Postal Regulatory Commission
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Estimating Volume Changes from Pricing Incentive Programs

Docket No. RM2010-9

REPLY COMMENTS OF THE PUBLIC REPRESENTATIVE

(February 11, 2011)

I. INTRODUCTION

Commission Order No. 469 initiated the current rulemaking to "investigate methodologies for estimating volume changes due to pricing incentive programs."[1] Commission Order No. 646 set a deadline for Reply Comments of February 11, 2009.[2]

II. STREAMLINING THE REGULATORY PROCESS

The Postal Service, the mailing community, and the Commission agree that Pricing Incentive Programs are a "judicious exercise of the Postal Service's pricing flexibility under the PAEA."[3] In 2009 and 2010, the Postal Service carried out three seasonal Pricing Incentive Programs, rebating over $150 million to mailers.[4]

The primary risk of Pricing Incentive Programs is the possibility that they will be designed and analyzed by methods that overlook individual results in favor of class-wide trends. In designing programs around class-wide trends, there is a potential that a few mailers will receive unreasonable discounts that jeopardize the profitability of the program. This risk is demonstrated by the results of the three Pricing Incentive Programs implemented to date. Over $80 million in discounts was concentrated in 75 mailers, while other participants, numbering over 2000, only realized rebates of roughly

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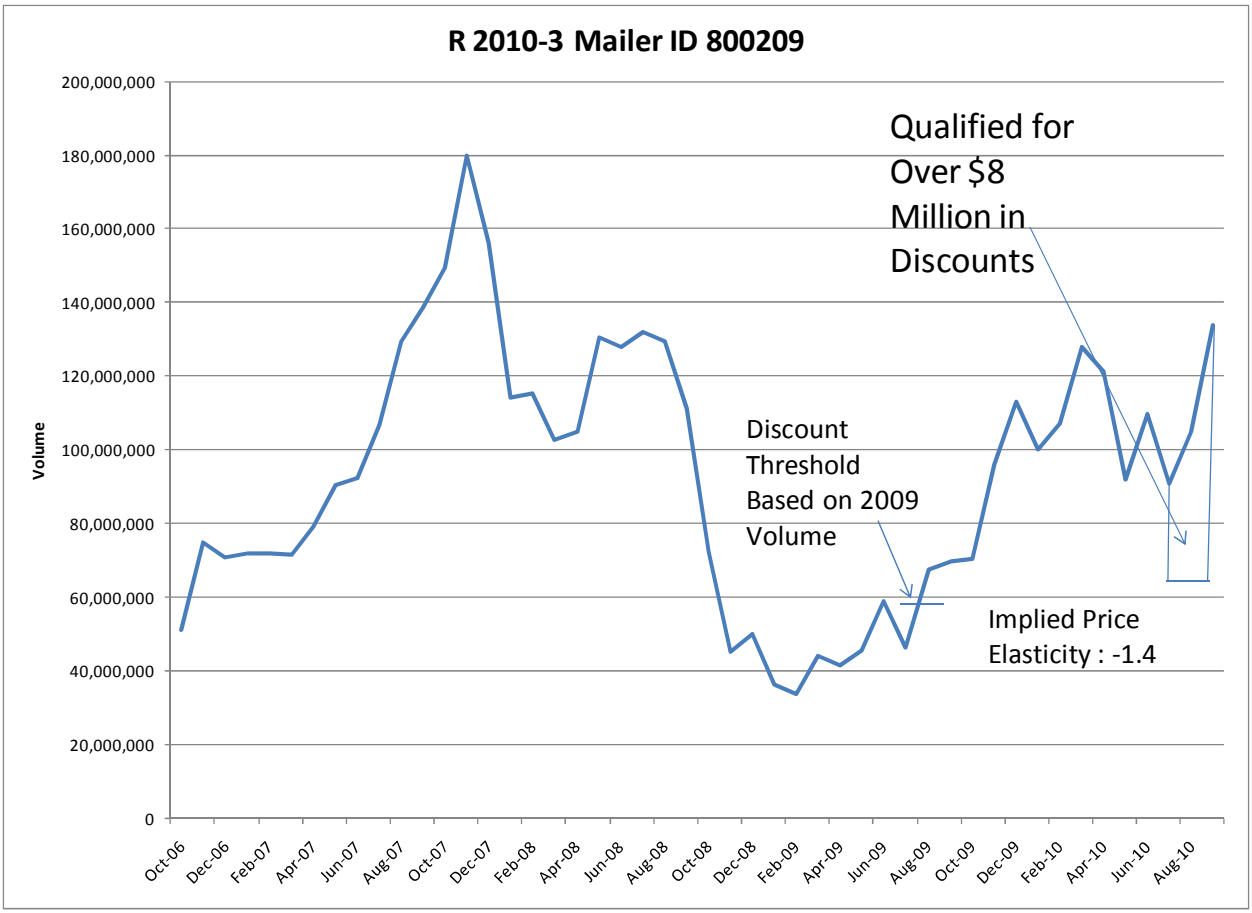
[1] Order No. 469, Notice of Proposed Rulemaking Concerning Methods to Estimate Volume Changes Caused By Pricing Incentive Programs (June 8, 2010).
[2] Order No. 646, Order Setting Date for Reply Comments (January 11, 2011).
[3] Order No. 219, Order Approving Standard Mail Volume Incentive Pricing Programs (June 4, 2009) at 2.
[4] Summer Sale PRC Report.zip (February 26, 2010), First-Class Mail Incentive-Order 299.zip (July 26, 2010) and 2010SS.PRC.Rep.WB2.xls (December 29, 2010)

$70 Million. The following chart, developed using information provided in the Postal Service's data collection report, highlights the risk of applying class-wide trends to individual mailers. This large mailer has unpredictable volumes, yet a class-wide trend is assumed to accurately predict, a year in advance, what the mailer will do. In order for the 30% discount for which the mailer qualified to have incentivized 71% volume growth over the threshold that it exhibited, the mailer would need to have experience an implausibly high -1.4 price elasticity response. From individual trend analysis, it appears about as likely that this mailer' volume increase was independent of the discount. This risk could be mitigated by basing the discount threshold on an objective average elasticity, as the established methodology does, or at a minimum capping the discount at a reasonable response.



If utilized properly, Pricing Incentive Programs may offer the opportunity for the vast majority of mailers to grow their volumes and contribution at discounted rates. However, under the current design of the discount programs, the majority of benefits accrue to a small group of mailers whose volume trend cannot be accurately predicted. Pitney Bowes comments that

> Adopting a methodology that minimizes the administrative burden imposed on the Postal Service and maximizes the Postal Service's ability to exercise its pricing flexibility is especially important in the context of the current financial challenges facing the Postal Service and the mailing industry. The need for innovative pricing incentive programs to stimulate new volumes and revenues is great. The approach adopted by the Commission can and should help facilitate expanded product and pricing innovations.

Comments of Pitney Bowes Inc., July 17, 2010 at 4.

The current accepted methodology offers the ideal solution to the problem posed by Pitney Bowes. By reiterating that the additional contribution from Pricing Incentive Programs and compliance with statutory compliance will be analyzed using objective average elasticity data, the Commission can encourage to the Postal Service to offer Pricing Incentive Programs that:

- Maximize the number of mailer that can earn discounts
- Minimize regulatory uncertainty and burden
- Minimize risk
- Maximize additional contribution to the Postal Service

III. POSTAL SERVICE HAS NOT PROPOSED OR ESTABILISHED A METHOD

The Initial Comments of the Postal Service urge the Commission to establish a reduced regulatory oversight role for the Commission with respect to Pricing Incentive

Programs.[5] The Postal Service states "it is unclear that any (method) produces reliable estimates of contribution change as a result of incentive programs."[6] The Postal Service further argues "that case for pursuing incentive programs must be a matter of business judgment by postal service management."[7] The Postal Service contends incentive programs should be an exercise of business judgment because "as prices of general applicability, the compliance evaluation of incentive programs should not depend on volume, revenue, or contribution growth as such, but rather on the more general requirement that the affected classes of mail cover their attributable cost."[8] The Postal Service describes the Pricing Incentive Programs as "rates of general applicability," but does not offer a legal rationale as to why these discounted rates are "rates of general applicability."

Since the Commission has a clearly defined statutory authority to evaluate special classification under 3622(c)(10), the Postal Service recommends "an approach based on historical patterns of growth, rather than market elasticities."[9]

The Postal Service proposes this general concept of "historical growth patterns" without setting forth a specific methodology that could be evaluated, replicated, and understood by those seeking to participate in the programs. The proposed concept would vest all of the decision making in a non-transparent process internal to the Postal Service. It would allow the Postal Service to alter the method of estimation of net contribution change to suit its needs in future Pricing Incentive Programs. This concept is put forward for the Commission's and mailers' consideration without analysis or specificity.

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[5] Initial Comments Of The United States Postal Service Concerning Methods To Estimate Volume Changes Caused By Pricing Incentive Programs (Postal Service Initial)(July 16, 2010) at 9, 10.
[6] Postal Service Initial at 9.

[7] Postal Service Initial at 9

[8] Postal Service Initial at 9, 10

[9] Postal Service Initial at 10

In addition to the lack of a method, the basic premise of the idea put for by the Postal Service is flawed. The Postal Service assumes that all mailers have identical volume trends in spite of objective evidence to the contrary. Appended to these comments are volume charts of the mailers that received over $500,000 in discounts in the two Standard Mail Summer Sale programs.[10] There is no discernable volume trend contained in these mailer histories, no identifiable pattern of consistent mailer growth patterns. The Postal Service continues to contend, in support of its volume trend analysis, that mailers have elasticities that differ significantly from the class average. However, the Postal Service is unable to put forward support of this contention with any data.

IV. INITIAL COMMENTS RAISE IMPORTANT ISSUES

Initial Comments were filed by Pitney Bowes, Discover Financial Services, and Saturation Mailers Coalition and Valassis Direct Mail, Inc. The comments raise important ideas that should be considered when analyzing what, if any, method should be used to determine statutory compliance.

a. Pitney Bowes – Risk and Reward

Pitney Bowes argues that the differences between the PAEA and the PRA "militate in favor of a greater risk tolerance for pricing incentive programs."[11] It further states that "no system can eliminate all risk; it can only substitute one risk for another."[12] Pitney Bowes appears not to favor the elasticity based approach developed during the PRA era, but it does not identify and weigh the defects of the current Commission methodology and advantages of a trend-based methodology. In approving the Pricing

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[10] The Postal Service has not yet finalized discounts in R2010-3. The appendix does not include mailers that Postal Service counsel identified as questionable. The Appendix will be revised when the R2010-3 results are finalized and reported.

[11] Comments of Pitney Bowes Inc. (Pitney Bowes Comments)(July 16, 2010) at 3

[12] Pitney Bowes Comments at 4

Incentive Programs to date, the Commission has exhibited a much larger risk tolerance than under the PRA, as the amount of discounts provided to mailers has far exceeded those paid under the PRA.

The risk tradeoff between the two methodologies is straightforward. Using the elasticity based approach, there is a risk that a mailer will only receive a discount on volume growth that is within the bounds of a typical price change response to a product offered by a monopolist. Using the trend based approach, there is a risk that a mailer will receive a discount on volume growth significantly outside the bounds of a typical price change response to even a product offered by a firm engaged in competition.

Pitney Bowes asserts that the PAEA insulates mailers from the negative effects of a poorly designed program due to the CPI price cap and the Postal Service's profit motive.[13] If the Postal Service was earning a profit, and had the Postal Service not recently filed an “exigent” rate increase requesting to raise rates above the CPI cap, this argument would have considerable merit. When the Postal Service is earning a profit and retaining its earnings, mailers not participating in a pricing incentive program will be protected from having rates raised due to poorly designed Pricing Incentive Programs.

b. Saturation Mailers Coalition and Valassis Direct Mail, Inc. – “Where'd it Go” Volume

VDM focuses on the difficulty in estimating not only “anyhow” volume and additional contribution but also “where'd it go” volume. VDM states that “Stemming further volume erosion is even more critical to the Postal Service’s viability than short-term gains – preventing existing mail from becoming “where’d it go” volume.”[14] By providing achievable discount thresholds to more mailers, and focusing discount dollars on all mailers, instead of a select few, the Postal Service can better leverage volume discounts to incentivize mailers to stem volume erosion.

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[13] Pitney Bowes Comments at 3

[14] Comments of Saturation Mailers Coalition and Valassis Direct Mail, Inc. (VDM Comments)(July 16, 2010) at 2

VDM further states “Regulatory barriers predicated on the difficulty or subjectivity of identifying potential “where’d it go” volumes in advance of an initiative will handcuff the Postal Service’s ability to respond to the market and retain critical volumes.”[15] This idea is not at odds with use of an elasticity based model. If the Postal Service, for example, wants to focus discounts on financial service mailers whose solicitation mail declined between 25 and 35% in a given year, with a target threshold of, for example, -10% growth, the elasticity method would offer a simple, streamlined process for quickly offering a discount that responds to the needs of that particular industry.

c. Discover Financial Services (DFS) -Qualitative Analysis

DFS states that “the bottom line is that there is no way the Commission can realistically assess how much contribution came from a program.”[16] The difference between precisely and realistically is important. For the Postal Service to have realized a profit in the programs offered to date, the elasticity of the few mailers receiving the majority of the discounts would need to have an absolute value greater than one. DFS does not state whether, if in its view, this elasticity assumption is realistic.

If an elasticity based approach provides an estimate of a mere $50, loss, it does not necessarily follow that the discount program was a failure and non-compliant with the statutory language of the PAEA. The elasticity based approach provides a realistic baseline with which to evaluate results. DFS argues that “it would be a mistake to assume that any significant part of the past behavior, based on past patters, would have continued anyhow, without the incentives in place.”[17] However, this is assumption is the central tenet of the Postal Service's proposed idea of using a trend-based approach.

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[15] VDM Comments at 7

[16] Reply Comments of Discover Financial Services (Discover Comments) (August 17, 2010) at 1

[17] Discover Comments at 2

V. ELASTICITY-BASED MODEL IS RATIONAL AND RIGOROUS

As discussed in the Initial Comments of the Public Representative in this docket, and more in-depth in the Opinion and Further Recommended Decision of the PRC in MC2004-3, the analytical tools exist to offer streamlined, reduced risk, and widely available Pricing Incentive Programs. By determining that the elasticity-based approach is the correct methodology to utilize in determining statutory compliance, the Commission will encourage the Postal Service to design its programs to benefit all mailers, not just a select few. By signaling to the mailing community that the Commission will present minimal regulatory uncertainty to a properly designed program, the Commission will maximize the ability of the Postal Service to announce a program with sufficient lead time for mailers to prepare a maximized response. Stating that volume responses far above the current or long-run elasticities are pure profit ignores a history of rigorously developed postal data. If the Postal Service wants to grow volume and contribution, it can succeed by incentivizing a smaller (but reasonable) volume range of discounts to a significantly larger base of customers. The mailing community clearly wants to participate in Pricing Incentive Programs, but with over 1500 customers signing up for programs with unreasonably developed thresholds, few have been able to.

VI. CONCLUSION

The Postal Service has not proposed a method for the Commission to endorse in this docket, in the best case it has proffered an idea for future consideration. To date, the Postal Service has provided over $150 Million in discounts without believing that any method can accurately measure if the Postal Service has realized a profit on its investment. While the Postal Service states that more information must be gathered before conclusions can be drawn, it has not pointed to any specific data that would help in this task. To date, it has not accurately collected the data even require by the Commissions data collection report, specifically concerning Mailer Service Provider

volumes. The Commission has a clearly identified statutory role in evaluating the desirability of special classifications. The Public Representative respectfully submits that the Commission should re-iterate the value and importance of utilizing the current accepted methodology in the design and analysis of Pricing Incentive Programs.

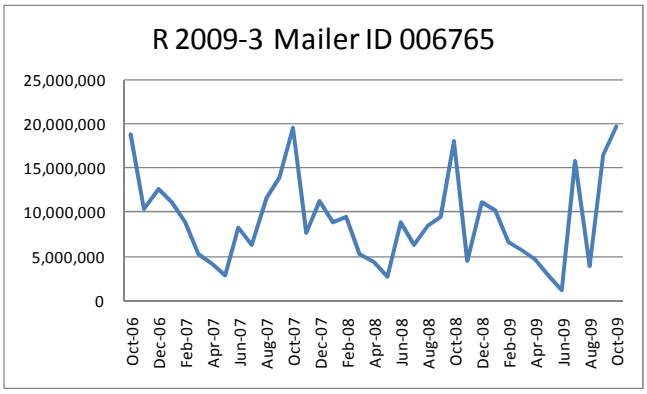
Respectfully submitted,

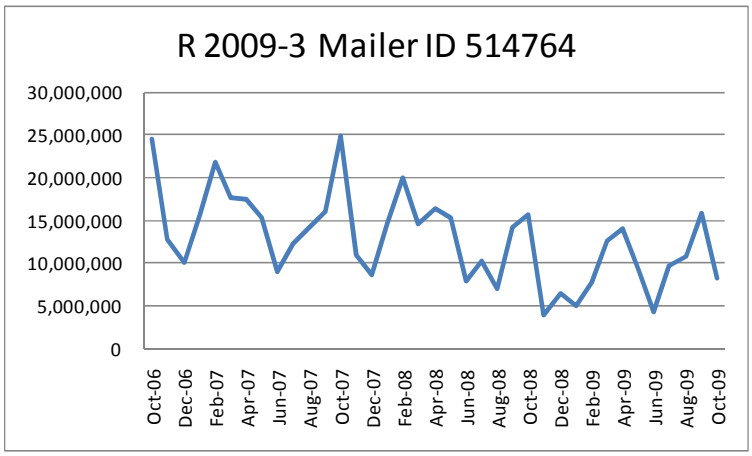
/s/ John P. Klingenberg

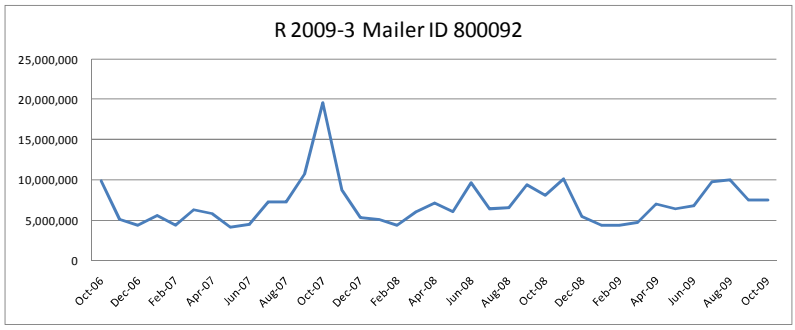
John P. Klingenberg
Public Representative

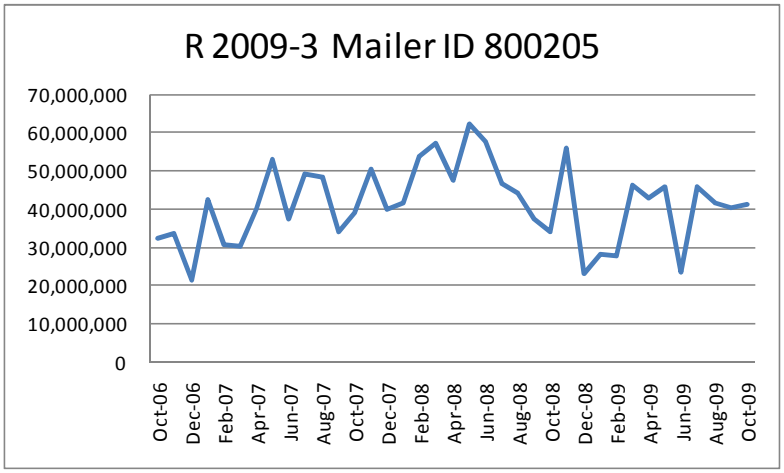
901 New York Avenue NW Suite 200
Washington DC 20268-0001
202-789-6863
klingejp@prc.gov

Appendix A: Mailer Volume History Charts





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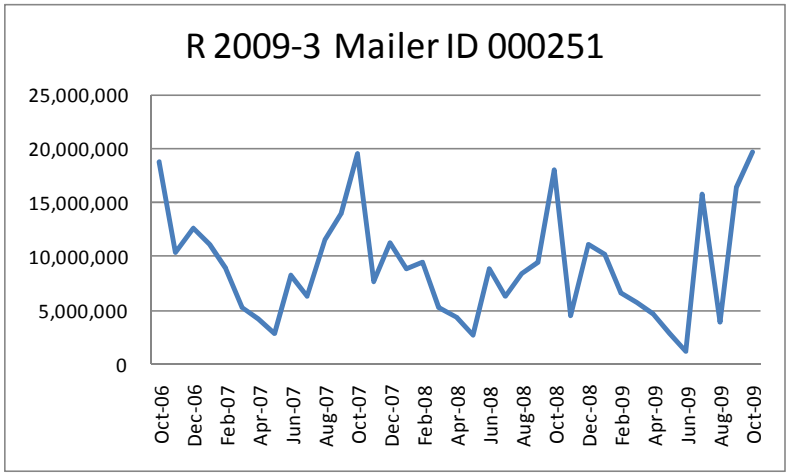
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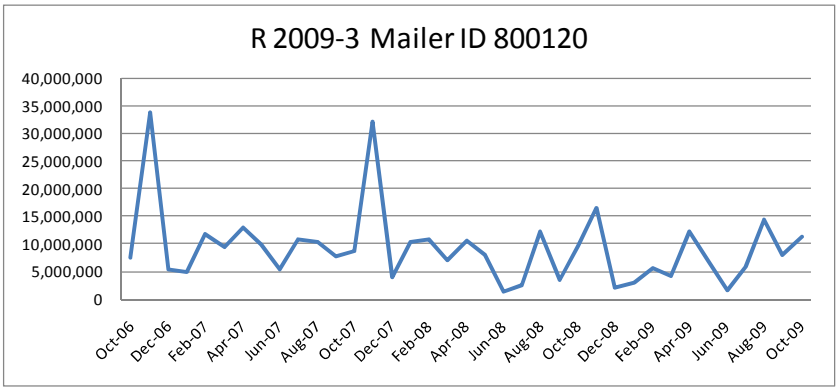
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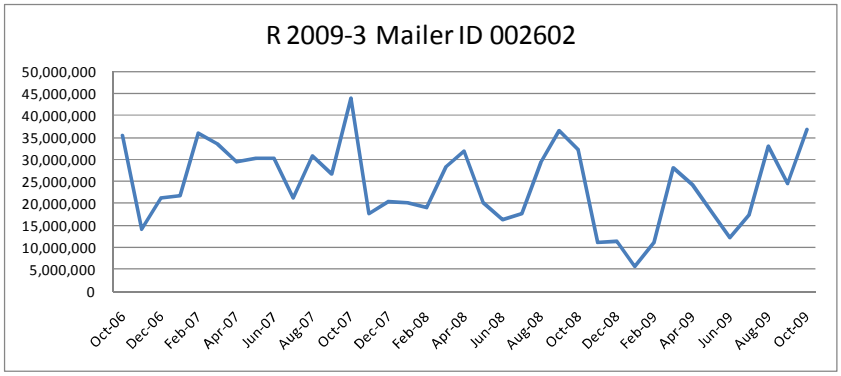
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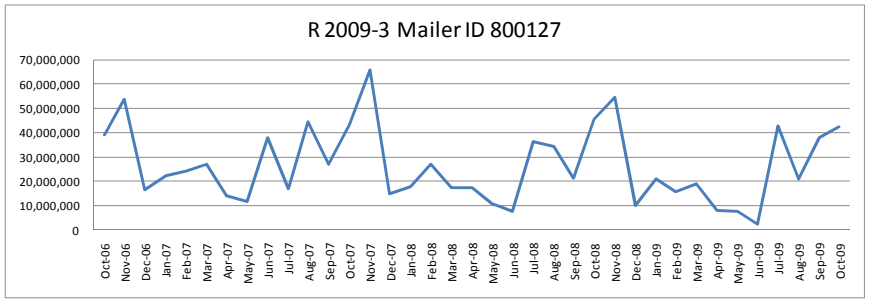
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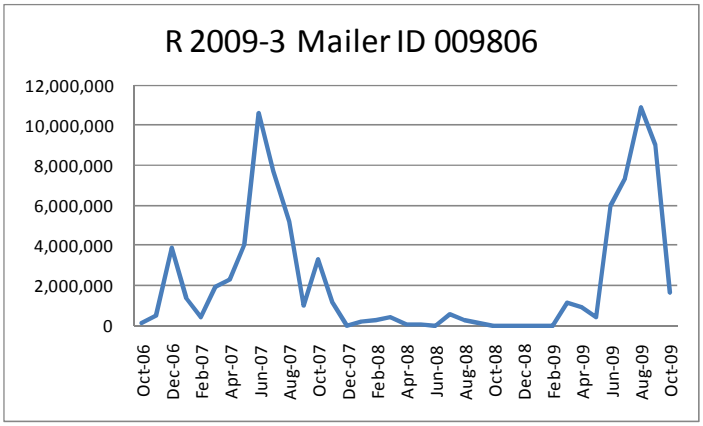
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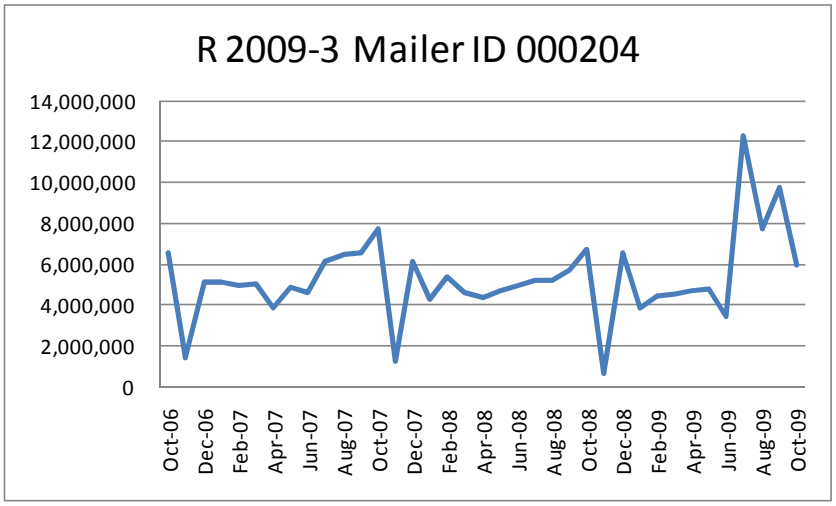
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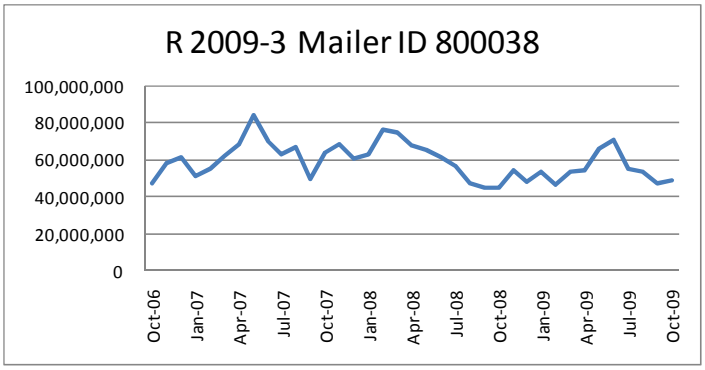
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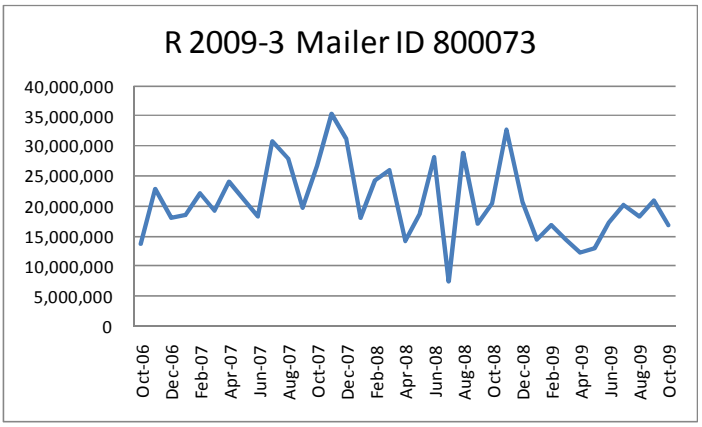
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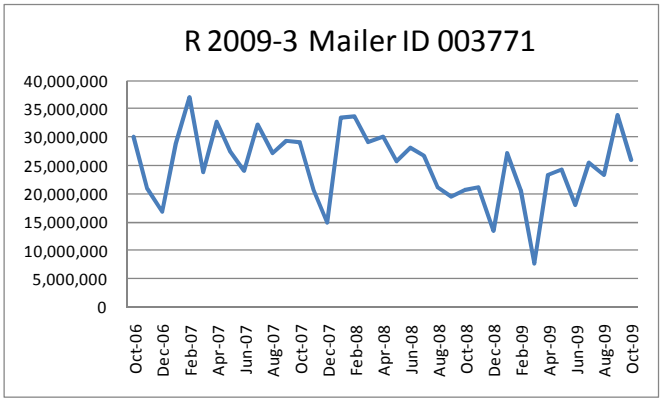
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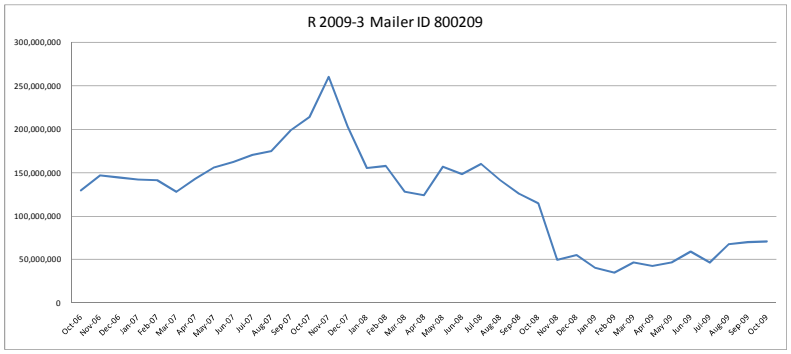
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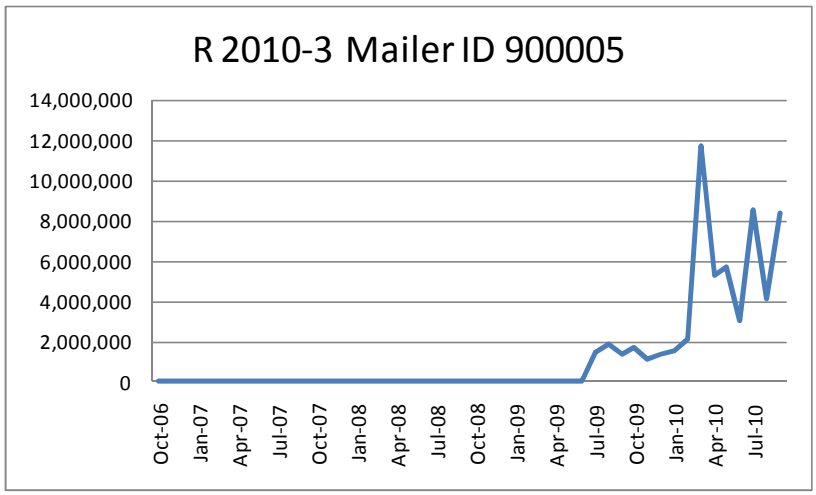
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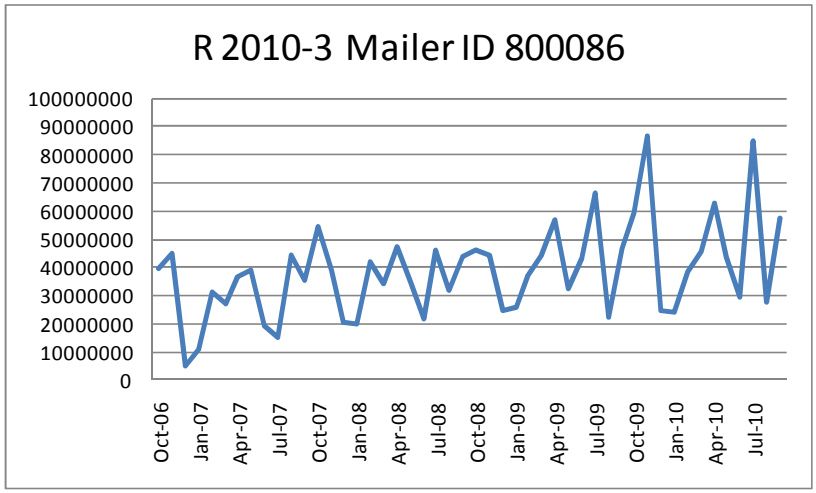
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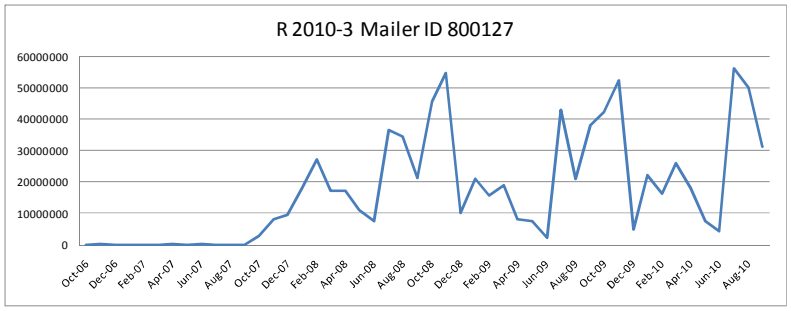
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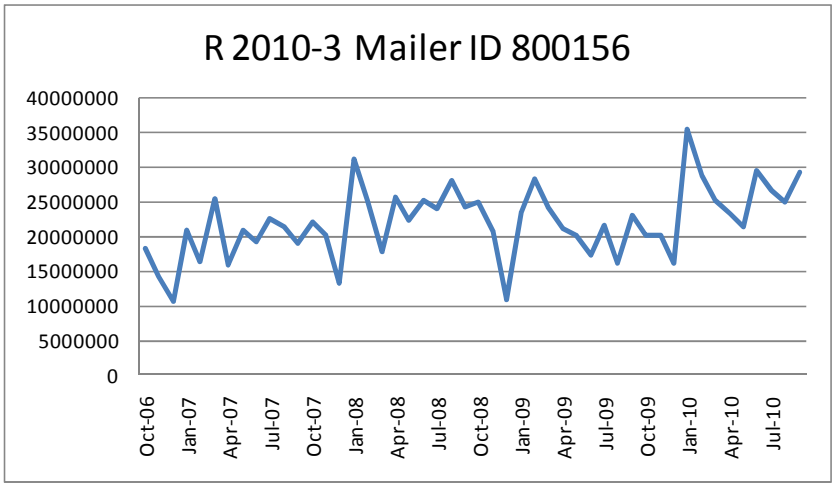
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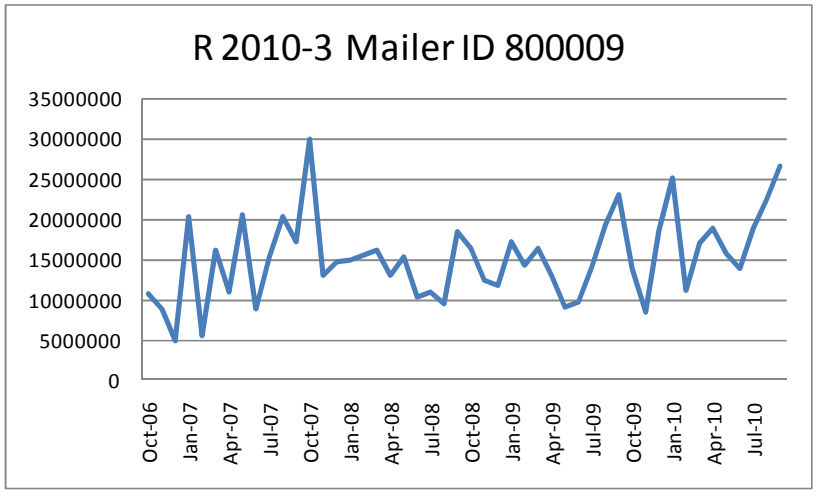
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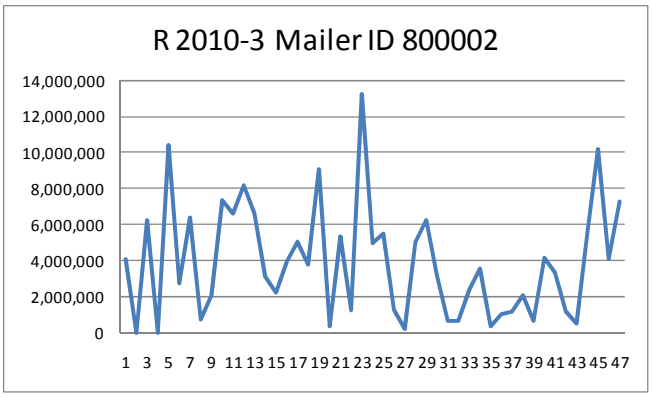
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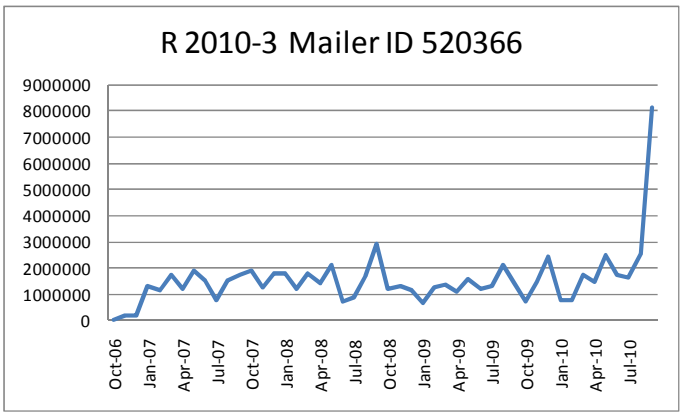
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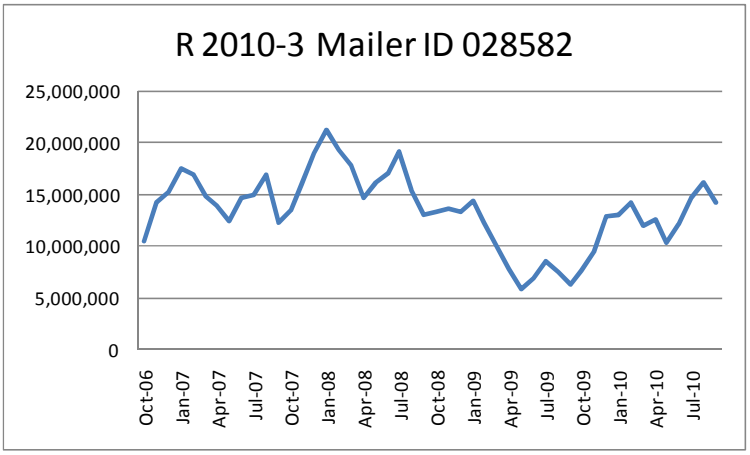
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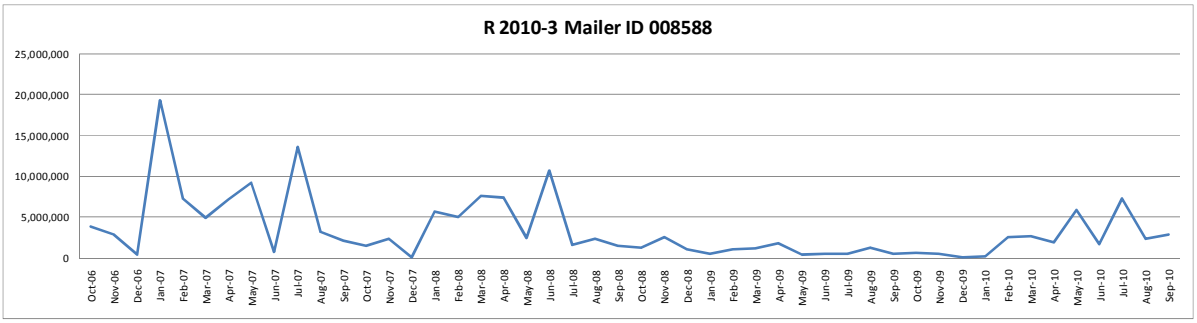
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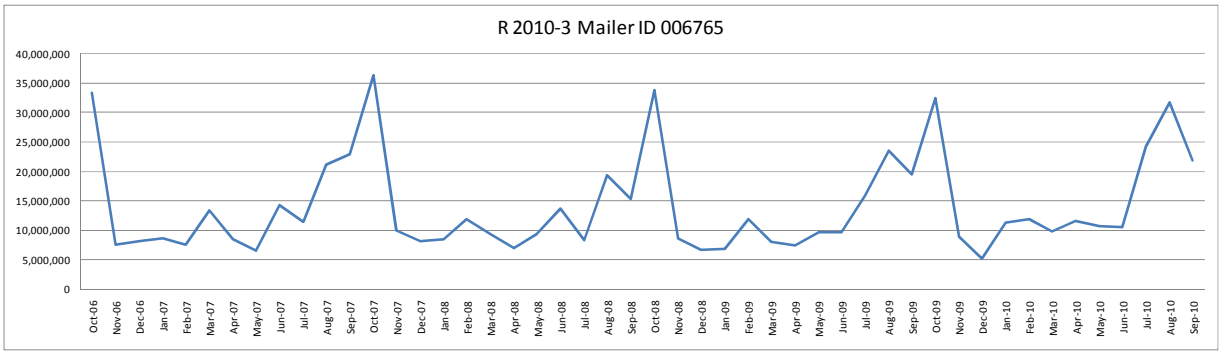
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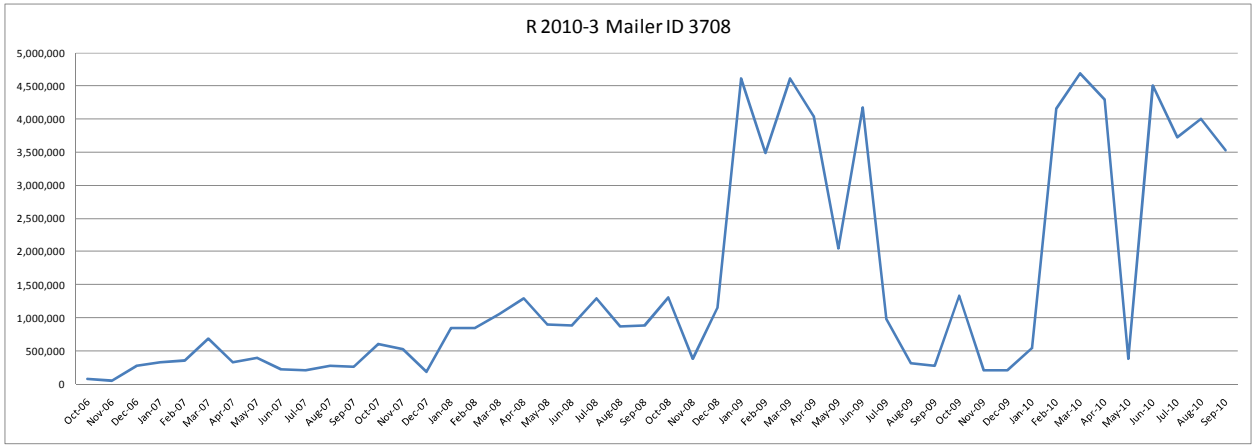
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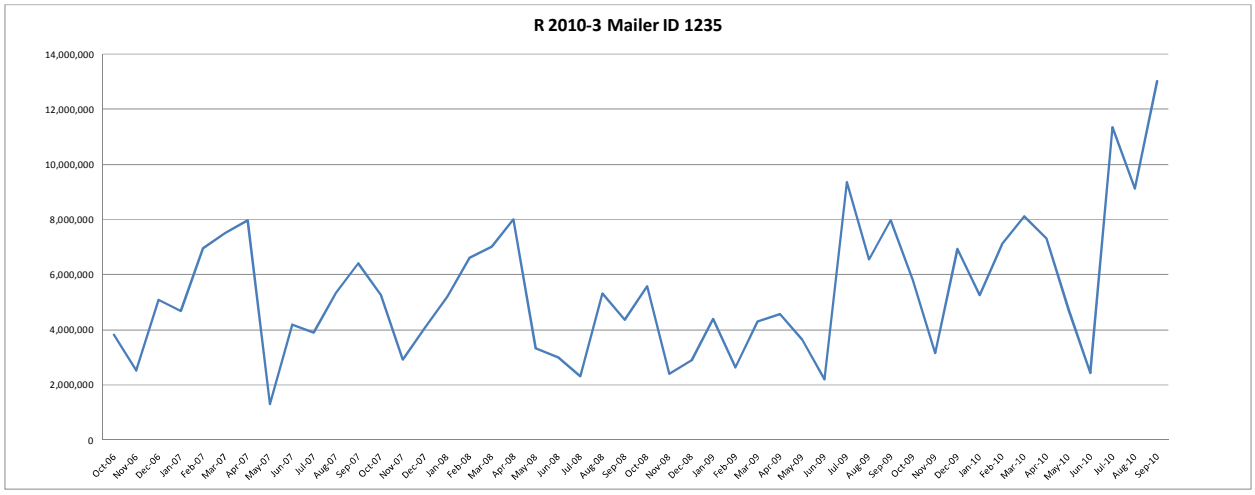
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