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BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON DC 20268-0001

Notice of Price Adjustment **Docket No. R2011-2**

COMMENTS OF PARCEL SHIPPERS ASSOCIATION & DIRECT MARKETING ASSOCIATION, INC. ON THE PLANNED PRICE ADJUSTMENTS FOR MARKET DOMINANT PRODUCTS AND RELATED MAIL CLASSIFICATION CHANGES (February 2, 2011)

Pursuant to Order No. 653, the Parcel Shippers Association (PSA) and the Direct Marketing Association (DMA) respectfully submit these comments in response to the United States Postal Service's (Postal Service) January 13, 2011 Notice of Market-Dominant Price Adjustment (Notice). PSA/DMA particularly wish to bring to the Commission's attention the concerns of its members over proposed, exorbitant price increases for Standard Mail parcels, which are far in excess of the overall class increase allowed by the cap of 1.7 percent. Below we discuss why the proposed increases are unjust and unreasonable and contrary to applicable law's[1] command for price predictability and stability, and how they will have an adverse impact, in many cases quite severe, on PSA/DMA members and others similarly situated. Finally, we ask the Commission to withhold its approval of these prices, and direct the Postal Service to bring the individual prices more in line with, yet still far in excess of, the

[1] The Postal Accountability and Enhancement Act (PAEA), Pub. L. No. 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.

overall average increase for Standard Mail and the price cap (1.7%), and we suggest a path for doing so.

I. The prices proposed for mailers of Standard Mail parcels are unjust, unreasonable, and contrary to the PAEA command for price predictability and stability (39 U. S. C. §3622(b)(2) and (8)).

The sheer magnitude of the increases proposed for Standard Mail parcels, compared to the price cap and the increases proposed for other products, establishes that the proposed prices are beyond the realm of reason. The Postal Service says the "average increase" for parcels and NFMs is 11.3%. Notice at 16. This average increase is, of course, many multiples of the price cap. But, examination of the individual prices for Standard Mail parcels shows increases which are better deemed outrageous for a market dominant product. The price increases proposed for machinable parcels sorted to 5 digits soar from 17% to 34%. As several PSA members have pointed out, these increases are worse than those proposed in the exigency price proceeding. In our comments in that docket we explained why the Commission should disapprove price increases of that size as unjust and unreasonable.[2] *See* Docket No. R2010-4, PSA Comments p. 4 et seq. The arguments we presented then with respect to the size and unexpected nature of the proposed increases apply equally here.

This latest proposal, however, is even worse than that proposed in the exigency for other reasons. If these Standard Mail parcel prices stand, postal reform's promise of price predictability and stability will *not* stand. *See* 39 U.S.C. §3622(b)(2). With this proposal, the Postal Service without warning has changed direction 180 degrees, a

[2] The Commission never reached the question of whether those Standard parcel/NFM prices were reasonable, disallowing the proposed price increases on other grounds.

complete about face, with respect to its price signals for worksharing. The Postal Service's proposal has chosen to punish, without reasonable explanation (because there could be none), mailers who in reliance on past price signals and guidance from the Postal Service have invested significant resources to prepare mail in a way that makes it most efficient for the Service to handle. These are mailers who prepare their packages to meet machinability standards and presort them to the 5-digit level, thereby relieving the Service of virtually all mail processing responsibility. They then enter their mail deep in the system, allowing the Service to also avoid the costs of transporting their packages. They do so even though often prices offered do not fully reward them for the savings they deliver to the Postal Service. They also do so, importantly, because experience shows that avoiding Postal Service processing and transportation results in better service. This is unfortunate but true, as explained in part II.

The huge rate increases for these highly efficient parcels amounts to nothing more than a bait-and-switch. In previous rate increases, the Postal Service has strongly encouraged increased worksharing. In the last price adjustment, Docket No. R2009-2, the Postal Service implemented prices that encouraged presorting and drop shipping. In response to those workshare incentives, PSA/DMA members made significant, often irreversible, investments in worksharing. Now, the Postal Service appears to be pursuing a new, very different approach regarding worksharing. These proposed prices reduce the incentive to presort and drop ship and suggest to mailers, where they can, to abandon both. This will result in entry further upstream, which will adversely affect costs and service.

Such large increases for these efficient parcels could perhaps be excused if they were necessary to comply with the PAEA's restrictions on workshare discounts (and even the workshare restrictions include exceptions); but they are not. The Postal Service's proposal is based upon a passthrough of only 55 percent of the cost avoided by presorting machinable parcels to 5-digit, well within the requirements of the law. *See* 39 U.S.C. §3622(d); Notice, Attachment B.

· These unjust, unreasonable, and unexpected proposed increases appear to be driven by two goals: first, to equalize prices for 5-digit drop shipped machinable and irregular parcels, a goal that we think may have merit; second, to increase revenue from the Standard Mail parcel product to a level where the product is "profitable," a laudable goal but one which should not be achieved by price-gouging Standard parcel mailers. Surprisingly, the Postal Service admits it can gouge these mailers because of the monopoly it holds in the Standard Mail fulfillment parcel market, the very same parcels it has proposed to transfer to the competitive category of mail in Docket No. MC2010-36.:

> The Postal Service intends to restructure its Standard Mail parcel offerings by broad market segment into parcels that are used to fulfill merchandise orders, believed to be less price elastic, and parcels that largely carry marketing messages, believed to be much more sensitive to postage prices. The Postal Service believes that 5-digit presorted parcels, particularly in the NFMs category, are most heavily weighted toward fulfillment parcels, and therefore are able to absorb relatively higher percentage increases than marketing parcels, which are more heavily concentrated at less fine presort tiers.

Notice at 37. This unreasonable use of market power was not allowed in the exigency case (R2010-4), it should not be allowed in the docket considering transferring Standard Mail fulfillment parcels to the competitive category of mail (MC2010-36), and it should not be permitted here.

II. The prices proposed for mailers of Standard Mail parcels will increase costs, decrease efficiency, and degrade service, thereby adversely affecting mailers of Standard Mail parcels. (39 U.S.C. §3622(b)(1) and (c)(3).

Generally, prices should reflect the savings resulting from worksharing. Indeed, in a perfect world, worksharing discounts would equal avoided costs. This is known as the Efficient Component Pricing Rule (ECPR) which the Commission has described as "an effective method for encouraging efficient mailing practices. The ECPR is the principle that workshare discounts should be set equal, on a per-unit basis, to the costs avoided by the Postal Service when the mailer performs the workshare activity." Order No. 26 at 22. The Commission has said it "strongly believes that efficient component pricing should be used as a guiding principle in establishing and maintaining workshare discounts. In both sections 3622(b) and 3622(c) the statute stresses the need for efficient rates and efficient component pricing is an established method of measuring efficient ratemaking." Id at 23.

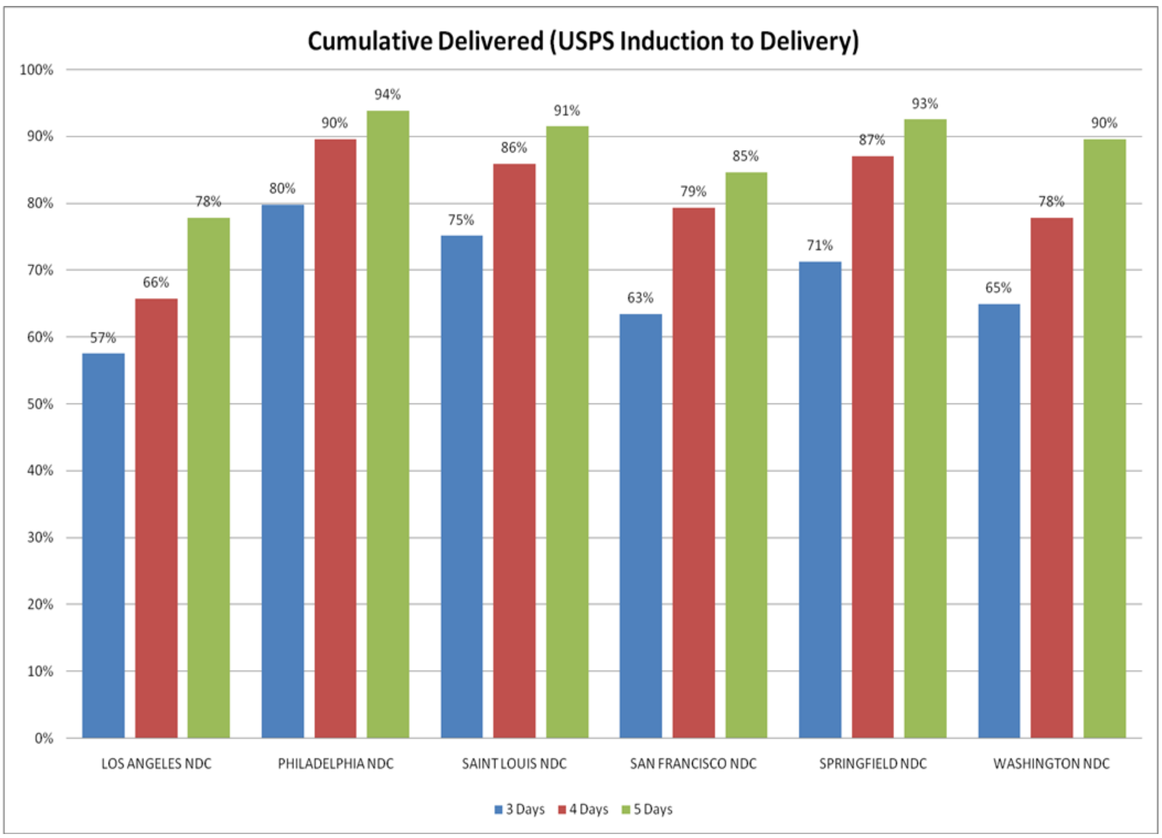
The analysis of worksharing rates set forth in Attachment B to the Notice demonstrates the failure of the proposed Standard Mail parcel prices to comply with the ECPR. These are not prices that promote efficiency as envisioned under the PAEA. 39 U.S.C. §3622(1).

If mailers of Standard Mail parcels are driven to move entry upstream from the Destination Delivery Unit (DDU) to the Destination Sectional Center Facility (DSCF) or from the DSCF to the Destination Network Distribution Center (DNDC), it will be because the proposed prices insufficiently reward processing (sorting to the 5-digit) or transportation. And, service will certainly suffer.

PSA members' experience shows that cycle time and service diminishes in relation to how far upstream packages are entered into the mail stream. As was demonstrated during the last holiday peak mailing period, our members know that service from the NDCs is not good. If more mail is forced upstream to NDCs, service will likely deteriorate further. Here are some comments and statistics we have received from members:

- Our service performance with packages entered at the DDUs is excellent with a scan rate of over 98%. Packages entered at the NDCs have a scan rate of about 82%.

- Our overall service allowing for 3 day delivery at the NDC is about 75%. This is being generous in that a number of locations have 2 day standards. Please note the chart below for performance for the month of December 2010 for specific NDCs:



- A larger problem is the outliers or “tail of mail” delays which may take an additional 7 days to get all the packages delivered from an NDC. The DDUs service performance is at the 99% level with all packages delivered within 3 days.

III. Relief

· PSA/DMA respectfully suggest that the Commission address the concerns expressed above. It can do so by directing the Postal Service to lower the proposed rate increase for 5-digit presorted parcels to a more just and reasonable level. It can do this, and still preserve elements of the Postal Service's proposed rate design by reducing the price increase for both machinable and irregular parcels that are sorted to 5-digits by seven cents. We estimate that this will reduce the average price increase for Standard parcels/NFMs to a less extreme, but still well above average, 7.3 percent.

IV. Conclusion

It appears to PSA/DMA that the Postal Service is trading possible short-term revenue for certain service degradation and a long-term strategy that was correctly discarded in the past. Instead of continuing to encourage mailers, through appropriate price signals, to perform work that increases overall efficiency, the Service has reversed course, giving signals that deter worksharing. In doing so, it has proposed Standard Mail parcel prices that are unjust and unreasonable and contrary to PAEA's command for price predictability and stability, and that will have adverse impacts, in many cases quite severe, on PSA members and others that are similarly situated. In response, we ask the Commission to withhold its approval of these prices and direct the Postal Service to bring the individual prices more in line with, but still far in excess of, the overall average increase for Standard Mail and the price cap (1.7%). It can do this, and still preserve elements of the Postal Service’s proposed rate design, by reducing the price increases for machinable and irregular parcels sorted to 5-digits by seven cents.

Respectfully submitted,

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