BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268–0001

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POSTAL RATE AND FEE CHANGES, 1997	Docket No. R97–1

NOTICE OF THE UNITED STATES POSTAL SERVICE
OF DECISION OF THE GOVERNORS

The following Decision of the Governors has been mailed to the service list in Docket No. R97-1:

Decision of the Governors of the United States Postal Service on the Recommended Decision of the Postal Rate Commission on Postal Rate and Fee Changes, Docket No. R97-1 (June 29, 1998)

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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DECISION OF THE GOVERNORS OF THE UNITED STATES POSTAL SERVICE ON THE RECOMMENDED DECISION OF THE POSTAL RATE COMMISSION ON POSTAL RATE AND FEE CHANGES, DOCKET NO. R97–1

June 29, 1998

On May 11, 1998, the Postal Rate Commission issued its Opinion and Recommended Decision in Docket No. R97-1. The Postal Service initiated this proceeding on July 10, 1997, with its Request for a Recommended Decision on Proposed Changes in Rates of Postage and Fees for Postal Services.

The Governors have concluded that, in general, the rates and fees recommended by the Postal Rate Commission will help maintain a fair and equitable mail classification system, and are in accordance with the policies of the Postal Reorganization Act. Therefore, with the minimal exceptions noted below, we accept the changes in rates, fees, and classifications recommended by the Commission.

We are issuing a separate Decision concerning the Commission's recommendations on Courtesy Envelope Mail and Prepaid Reply Mail.

In addition, we have concluded that three matters require further action or clarification. We are seeking reconsideration of these matters. While correction or clarification more accurately describes our purpose, the statute describes this option as "allow[ance] under protest." First, as the Commission indicated to us by letter, the rates it recommended for In-County Periodicals Mail create an anomalous result that the Commission did not intend. Specifically, barcoded letters and flats would pay higher rates when they are more finely presorted. The Commission has invited us to return this limited matter for correction. Second, some uncertainty about the recommended treatment of Library Mail calls for clarification or further action. Third, the recommendation of rates for parcel post deposited at the destination delivery unit would benefit from further explanation in one minor respect. We discuss these matters further in the following section on Rates and Fees.

EXPLANATION

RATES AND FEES

First-Class Mail

Letters and Sealed Parcels. The Commission has recommended increases in the rates for First-Class Mail letters and sealed parcels, including a one-cent increase in the rate for the first ounce of First-Class Mail from 32 to 33 cents. The First-Class Mail recommendations reflect a cost coverage of 172.4 percent for letters and sealed parcels and a 1.7 percent average rate increase. In view of the modest revenue requirement, the recommendation of a penny increase in the basic First-Class Mail rate is a necessary step to a fair and equitable allocation of the institutional cost burden among all mail classes and postal services. Accordingly, we accept the penny increase.

We also accept the rates and discounts recommended for the various existing First-Class Mail worksharing categories. The recommendations for these bulk First-Class Mail rate categories are supported by record evidence and will continue to advance the automation goals of the Postal Service. We note that the differences between the worksharing discounts proposed by the Postal Service and those recommended by the Commission result largely from the Commission's decision not to adopt the volume variability analysis presented by the Postal Service in this proceeding and its adjustments to the revenue requirement, rather than from differences about rate policy.

The Postal Service proposed that the additional-ounce rate be maintained at 23 cents. In the circumstances of this case, we accept the recommendation that the additional-ounce rate be reduced to 22 cents. In light of the modest revenue requirement, we find the recommended reduction to be consistent with past practice for maintaining a uniform additional-ounce rate.

We accept the recommendations to maintain the nonstandard surcharge at the current levels. Cost data which emerged in this case suggested that the processing cost difference between nonstandard and standard one-ounce First-Class Mail pieces may be widening significantly. These data provided support for the nonstandard surcharge increases proposed by the Postal Service. We also agree with the Commission, however, that mailers and the Postal Service may benefit significantly from a review of the physical non-machinability specifications which distinguish between standard and nonstandard one-ounce First-Class Mail pieces, and which serve to identify the pieces subject to a surcharge.

The Postal Service proposed that the current 11-ounce weight breakpoint between First-Class Mail and Priority Mail be retained. The Commission recommended that it be increased to 13 ounces. This breakpoint has been adjusted periodically from time to time. As a result of the diverging networks for Priority Mail and First Class Mail, changing the breakpoint now involves operational considerations which were not fully addressed. In the circumstances of this case, nevertheless, we accept the recommended change.

First-Class Mail Cards. The Commission recommended that the basic rate for single-piece post cards be retained at its current level, 20 cents, in order to help "ensure that there is at least one relatively inexpensive postal category that can be used by the general public, businesses and organizations." PRC Op. R97-1, Vol. 1, at 349. Relatively minor changes are recommended in some of the rates for the existing workshared card categories. The recommended cost coverage for cards is 150.5 percent and the recommended rate design produces an average rate increase of only 0.2 percent. We find that these recommendations are supported by record evidence. Accordingly, we accept the rate recommendations for existing First-Class Mail card categories.

The Commission's Opinion considered two issues raised by an intervenor about the long-standing postcard length limitation and the rate category eligibility requirements from postcard classification reform in Docket No. MC95-1. The Commission found no compelling basis upon which to recommend any change. We agree that the issues are appropriate for the postcard mailing industry to address to postal management for review and response.

Reply Mail Rate Categories. The Commission recommended the establishment of three new classifications of First-Class Mail, designed principally for First-Class Mail reply letters and cards: Qualified Business Reply Mail (QBRM) and Prepaid Reply Mail (PRM), which were proposed by the Postal Service; and Courtesy Envelope Mail (CEM), which was proposed by the Commission's Office of the Consumer Advocate. We address the QBRM recommendation below in this decision. The PRM and CEM recommendations are addressed in a separate decision issued today.

QBRM is prebarcoded single-piece reply mail for which the recipient pays the postage and associated fees. This mail costs less to process than non-barcoded mail does. The QBRM proposal invites a broader base of customers to share more directly in the benefits of automated mail processing (irrespective of the separate costs and per-piece fees associated with Postal Service accounting performed before such mail is tendered to the recipient).

Prebarcoded BRM currently consists of First-Class Mail pieces prepared in accordance with postal specifications by the intended recipient (a BRM account holder) and distributed for potential return at the account holder's expense. BRM pieces do not require that postage be affixed by the person entering them into the mailstream. When these pieces are mailed, the Postal Service sorts them to the mail exit point that serves the recipient's address, determines the postage, assesses a per-piece fee for accounting functions, and deducts the postage and fees from the recipient's advance deposit BRM account.

Historically, the postage deducted for each piece of prebarcoded automation-compatible BRM has been the basic First-Class Mail rate. Establishment of the QBRM rate category for First-Class Mail recognizes, in the postage paid by the recipient for each piece, the mail processing cost savings characteristics associated with automation-compatible prebarcoded BRM pieces. As proposed by the Postal Service and recommended by the Commission, instead of paying 33 cents postage per one-ounce letter plus the per-piece accounting fee, the QBRM recipient will pay 30 cents postage, plus the accounting fee.

The QBRM recommendation provides a significant improvement in the design of the First-Class Mail stream. The convenience of not having to affix postage to a mail piece appears to be an attractive feature to the household mailing public and others who send reply mail. A broader spectrum of the general mailing public will more directly benefit from lower postage through automation, without bearing the burden of affixing postage themselves. We expect that interested parties will continue to explore other ways in which the First-Class Mail stream can be made a more attractive medium for the transmission of reply correspondence and transactions on which postage is paid by the recipient. Accordingly, we accept the establishment of the QBRM rate categories for letters and cards.

The per-piece fee we accept for QBRM does not distinguish between sites that use automated accounting procedures and sites that do not. In this regard, we are concerned that our approval of this fee does not sufficiently encourage the use of available automated postal accounting procedures. We are also disappointed by the degree to which the evidence in this case appears to suggest that the automated BRM accounting program has not met expectations. Notwithstanding our acceptance of the recommended QBRM per-piece fee, we expect that postal management will further examine BRM accounting operations to determine why the cost savings expected in connection with the implementation of automated BRM accounting procedures following Docket No. R87-1 remain to be realized. We anticipate that management will explore whether such factors as the volume received per reply mail account materially affect costs and should influence the fees charged to different reply mail accounts. Alternative accounting procedures are needed that will be less costly to both the reply mail recipient and the Postal Service while meeting revenue protection standards and customer satisfaction objectives. The Postal Service must seize this opportunity to explore improvements within reach and to determine whether the universal QBRM per-piece fee accepted in this proceeding is an appropriate long-term solution.

Priority Mail. The Commission recommended that Priority Mail rates be increased by 5.6 percent overall, somewhat less than the increase requested. The Commission recommended that the important two-pound-and-under rate be set at $3.20, as requested, and made only moderate changes in the rates for pieces above two pounds. The Commission also agreed that the little-used category for presorted Priority Mail should be removed from the classification schedule, and that the costs of a new electronic Delivery Confirmation service for Priority Mail should be included in the base rate, with no separate charge. Finally, the Commission recommended that the pick-up fee applicable to Priority Mail and other classes be increased to $8.25, as requested. We find that the evidence of record supports both the overall recommended increase and the individual recommended rates and fees. We therefore accept these recommendations.

Express Mail

For Express Mail, the Commission has recommended an average rate increase of 9 percent, substantially greater than the 3.65 percent increase requested by the Postal Service. Key factors underlying the higher recommended rates were the new attributions of the entire purchased transportation cost of the Eagle Network and the Western Network, and of a large portion of Special Delivery Messenger costs, to this class.

Our principal concerns are with the increase in the Post Office to Addressee letter rate of a full dollar, to $11.75, and with large increases in other Express Mail rates. Given the substantial competition faced by Express Mail in the market for overnight delivery, Express Mail's position in this market may be weakened further by such increases. Nevertheless, the recommended rates appear to be sufficiently grounded on the record to meet applicable legal standards. Thus, we accept the recommendations.

Standard Mail

Regular Subclass. For the Regular subclass, the Commission recommended a 135 percent cost coverage. The Commission found this result to be supported by a variety of factors, including the impact on mailers, the "intermediate intrinsic value of service" that mail matter in this subclass shares, limited competition with alternative delivery, and an extensive system of worksharing discounts. The Commission has recommended presort and automation discounts that encourage mailer worksharing. We accept these rates.

Enhanced Carrier Route. The Commission recommended a 203 percent cost coverage for the Enhanced Carrier Route (ECR) subclass. The recommended density discounts include measured savings in both mail processing and delivery. Inclusion of mail processing savings furthers the well-established objective of recognizing cost savings in worksharing discounts. The Commission's recommended rate design also supports the automation program by creating appropriate rate relationships between the Enhanced Carrier Route Basic tier and the Regular Automation 5-Digit letter category.

The Commission declined to accept the Postal Service's proposed reductions in the pound rate for Enhanced Carrier Route subclass mail. We have received persuasive comments in support of such reductions submitted to us by several parties, including the Saturation Mail Coalition (SMC), the Alliance of Independent Store Owners and Professionals (AISOP), and the Mail Order Association of America (MOAA). SMC states that the refusal to reduce the ECR pound rate is contrary to the compelling evidence that the current 66.3 cent pound rate greatly exceeds weight-related postal costs. AISOP notes that the high pound rate hurts small advertisers, and turns Postal Service customers into competitors since the heavier the publication gets, the more tempting it is to switch to private delivery. MOAA points out that the rejection of the pound rate proposal in this proceeding is on different grounds than the rejection in Docket No. MC95-1. The earlier rejection made no attempt to justify the recommended high pound rate based on the relationship between weight and costs. Instead, the Commission explained its rejection by stating that it had adopted an algebraic formula in which the pound rate was an output of the formula. Although the Commission's conclusion that the pound rate need not be the output of an algebraic exercise is an advance, abundant record evidence supported the proposed reduction in the pound rate.

As a reason for not adopting a lower pound rate, the Commission's Opinion questioned the reliability of the cost study presented by the Postal Service. An expectation that the Postal Service consider alternative study designs seems to establish a greater evidentiary burden than necessary, especially given the fact that the intervenor who offered suggestions in this regard agreed that the proposed pound rate reduction was still conservative. We encourage the Commission to take a fresh look at the entire issue of weight-related costs and rates at its next opportunity. The Postal Service will seek additional cost and market support for lowering the pound rate, to address the Commission's concerns. Unsubstantiated claims of competitive harm were cited as a basis for retaining the existing pound rates. Maintenance of the existing pound rates, in our view, does not promote competition in the market for delivery of heavier-weight geographically-targeted advertising matter.[1]

Nonetheless, we accept the recommended Enhanced Carrier Route subclass rates.

Nonprofit and Nonprofit Enhanced Carrier Route. In accordance with the Revenue Forgone Reform Act, rates for the Nonprofit and Nonprofit Enhanced Carrier Route subclasses are designed to yield the target cost coverages mandated by the Act. As a consequence of higher reported costs for Nonprofit, the Commission recommended a rate increase resulting in a cost coverage of 113.7 percent. For Nonprofit Enhanced Carrier Route, however, the Commission recommended a rate decrease due to reductions in the reported costs for this subclass. The Commission based these recommendations on findings of adequate record support for the allocations of costs to these categories. We accept the recommended rates for these subclasses.

Destination Entry. The Commission recommended destination entry discounts that pass through 85 percent of the savings, as calculated by the Commission, for dropshipment. The recommended discounts fairly balance the objective of recognizing cost savings due to worksharing with the goal of moderating the need to increase revenue from non-workshared mail. We accept the recommended discounts.

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[1] The Opinion offered, as one justification for the recommended cost coverage, that one of the Commission's responsibilities is to assure that the "Postal Service and private enterprises compete on a level playing field." The phrase is more of a conclusory slogan than an informative standard. Judicial precedent holds that the appropriate consideration for development in ratemaking is the effect on competition generally.

Single-Piece. As proposed by the Postal Service and recommended by the Commission, this subclass will be eliminated in light of its cost and service characteristics. We accept this change.

Residual Shape Surcharge. The Commission recommended a 10-cent surcharge for Standard Mail (A) pieces that are prepared as parcels or are not letter- or flat-shaped. This recommended rate adopts the Postal Service's proposal. It fairly responds to the Commission's concerns, raised in its Opinion in Docket No. MC95–1, for correcting the relationship between costs and revenues for residual shapes in Standard Mail (A). The recommended level of the surcharge is supported in the record, is fair and equitable, and is consistent with the pertinent provisions of the Act. It is a good first step towards a surcharge that reflects the higher costs of parcel processing. We therefore accept this rate, along with the corresponding classification changes that establish its scope and application.

Parcel Post. The Commission recommended rates which produce an average increase of 12.4 percent and a cost coverage of 109 percent. This cost coverage is higher than not only the cost coverage proposed by the Postal Service (104 percent), but also that proposed by United Parcel Service (107 percent). The Postal Service had proposed an overall increase of 10.2 percent.

The Commission recommended several new classifications and attendant discounts for worksharing activities for Parcel Post mailers, which the Postal Service proposed. These are discounts for prebarcoding, and for dropshipment of Parcel Post at the origin Bulk Mail Center, destination Sectional Center Facility, and destination delivery unit. These recommendations will meet the longstanding need of Parcel Post customers having sufficient volumes for worksharing opportunities similar to those long provided to mailers of other types of mail. Smaller mailers will benefit as well through the opportunity for their Parcel Post mail to be consolidated with other mail by private firms, for entry deeper in the postal mailstream, promoting efficiencies and providing better service to these customers. Commercial shippers of parcels and their residential customers, however, face significant increases in the destination bulk mail center rate schedule. We believe the effects of the rate increases on these customers should be considered more carefully in the future.

The Commission also recommended a classification change to allow the mailing of parcels up to 130 inches in length and girth combined, an increase from the current limit of 108 inches. The Commission recommended separate rates for these parcels, regardless of weight. This change will meet the needs of mailers who have had to split their shipments between carriers, due to the existing lower maximum.

The Commission also recommended, as requested, the reinstitution of the "stop-loss" or "balloon" rate for bulky but lightweight Parcel Post pieces that exceed 84 inches in length and girth combined and weigh less than 15 pounds. Such pieces will be subject to the 15 pound rate.

On the whole, we find that the Commission's recommendations of rate and classifications for Parcel Post satisfy the applicable statutory criteria. We believe the changes respond to the needs of Parcel Post customers and are in the public interest. A question has arisen, however, regarding the 2-pound rate of $1.10 recommended for the DDU category of Parcel Post. In response to a motion filed by UPS on June 5, the Commission indicated in Order No. 1213 (June 19, 1998) that the rate it had recommended for that cell is "anomalous," but the Commission would quickly consider corrective action if we were to request reconsideration of the matter. We are satisfied with the overall revenue effects of establishing the DDU discounts as recommended. As a question has arisen about the process by which the 2-pound rate was developed, however, we believe that it would be useful for the Commission to have the opportunity to reexamine its recommendation, and we are returning the matter for reconsideration. We stress, however, that we are not necessarily seeking for the Commission to alter its recommendation. Moreover, even if the Commission were to adjust the 2-pound rate for DDU Parcel Post, we would expect that some of the additional revenue that might be generated by a higher 2-pound rate could be used to mitigate rates in other DDU rate cells, leaving the net revenue consequences of establishment of the DDU discounts unchanged. To that effect, in accordance with the offer made by the Commission in Order No. 1213, we are allowing the DDU Parcel Post rates under protest, and returning this limited matter for reconsideration and further explanation.

Bound Printed Matter. The Commission recommended rates averaging an increase of 5 percent, the same level requested by the Postal Service, and a cost coverage of 136 percent. The Commission also recommended a proposed prebarcode discount. We find that the recommendations of rates and classifications for Bound Printed Matter satisfy the applicable statutory criteria, and we accept those recommendations.

Special Standard Mail. The Commission recommended rates which result in an average decrease of 9.6 percent and a cost coverage of 106 percent. The Commission also recommended the proposed prebarcode discount. The Postal Service had proposed an average decrease of 0.4 percent. We find that the Commission's recommendations of rates and classifications for Special Standard Mail satisfy the applicable statutory criteria and we accept those recommendations.

Library Mail. The Postal Service proposed increased rates for Library Mail by an average of 14.3 percent. These rates were based on Library Mail costs, which are somewhat volatile due to the small size of the sample. The proposed rates would have resulted in Library rates being higher than Special Standard Mail rates, for which most, but not all, Library Mail is also eligible. Accordingly, the Postal Service had assumed that all Library Mail material that could qualify for Special Standard Mail rates (estimated to be 95 percent of Library Mail) would be mailed at the proposed Special Standard Mail rates.

In place of the proposed approach, the Commission stated that it is "declining to recommend distinct rates for the subclass ...." Instead, it "recommends access for all matter currently eligible for mailing as Library Mail to the Special Standard subclass." PRC Op. R97-1, Vol. 1, at 509. The Commission therefore recommended an amendment of the Special Standard subclass DMCS language to allow all material eligible for Library Mail to be mailed as Special Standard Mail. At the same time, the Commission stated that its "recommended solution *should not be considered a proposal to abolish Library Mail as a recognized mail classification.*" *Id.* The Commission suggested that the Postal Service "focus special scrutiny" on Library Mail.

While we find acceptable the general result which the Commission appears to intend for Library Mail, we are returning the Commission's recommended decision on that subclass for reconsideration for several reasons. Additional time and focus seems required to resolve Library Mail issues in a sufficiently clear and consistent manner. First, the law states that "[u]pon receiving a request, the Commission *shall* make a recommended decision on the request for changes in rates ...." 39 U.S.C. § 3622(b) (emphasis added). Yet the Commission has stated that it is declining to recommend Library rates. This needs to be carefully considered.

Second, the joint rate schedule (combined Schedules 323.1 and 323.2) actually recommended by the Commission is unclear. By its terms, it would appear to suggest that all of the rates recommended for Special Standard Mail are also available to Library Mail users. Yet the Special Standard Mail subclass includes presort rate categories (Level A and Level B) that do not exist within the classification schedule for Library Mail. Examining page 19 of the Commission's Appendix G indicates that the Commission apparently did not intend for Level A and Level B rates to be available to Library Mail users, but such an intent cannot be deduced from the rate schedule itself. From the Commission's workpapers submitted as part of PRC-LR-15, however, the Commission's intentions relative to the Level A and Level B rates seem less clear. Ultimately, because the Commission modified the joint rate schedule reproduced in PRC-LR-15 before including it within the Recommended Decision, and chose not to recommend necessary supporting classification changes to qualify Library Mail for Level A and Level B rates — classification changes which would have been devoid of record support — the Commission apparently did not intend for those discount rates to be available.

Third, allowing all Library Mail to qualify for Special Standard Mail and pay Special Standard Mail rates may be inconsistent with the Commission's stated intent to seek to preserve the

Library Mail subclass. It would appear to us, rather, that such a change would actually encourage mailer behavior so blurring the distinction between the two subclasses that collection of accurate Library Mail cost data under such a regime might be virtually impossible. Moreover, while closely related matters were discussed over the course of the proceeding, no proposal explicitly designed to expand Special Standard Mail eligibility to all qualified Library Mail was advanced on the record, and no testimony addressed such a proposal.

These problems could be avoided by means of a discrete rate schedule for Library Mail, containing the rates (as shown on page 19 of the Commission's Appendix G) which apply to the parallel rate elements for Special Standard Mail, while omitting (as does page 19) the Level A and Level B rates. The recommendation of a discrete rate schedule for Library Mail, using rate elements from the Special Standard Mail rate schedule, closely corresponds to the treatment afforded Classroom Periodicals vis-a-vis the Nonprofit Periodicals rate schedule. The only difference would be that, in this instance, the rate schedules would not be identical, because of the lack of completely parallel rate categories across the two Standard Mail subclasses. Recommendation of such a rate schedule would obviate the need for a temporary classification "bridge." The distinction between the two subclasses would be maintained. No future action would be required later to remove the "bridge."

As we hope the above discussion makes clear, while returning this matter to the Commission, we embrace the practical rate consequences apparently intended by the Commission — that Library Mail, for now, pay the same rates as unpresorted Special Standard Mail pays. This was the basic premise for the Postal Service's proposal as well. Using page 19 of the Commission's Appendix G as our guide, we conclude that Library Mail users would pay the exact same rates under a separate-schedule solution as under the joint-schedule recommendation, and that the revenue consequences to the Postal Service would be the same. The primary differences, as we see them, are greater clarity, less administrative disruption, and enhanced prospects for the future viability of Library Mail as a distinct subclass. Like the Commission, however, we must also admit the possibility that evolving mail characteristics may at some point render unattainable lower cost-based rates for Library Mail than for corresponding Special Standard

Mail. For now, we accept the Commission's recommended joint rate schedule under protest, we take no action on the recommended classification "bridge" (recommended DMCS § 323.11.k), and we return the matter for reconsideration.

Periodicals

Regular Publications. For the Regular subclass, the Commission recommended rates resulting in an average increase of 4.6 percent and a cost coverage of 101 percent. Compared to the Postal Service's proposed cost methodology, which the Commission declined to adopt, the Commission's cost methodology recognizes higher attributable costs for Periodicals mail. Under the Postal Service's proposed approach, the cost coverage underlying the recommended rates would be greater than 101 percent. In the circumstances of this case, we accept these rates.

We are concerned that the per-piece discounts recommended for destination (SCF and DDU) entry are substantially smaller than the current discounts, and could reduce customer dropshipping. To the extent that the reduced discounts reflect a change from the Commission's Docket No. MC95-1 methodology for calculating the cost savings, we hope that the methodologies can be addressed in the future, so that more consistent signals can be sent to the affected customers.

Nonprofit Publications. The Commission recommended rates which represent an average increase of 8.0 percent and a cost coverage of 100.7 percent. The Commission determined that these rates reflect the appropriate allocation of costs supported on the record, in accordance with the Revenue Forgone Reform Act. We accept these rates.

Classroom Publications. We accept the Commission's recommendation of a 12.1 percent rate increase for Classroom publications, based upon application of Nonprofit rates to this subclass. Although the resulting cost coverage is under 100 percent, we believe that the Classroom rates satisfy statutory requirements, given the questions concerning the FY 1996 reported costs of the Classroom subclass underlying the cost coverage calculation.

Within County. For within-county publications, the Commission recommended a 100.5 percent cost coverage at full rates. In a letter to the Chairman of the Board of Governors dated May 20, 1998, the Secretary of the Commission brought to our attention an anomalous consequence of its recommended rates for within-county. The letter stated:

> The Commission has now become aware that the recommended rates applicable to a small segment of Within County Periodicals, specifically, the rates for pieces eligible for prebarcode discounts, would not reflect the proper relative benefit for presortation. This result was unintended.

The letter further proposed that the Commission would expeditiously consider recommending more appropriate rates if the Governors were to return the matter. Accordingly, we are exercising our authority under 39 U.S.C. § 3625 to allow these rates under protest and seek reconsideration. In taking this action, we emphasize that our "protest" in this instance is a statutory term of art and is consistent with the Commission's invitation to correct this unintended result.

The Commission also recommended a classification change for the Within County subclass, making the high density discount available for mail going to at least 25 percent of the possible deliveries on a route. Currently, the high density discount is limited to at least 125 pieces of walk-sequenced mail. We accept this classification change with the expectation that it will enable the Postal Service to test whether the high density discount should apply more readily to walk-sequenced mail on small carrier routes.

Science of Agriculture. The rates are identical to Regular rates except for the pound rate for zones 1 and 2, the destination SCF, and the destination delivery unit. By statute, these pound rates are set at 75 percent of the corresponding Regular rates. We accept the recommended rates.

Classification change. The Commission recommended the Postal Service's proposal to replace the 3/5-digit presort category with separate 3-digit and 5-digit categories, and expand the scope of the 3-digit category to include all mail sorted to 3-digit areas, rather than to just "unique" 3-digit ZIP Codes. We accept these classification changes, which allow Periodicals rates to reflect costs and operational considerations more closely.

Special Services

The Commission recommended fees for the special services, as well as various annual permit and licensing fees. We accept the fees recommended by the Commission. With respect to special handling service, the Commission recommended that the current fees be maintained, because the record lacked reliable cost evidence to change the fees. While we expect the Postal Service to provide better cost information in the future, we are concerned about simply maintaining the current fees in such circumstances, because those fees may not cover costs. The Postal Service may need to request higher fees for this service should the recommended fees prove inadequate.

Classification changes. We accept the Commission's recommendations of several classification changes for special services as proposed by the Postal Service. These changes include the creation of classifications for delivery confirmation service and bulk insurance, the renaming of the "prebarcoded" BRM fee category to "Qualified" (reflecting the creation of the Qualified BRM postage rate), the elimination of the option for uninsured registered mail valued between $0.01 and $100, and the offering of an electronic version of return receipt service for delivery confirmation customers. As noted in the Board of Governors' resolution establishing the effective date for the changes adopted in this Decision, delivery confirmation service, as well as the classification change allowing delivery confirmation service as a sole prerequisite for return receipt service, will be implemented at a later time. The implementation of these new service features will correspond with system deployment and will be effective on or before June 1, 1999.

UNDERLYING MATTERS

Several other aspects of the Commission's Opinion and Recommended Decision warrant discussion in this Decision. We discuss these matters in some detail below.

REVENUE REQUIREMENT

The Commission estimated that the rates and fees recommended, together with other revenue sources, will provide total revenues of $60,891,356,000, approximately $754 million less than the Postal Service's estimate based on its proposed rates and fees. The Commission estimated that the recommended rates and fees will result in a test-year surplus of $19.7 million, after recovery of $377 million for prior years' losses.

In an important respect this case was unusual. The revenue requirement was driven in large part by the need to fund specific management initiatives and programs, many of which have been approved by the Board of Governors to maintain and improve service for the public, as well as by the usual need to cover expenses and repay prior years' losses. These initiatives are critical to the continued viability of the Postal Service, and its readiness to improve services and meet its customers' needs into the next century.

The Commission reduced the revenue requirement by $745 million. This total includes a net reduction of $511 million to account for changes in inflation and other updates, $101 million in assumed supervisor cost savings, $70 million of prior year loss recovery, and $63 million reflecting the effect of the recommended rates and a number of corrections and adjustments.

The largest reductions to the revenue requirement were based on known cost changes resulting from lower-than-expected inflation and other factors. These changes, totaling approximately $511 million, were presented by the Postal Service in rebuttal testimony. The Commission also reduced the amount for recovery of prior years' losses by $70 million, based on the actual surplus for Fiscal Year 1997. These reductions are similar to adjustments the Commission has made in prior cases.

In adopting these adjustments, the Commission declined to incorporate certain partially-offsetting cost increases associated with managerial programs indicated in the rebuttal testimony. Similarly, the Commission reduced the revenue requirement by $101 million to account for changes in supervisor costs based on one party's unsupported speculations that such costs were overlooked. While, in this instance, we do not challenge the resulting rates on this basis, these reductions have superseded management's judgment concerning these program expenses.

The Postal Service originally requested a provision for contingencies in the amount of one percent of total accrued costs, significantly lower than the percentages requested in recent cases (2 percent in Docket No. R94-1, and 3.5 percent in Docket No. R90-1). In his testimony, the Controller indicated that, if the Commission based its recommendations on the revenue requirement proposed by the Postal Service, yet acknowledged reductions in expenses and other changes he outlined, an increase in the amount available for contingencies (from 1 percent to 1.5 percent) would be justified. The Controller's testimony was not that the contingency was merely a "plug," as suggested by the Commission, but that it was a judgmental determination by management as the product of balancing all of the policy objectives embodied in the Postal Service's Request. In light of reduced expense estimates, the record, supplemented by the Controller's testimony, supports a policy determination that a higher contingency was warranted. In this respect, the treatment of the contingency element as solely a question of objective fact or prediction is inconsistent with the Postal Service's discretion to determine a reasonable provision for contingencies as a matter of policy judgment.

The outcome on this issue also seems inconsistent with earlier omnibus rate cases, in which increased estimates of costs left the Postal Service with a significantly smaller contingency than requested within the context of the original revenue requirement, which the Postal Service decided not to adjust upward. In this case, where the estimates of costs decreased, the precedent and the record supported retaining the original revenue requirement, even if a higher amount available for contingencies resulted.

While we appreciate that the context for the current docket fortunately includes a healthier financial posture for the Postal Service than has often been the case in the past, we do not accept that a more relaxed approach to downsizing the revenue requirement should become a standard for future cases.

The Governors and the Commission continue to be in substantial agreement on the need to protect the financial health of the Postal Service by recovering past losses to restore equity. In its Opinion the Commission expressed satisfaction with the Postal Service's equity restoration policy as reflected in Board of Governors Resolution No. 95-9, which in part responded to previous recommendations of the Commission. Strong financial performance over the past several years has enabled the Postal Service for the first time to make significant, consistent progress toward restoring its equity account. We emphasize our understanding that the Resolution contemplates management's recovery of prior years' losses at a more rapid rate, if possible, than that based on the amount included in the revenue requirement. Continued surpluses above and beyond those anticipated will allow for the complete restoration of equity in the near future, obviating the need to include this provision in subsequent revenue requirements, and thus relieving the ratepayers of a burden they have carried for many years.

We now turn to some of the issues which proved particularly controversial in this docket.

ECONOMIC COSTING FRAMEWORK

In this case, the Postal Service presented not only a variety of new analyses to improve postal costing, but also set forth in testimony a comprehensive economic framework for developing and applying such analyses in an objective, consistent, and productive manner. As stated by economist Professor Panzar, the framework is necessary to allow full consideration of the economic efficiency tradeoffs inherent in the development of a set of postal rates which are appropriate for each subclass, and which allow the Postal Service to achieve overall financial breakeven. The Commission appeared to embrace certain constituent parts of this analysis, but declined to accept the overall framework, or any alternative comprehensive framework. We remain committed to appropriate consideration of concerns of economic efficiency, and to the utility of a sound analytic framework to assist in that endeavor. Consequently, we believe that the marginal/incremental cost framework provides a useful approach to postal costing, and hope that the Commission will be receptive to a sounder framework as its reservations can be addressed.

MAIL PROCESSING COSTS

Mail processing costs account for nearly one fourth of the Postal Service's total accrued costs. The appropriate treatment of these costs is thus of great importance. In this proceeding, in response to concerns raised previously by the Commission and the parties, the Postal Service introduced a sophisticated, integrated economic and operational analysis of mail processing labor costs. For the first time, the Postal Service presented detailed data, supported by sound economic theory and subjected to rigorous econometric scrutiny, which identified the mail processing labor costs that vary with volume, and distributed those costs to the classes and subclasses of mail that cause them. We do not agree with all of the findings in the Commission's Opinion on this matter. We note comments to the Governors from Dow Jones & Company, the Magazine Publishers of America, and the American Business Press taking issue with certain of the Commission's findings as well.

We anticipate that the Postal Service and other interested parties will continue to explore this crucial area and address it further in future proceedings. In particular, we are now convinced that mail processing labor costs do not vary 100 percent with volume. Nevertheless, it appears that consensus on this matter is unlikely in the context of a request for reconsideration based on the existing record, and would be much more likely in the context of an expanded record in some future proceeding, in which the Postal Service and the other parties can address the concerns articulated by the Commission in this case. The Commission felt there were a number of unresolved issues concerning this portion of the analysis which require further scrutiny. The Commission's Opinion, in some respects, provides helpful guidance on how the parties might address issues of concern.

ESTIMATE OF ANTICIPATED REVENUE

The Postal Reorganization Act requires that our Decision include an estimate of anticipated revenues, 39 U.S.C. § 3625(e). In accordance with our action on the Commission's Recommended Decision, we estimate that the rates that we are accepting would result in test year costs and revenues of approximately $60.9 billion. Our conclusion in this regard reflects the somewhat unusual posture of this case, compared to other general rate proceedings in recent years. This case was litigated in substantial part during the test period for which costs, volumes, and revenues were estimated for the purpose of proposing and recommending rates and fees (Fiscal Year 1998). From the time when the case was filed (July 10, 1997), and after the standard ten-month proceeding before the Commission, the soonest the Postal Service could have practically implemented the recommendations would have been in June or July during the Test Year. The Postal Service's proposals were reviewed under estimates reflecting an assumption, contrary to fact, that new rates were implemented on October 1, 1997. While the degree of overlap between the litigation and the test period was unusual, it was not unprecedented, and it complied with the Commission's Rules of Practice and Procedure. The Commission considered the financial foundation of the Postal Service's request on this basis.

As explained below, the actual date on which the recommended changes will take effect has been determined separately by the Board of Governors, in accordance with its authority under 39 U.S.C. § 3625(f). With exceptions noted, the Board has concluded that the adjustments should be implemented on January 10, 1999. While this date falls after conclusion of FY 1998, the Board's decision is consistent with the Commission's recommendations, supported by the record of the proceeding, and the factors influencing the Board's judgment setting the effective date. In fact, the Commission in its Opinion expressed the view that the Postal Service's financial circumstances would not necessitate implementation before January 1999. The Board has, however, selected the effective date independently, in accordance with its statutory authority.

ORDER

In accordance with the foregoing Decision of the Governors, with the exceptions noted therein and further identified below, the changes in postal rates and fees and in the Domestic Mail Classification Schedule attached hereto and incorporated herein are hereby accepted and ordered into effect. Also in accordance with the foregoing Decision of the Governors, the attached rate schedules for Within County Periodicals, Library Rate Mail, and DDU Parcel Post are hereby allowed under protest, and returned to the Postal Rate Commission for reconsideration. In accordance with Resolution No. 98-6 of the Board of Governors, dated June 29, 1998, the majority of the changes will take effect at 12:01 a.m. on January 10, 1999. As further specified in Resolution 98-6, the new delivery confirmation service, as well as the classification change allowing delivery confirmation service as a sole prerequisite for return receipt service, will take effect at a time and date to be determined subsequently by the Board of Governors, in accordance with the Board's judgment concerning the availability of these service features.

Accordingly, all of the attached rate, fee, and classification changes will take effect on January 10, 1999, except for the changes to the Domestic Mail Classification Schedule related to delivery confirmation (DMCS sections 260j, 362g, 945.21e, and 948), and the delivery confirmation fees set forth in Fee Schedule 948.

In choosing this effective date, the Board has taken into account several considerations, within the context of its overall financial and other policies. These factors include the Postal Service's current financial situation, as reflected in the Annual Report for the most recently concluded fiscal year (FY 1997), as well as reports of financial and operating results and expectations for FY 1998. In FY 1998, the Board once again expects the Postal Service to gain a net income. January will mark four years since the last general rate increase, and a net income has been gained in each of the last four years. The Board has further concluded that implementing the instant increases in January of FY 1999 is consistent with the Postal Service's goal for equity restoration through FY 1998, in accordance with Resolution No. 95-9 and the Commission's recommendation for the recovery of prior years' losses. Other factors influencing implementation include the effects on mailers, and considerations affecting administration of the changed rate and classification schedules. In this regard, we note that the Governors have received numerous comments from mailers and others expressing a preference for implementation in 1999. The Board has concluded that a January effective date would best provide for a smooth transition to the changes by the Postal Service and mailers, including consideration of the need to develop new mailing rules and requirements and create computer software applications for use by mailers and others.

The foregoing was adopted by the Governors on June 29, 1998.

By The Governors:

Chairman

RESOLUTION OF THE BOARD OF GOVERNORS
OF THE
UNITED STATES POSTAL SERVICE
Resolution No. 98-6

Effective Date of New Rates
of Postage and Fees

RESOLVED:

Pursuant to section 3625(f) of Title 39, United States Code, the Board of Governors determines that except as further provided in this Resolution, the rates of postage and fees for postal services and the changes in mail classification that were ordered to be placed into effect by the Decision of the Governors adopted on June 29, 1998, shall become effective at 12:01 a.m. on January 10, 1999.

The Board of Governors has determined that implementation of the new delivery confirmation service approved in the Governors' Decision, as well as the classification change allowing delivery confirmation as a sole prerequisite for return receipt service, should take place after the effective date established for the other changes approved and allowed by the Governors. Later implementation will provide time for deployment of the technology needed to provide these service features. Selection of an effective date will accordingly be deferred pending future action by the Board on this matter.

The foregoing Resolution was adopted by the Board of Governors on June 29, 1998.

Thomas J. Koerber
Secretary