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

NOTICE OF PRICE ADJUSTMENT

Docket No. R2011-2

RESPONSES OF THE UNITED STATES POSTAL SERVICE TO
QUESTIONS 1-16 OF CHAIRMAN'S INFORMATION REQUEST NO. 1
(February 9, 2011)

The Postal Service hereby files its responses to questions 1-16 of Chairman's Information Request No. 1, issued on February 2, 2011. Each question is stated verbatim, and followed by the response. Certain responses refer to nonpublic material provided within USPS-R2011-2/NP1, filed today.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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February 9, 2011

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO CHAIRMAN'S INFORMATION REQUEST NO. 1

1. One of the stated eligibility requirements for the proposed First-Class Mail Commercial Plus parcels category is that the mailer makes an annual volume commitment of 5,000 pieces. Postal Service Notice at 15.

a. Please explain the rationale for requiring an annual volume commitment, and for the selection of 5,000 pieces as opposed to a smaller or larger commitment.
b. Please identify the category or categories of mail (*e.g.,* Commercial Plus parcels or all Commercial First-Class parcels) that will count toward the commitment, and describe the process the Postal Service will use to verify that each mailer meets the minimum volume.
c. Please identify the penalty (or other consequences) a mailer will incur for failing to satisfy its volume commitment.

RESPONSE:

a) The objective of this offering is to create another option for high volume parcel mailers that likely pay via Permit imprint. Mailers of parcels that weigh between 13 and 16 ounces currently use either Standard Mail or a Postal Service competitor, even if they use First-Class Mail for their lighter weight (under 13 ounce) parcels. The Commercial Plus rate category will allow these high volume mailers to use First-Class Mail for all their parcels that weigh less than 16 ounces. Once a customer commits to the 5,000 piece volume requirement, the Postal Service will work to ensure that the 13 to 16 ounce pieces are isolated and handled properly within the First-Class Mail stream. The required higher volumes will result in a more consistent inflow of volume and better enable the Postal Service to process the volume properly and on a regular basis.

b) Only Commercial Plus parcels will count towards the annual commitment. The Postal Service will verify that mailers meet the commitment using its PostalOne! system.

c) Customers who fail to meet their volume commitment will not be allowed to use Commercial Plus pricing for subsequent mailings. In addition, previous mailings for which First-Class Mail Commercial Plus prices were charged will be assessed the price difference between First-Class Mail Commercial Plus and Priority Mail Commercial Base.

2. In response to CHIR No. 1, question 1 in Docket No. ACR2010, the Postal Service provided revised cost avoidance and passthrough calculations that removed the effects of Proposal Nine (on which the Commission has not made a final decision). *See* Docket No. ACR2010 USPS-FY10-42. Three discounts (automation AADC presort letters, automation 3-digit presort letters, and automation AADC presort cards) that were designed to pass through 100 percent of avoided costs based on the calculations as filed (incorporating Proposal Nine) exceed 100 percent of avoided costs under the accepted methodology. For each of these discounts, please identify the exception claimed under 39 U.S.C. 3622(e) and explain how it applies to the proposed discount.

RESPONSE:

When the Postal Service set its prices for First-Class Mail Automation Letters and Cards, it did not focus its attention on how these prices could be justified should the Commission decline to approve the improvements to the letters cost model that were the subject of Proposal Nine. The Postal Service believes that the Proposal Nine methodologies produce measurements of avoided costs that are more accurate than were available under the older methodologies. The Postal Service's view is supported by the fact that Proposal Nine has not generated any adverse comments from the public or the mailing community. The Postal Service therefore is unable to provide justification for an exception under section 3622(e) for discounts which do not exceed the best available measurements of avoided costs, but that appear to exceed costs measured using less accurate methodologies.

3. [Periodicals] In response to CHIR No. 1 questions 2 through 8 in Docket No. ACR2010, the Postal Service provided updated cost avoidance calculations. As a result, some cost coverages changed. Specifically, the passthrough for 3-digit automation letters increased from 400 percent to 1,000 percent. Please identify the exception claimed under 39 U.S.C. 3622(e) and explain how it applies to the proposed discount.

RESPONSE:

When the Postal Service set its prices for Periodicals' Automation Letters, it did not focus on how these prices could be justified should the Commission decline to approve the improvements to the letters cost model that were the subject of Proposal Nine. The Postal Service believes that the Proposal Nine methodologies produce measurements of avoided costs that are more accurate than were available under the older methodologies. The Postal Service's view is supported by the fact that Proposal Nine has not generated any adverse comments from the public or the mailing community. For this reason the Postal Service did not provide justification for an exception under 3622(e) for discounts which exceed both the best available measurements of avoided costs and costs measured using less accurate methodologies.

In this particular instance, concerning passthroughs for the Periodicals subclasses, which consist exclusively of mail matter of educational, cultural, scientific or informational value, the 39 U.S.C. 3622(e)(2)(C) exception applies.

4. In Docket No. R2010-4, the Postal Service referred to the "delicate financial position of the catalog industry" and proposed a 5.1 percent increase for Standard Mail Flats. Docket No. R2010-4, Kiefer at 28-30. In the instant docket, the Postal Service again reasons that a cautious approach is warranted due to the delicate financial position of the catalog industry, but proposes a 0.835 percent increase for Standard Mail Flats.

a. How has the financial position of the catalog industry changed between the filing of Docket No. R2010-4 and Docket No. R2011-2?

b. Given that Standard Mail Flats do not cover their costs, please reconcile the increase proposed in Docket No. R2010-4 with that proposed in this proceeding.

c. Please explain how the proposed increases for Standard Mail Letters and Flats apportion the costs of the Postal Service on a fair and equitable basis as required by 39 U.S.C. 101(d).

d. Please explain how the proposed increase for Flats ensures adequate revenues to maintain financial stability as required by 39 U.S.C. 3622(b)(5).

RESPONSE:

a. The Catalog industry is still feeling the effects of a long-term recession and the fragmentation of marketing channels. Continued pressure on catalogers has prompted long running catalogers to file for bankruptcy under Chapter 11 (e.g. Orchard Brands); to eliminate catalogs from the marketing mix (e.g. JCPenney); or to go out of business altogether. Catalogs have continued to decline in total volume, *even in the absence of a price increase*. Developments like these are a significant reason why the volume of the Standard Mail Flats product fell by 5.0 percent in FY 2010, Quarter 3 (compared to FY 2009, Quarter 3), when Standard Mail as a whole grew by 4.6 percent, and why Flats volume fell by 2.9 percent in FY 2010, Quarter 4 (compared to FY 2009, Quarter 4), when overall Standard Mail volume grew by 8.9 percent. These volume data were not available when the Postal Service filed its request for an exigent price increase in Docket No. R2010-4. The whole catalog industry continues to be in dire straits and has not experienced any significant or sustained improvement between the filing of

Docket Nos. R2010-4 and R2011-2. Indeed the Postal Service believes that the situation worsened over this period.

b. Please see the response to part a. Given the evidence that the economic situation of the catalog industry was worsening, and not improving, the Postal Service determined that, just as it had done in Docket No. R2010-4, the increase for Flats should be less than the increase for other portions of Standard Mail. As a result, even though the overall increase sought in this proceeding for all of Standard Mail is quite modest (1.7 percent), the increase sought for Flats is even more modest (0.8 percent). For this reason, the Postal Service's price adjustment noticed in Docket No. R2011-2 contains an increase for Standard Mail Flats that is well below the 12-month CPI inflation level.

c. Please see the responses to parts a. and b., above. As indicated in those responses, the catalog industry (the major user of Standard Mail Flats) has undergone and is continuing to undergo severe financial pressures. Furthermore, as discussed by the Postal Service in Docket No. R2010-4, the Postal Service sees the catalog industry as a growth segment in its business. (Statement of James M. Kiefer on Behalf of the United States Postal Service at 23). Moreover, the catalog industry as a whole makes a net positive contribution to the Postal Service. *See* Docket No. R2010-4, Response to POIR 3, Question 7 (August 9, 2010). Within the specific context of the overall set of price increases to be implemented on April 17, 2011, the Postal Service has made a considered business judgment as to the size of the postage increase that the catalog industry can be requested to bear while still having a reasonable chance of seeing the catalog segment remain a vital and viable contributor to the Postal Service's overall business. There is nothing that is either unfair or inequitable in giving an ailing industry with reasonable prospects for a healthy recovery a temporary break so that it can get back on its feet. The Postal Service foresees no permanent subsidy for the Flats product. Its pricing is designed to give temporary assistance during a limited recovery period. During that period other products may have to bear a greater portion of Postal Service costs; there is nothing inherently unfair or inequitable about such a temporary apportionment.

d. The provisions of 39 U.S.C. § 3622(b)(5) constitute one of the objectives that the "modern system for regulating rates" is to be designed to achieve. As such, the Postal Service believes that it is incumbent upon the design of the price regulation system, rather than each pricing decision, or each rate cell, taken by itself, to "ensure" the financial stability of the Postal Service. Nevertheless, the Postal Service recognizes that each pricing decision has an impact on the Postal Service's financial well being, and it keeps this fact in mind when it develops its pricing. Under the price cap regime imposed by the PAEA, the overall price increase for Standard Mail (and for every other market-dominant class of mail and services) is limited by the price cap. Whenever the Postal Service adjusts prices to the full extent of its price cap (as it has done in this case), it is doing as much as it is possible for it to do under the law to ensure that it has adequate revenues to maintain the financial stability of the Postal Service. Whether one product or mail category within a class receives an above-average increase or a below-average increase is immaterial. The Postal Service does not see how adjusting the prices of products receiving below-average increases to the average level, or indeed, above the average could be expected *a priori* to generate more revenue than had the prices remained as initially proposed. Any increase in one product's price would have to be offset by a decrease in the prices of one or more other products with no predictable increase in total revenues and no predictable impact on the financial stability of the Postal Service.

5. For each Standard Mail discount below, please identify the exception claimed under 39 U.S.C. 3622(e) and explain how it applies to the proposed discount.

a. Presort discount for NDC Machinable Parcels;
b. Presort discount for SCF Irregular Parcels; and
c. Presort discount for SCF NFMs.

RESPONSE:

The Postal Service believes that the exceptions for all of these discounts were identified in its discussion in pages 33 through 36 of its Notice of Rate Adjustment. Please see items a to c, below for explicit citations.

a. The exception claimed for NDC presorted machinable parcels (as well as for NDC presorted irregular parcels and NFMs) is section 3622(e)(2)(D) as stated on page 35, lines 19-20 of the Notice, with the rationale supporting the claim presented in the discussion beginning on page 33, line 22, and extending through page 35, line 19. The rationale is the same for all NDC presorted Standard Mail parcels and NFMs.

b-c. The exception claimed for SCF presorted irregular parcels and NFMs is section 3622(e)(2)(D), as stated on page 36, lines 18-20 of the Notice, with the rationale supporting the claim presented in the discussion beginning on page 35, line 21, and extending through page 36, line 20. The rationale is the same for both Standard Mail irregular parcels and NFMs that are presorted to SCFs.

6. [Standard Mail] In response to CHIR No. 1, question 10 in Docket No. ACR2010, the Postal Service provided revised cost avoidance and passthrough calculations that removed the effects of Proposal Nine (on which the Commission has not made a final decision). *See* Docket No. ACR2010 USPS-FY10-42. One discount (Nonautomation 3-digit Nonmachinable Letters) that was designed to pass through 100 percent of avoided costs based on the calculations as filed (incorporating Proposal Nine) exceeds 100 percent of avoided costs under the accepted methodology. Please identify the exception claimed under 39 U.S.C. 3622(e) and explain how it applies to the proposed discount.

RESPONSE:

When the Postal Service set its prices for nonmachinable letters, it did not focus on how these prices could be justified should the Commission decline to approve the improvements to the letters cost model that were the subject of Proposal Nine. The Postal Service believes that the Proposal Nine methodologies produce measurements of avoided costs that are more accurate than were available under the older methodologies. The Postal Service's view is supported by the fact that Proposal Nine has not generated any adverse comments from the public or the mailing community. For this reason the Postal Service is unable to provide justification for an exception under 3622(e) for discounts which do not exceed the best available measurements of avoided costs but that appear to exceed costs measured using less accurate methodologies.

7. Please refer to 'USPS-R2011-2/2 - Standard Mail Cap Compliance', CAPCALC-STD-FY2011.xls, cells D28 and D29 in worksheets 'HD-Sat-CR Com. Cap Wts.' and 'HD-Sat-CR NP Cap Wts.' Separately, for each of these worksheets, please disaggregate the volume of letters and flats receiving the IMb discount by Standard Mail product.

RESPONSE:

RPW data on IMb volumes, on which the cited worksheets are based, are not available at a finer disaggregation than shown in those worksheets, so it is not possible to separate these volumes by product.

8. Please refer to FY2011SPParcel_Post.xlsx, tab: New SPPP Prices, Cells: AA89 and AI89. Confirm that the weighted index for planned rates of combination enclosures should be increased by the same percentage as the First-Class Mail single-piece first-ounce letter rate (44/44-1= 0.00%), rather than by the average increase for single-piece Parcel Post. *See* Docket No. R2008-1 Notice of United States Postal Service of Errata to Market-Dominant Price Adjustment Filing (Errata), February 29, 2008, at 6.

a. If confirmed, please provide updated workpapers.

b. If not confirmed, please explain.

c. In addition, please explain why Cell: AA89 includes the Alaska Bypass fixed weight index, and Cell: AI89 does not. If necessary, please provide updated workpapers.

RESPONSE:

a. Confirmed. The weighted index for planned rates of combination enclosures should be increased by the same percentage as the First-Class Mail single-piece first-ounce letter rate, rather than by the average increase for single-piece Parcel Post. From workbook "FY2011SPParcel_Post.xlsx," tab <New SPPP Prices>, Cell AI89, the formula should be changed to "=AA89*44/44." The updated workpapers are attached to this response electronically as an Excel file titled ChIR.1.Q.8.FY11SPParcel Post(Rev).xls.

b. N/A

c. The formula in cell AA89 needs to be corrected. Cell AA89 should not include the Alaska Bypass fixed weight index. The change is:

From: Inputs!C15*(SUM(AA12:AA83)+AA87)

To: Inputs!C15*SUM(AA12:AA83)

The updated workpapers are included in the Excel file referenced above.

9. In FY 2010, single-piece Parcel Post had a cost coverage of 89.3 percent. In the 2010 ACR, the Postal Service states "[T]he Postal Service believes pricing and product actions need to be taken to improve Single-Piece Parcel Post's cost coverage." 2010 ACR at 39. Is the Postal Service's proposal to increase one to five pound single-piece Parcel Post rates part of the "pricing and product actions need to be taken to improve Single-Piece Parcel Post's cost coverage?" If so, please explain how the proposal in the instant docket is the most efficacious means to improve the product's cost coverage. If not, please elaborate.

RESPONSE:

Yes, the one to five pound Single-Piece Parcel Post rates are being increased in part to improve the cost coverage from the current 82.1 percent (not 89.3 percent as referenced in the first sentence of the question). The Postal Service is proposing to allow prices at the one-pound increment to vary by zone. This proposal allows for price differentiation by zone, with higher price increases for more distant zones beginning at one pound. Raising the long haul prices more than short haul prices should discourage a disproportionate influx of expensive, non-compensatory long haul pieces attracted by unzoned pricing for the pieces. This pricing change should result in a more balanced usage of Parcel Post, helping to improve its cost coverage, even if there were no net price increase for the product as a whole. The smoothing of prices from two to five pounds reflects the relaxed pricing constraint at one pound. Additionally, based on the FY 2010 billing determinants, approximately 50 percent of total revenue is reported at less than or equal to five pounds, so the weighted price increase of about 1.8 percent provides a modest revenue gain with respect to the "after rates" calculation.

Within the limits imposed by the price cap, the Postal Service is not only attempting to improve the cost coverage for Parcel Post, but for Package Services as a whole. Cost coverages for Bound Printed Matter parcels, Media Mail, and Library Mail also are being addressed by increasing prices relatively higher than for other categories in Package Services that are covering their costs. The new pricing is not expected to fully solve the Parcel Post cost coverage problem, because Parcel Post's pricing is part of the overall pricing package that is needed for Package Services.

10. [Please refer to Library Reference USPS-R2011-2/LR5, Excel file "CAPCALC-SpecServ-FY10 Revised."] Excel file "CAPCALC-SpecServ-FY10 Revised" contains a worksheet for the Scheduled Pick-Up Service (Pickup On Demand); however, the 'Chang Calc' worksheet does not include the Scheduled Pick-Up in the average price increase for the class. Please confirm that the revenue for Scheduled Pick-Up Service should be included in the average price increase for the class. If not confirmed, please explain.

RESPONSE:

Not Confirmed. The Pick-Up Service worksheet was inadvertently included in "CAPCALC-SpecServ-FY10 Revised". Pick-Up Service is not a special service in the MCS. Instead, this service is a feature of Single Piece Parcel Post, Priority Mail, Express Mail, and some International Mail products, so its revenue is included with those products/classes in the Billing Determinants filed on December 2, 2010. The pickup charge does not increase in this filing, so adding Pick-Up Service to Single Piece Parcel Post (the only market-dominant product for which Pick-Up Service is a feature) would result in a slightly reduced cap utilization.

11. For Stamped Envelopes service, please reconcile the billing determinant data provided in the instant proceeding with the billing determinant data provided in Docket No. ACR2010.

RESPONSE:

To the extent that there are discrepancies, the billing determinants data provided in the instant proceeding are accurate, while the data provided in Docket No. ACR2010 were erroneous. Therefore, the correct data have been used in this proceeding.

12. For Stamp Fulfillment Services, the Mail Classification Schedule contains the following four rate categories:

SFS Prices as of Docket No. MC2009-19	
Type of SFS Order	**Price**
Orders mailed to domestic United States destinations	$1.00
Custom orders mailed to domestic United States destinations	$3.00
Orders mailed to destinations outside of domestic United States	$6.00
Custom orders mailed to destinations outside of domestic United States	$8.00

The cap calculation for Stamp Fulfillment Services only include one rate category, orders mailed to domestic United States destinations.

a. Please confirm that the Postal Service does not intend to increase prices for
   i. custom orders mailed to domestic United States destinations;
   ii. orders mailed to destinations outside of domestic United States; and
   iii. custom orders mailed to destinations outside of domestic United States.

b. If not confirmed, please elaborate, providing changed fees and revised cap calculation.

RESPONSE:

a. All subparts are confirmed.

b. Not applicable.

13. Please refer to USPS-R2011-2/1, and the Excel file Inbound_CAPCALC-FCMI-FY2010.xls, worksheet Inbound FCMI BD Summary, which shows "Volume Summary" and "Weight – Kilogram Summary" tables. For each table, please confirm that the "Total" figure in the row "Total FCMI ROW" includes ROW Registered Mail volume and weight data, respectively. If not confirmed, please explain. If confirmed, please explain why ROW Registered Mail volume and weight data are included, given that the Postal Service previously excluded such ROW Registered Mail data from the analogous worksheet in Docket No. R2010-4, USPS-R2010-4/1, Excel file Inbound_FCMI_Worksheets_R2010-4.xls. *See also* USPS-R2010-4/1 (Revised August 6, 2010), First-Class Mail Worksheets, at page 8 ("Inbound Registered Mail is not considered to be Inbound FCMI volume.")

RESPONSE:

Confirmed. Since Inbound International Registered Mail is inducted into the First-Class Mail stream, the inbound ROW Registered Mail volume and weight were included in the FCMI ROW totals in order to calculate terminal dues revenues using the provisional terminal dues rates for CY 2010 and CY 2011. The additional CY 2010 and CY 2011 payment rate of 0.55 SDR per item for registered remuneration was not included in the revenue calculations.

14. Please refer to USPS-R2011-2/1, and the Excel file Inbound_CAPCALC-FCMI-FY2010.xls, worksheet tab Inbound Revenue Calculation.

a. In the tables "FY10 VOLUME" and "FY10 KILOGRAMS," the volume and kilogram figures in the columns headed "A-LC/AO" are obtained directly from the ICRA in the Excel file Reports.xls, worksheet tab ICRA Database for foreign origin "alc" Pieces and Gross Kg. By contrast, the sum of the volume and kilogram figures in the columns headed "SAO" and "SAL-LC/AO," respectively, equals the volume and kilogram figures in the worksheet tab ICRA Database for foreign origin "sao" Pieces and Gross Kg. Please explain the rationale and provide the formulas for making the allocation of "sao" Pieces and Gross Kg between "SAO" and "SAL-LC/AO," respectively, in the tables "FY10 VOLUME" and "FY10 KILOGRAMS."

b. In the tables "CY 2010 INBOUND REVENUE ($U.S.)" and "CY 2011 INBOUND REVENUE ($U.S.)," revenues from some target system countries are calculated using both a per item and per kilogram terminal dues rate, while revenues from other target system countries are calculated using only the per kilogram rate. (*Compare*, for example, target system countries 708 and 714.) Please confirm that revenues for all target system countries should be calculated using both the per item and per kilogram terminal dues rates. If confirmed, please revise the tables "CY 2010 INBOUND REVENUE ($U.S.)" and "CY 2011 INBOUND REVENUE ($U.S.)" to show the calculation of CY 2010 and CY 2011 revenues using both the per item and per kilogram terminal dues rates for all target system countries. If not confirmed, please explain.

RESPONSE:

(a) Please see ChIR.1.Q.14a_R2010-2.NONPUBLIC.xls, which is filed under seal as part of USPS-R2011-2/NP1. The FY 2010 inbound letter-post data is the sum of the Q1 FY 2010 and Q2-4 FY 2010 volumes and weights from the Kg1, Kg2, Vol1, and Vol2 tabs of Inbound Calcs.xls.

(b) Confirmed. The revenue for the Target System countries was calculated using the per piece and per kilogram terminal dues rates. For Target System countries 708 and 714, the CY 2010 inbound revenue was calculated using the CY 2010 provisional terminal dues rates of [Redacted] SDR per piece and [Redacted] SDR per kilogram. The CY 2011 inbound revenue was calculated using the CY 2011 provisional terminal dues rates of [Redacted] SDR per piece and [Redacted] SDR per kilogram.

An unredacted version of this response is filed under seal as part of USPS-R2011-2/NP1.

15. Please refer to USPS-R2011-2/1, and the Excel file Inbound_CAPCALC-FCMI-FY2010.xls, worksheet tab Inbound Revenue Calculation. In the tables "CY 2010 INBOUND REVENUE ($U.S.)" and "CY 2011 INBOUND REVENUE ($U.S.)," inbound volume and kilograms from Canada are excluded from the Postal Service's calculation of revenues. In Docket No. R2010-4, Library Reference USPS-R2010-4/1 (Revised August 6, 2010), First-Class Mail Worksheets, at page 7, the Postal Service justifies the exclusion of inbound volume and kilograms from Canada pursuant to 39 CFR 3010.24. Please explain why it is impractical to identify the rates of general applicability to be used with inbound volume and kilograms from Canada in calculating CY 2010 and CY 2011 inbound revenues.

RESPONSE:

Since the Canada rates are part of a Type II NSA, the inbound data from Canada was excluded from the inbound CAP calculation under 39 CFR 3010.24 because the rates of general applicability do not exist for inbound mail.

16. On January 2, 2011, the simplified addressing option became available for the delivery of saturation flats and irregular parcels on city carrier routes. According to a press release (dated January 21, 2011), the Postal Service expects to generate new revenue as a result of this change. Please discuss the ramifications of this initiative on the calculation of the price cap.

RESPONSE:

In its decision in Docket No. R2011-1 ("Classification and Price Adjustments for First-Class and Standard Mail Initiatives"), the Commission ruled that expected new volume should not be considered in the price-cap calculation. Specifically, the Commission stated that "[a]djustments to the volume weights [used to measure the percentage change in rates] … should not attempt to anticipate changes in mailers' behavior in response to changes in prices or classifications" (Order No. 606 at 19 (December 10, 2010))."

With that guidance, the Postal Service has treated the potential new volume and revenue from simplified addressing appropriately by excluding it from the calculation of the price cap, especially since there is no price difference for the new option.

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