 2), Filed 5/24/2010, Filing Copy Standard BDs 2010Q2--MCS--WP.xls (Excludes Pieces Paid at First-Class Rates)

[3] Percentage Distribution of [2]

[4] FY 2009 totals multiplied by [3]

[5] Kiefer Statement, Appendix B

[6] SUMPRODUCT([1], [5])

[7] SUMPRODUCT([4], [5])

[8] = [7] - [6]