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

ANNUAL COMPLIANCE REPORT, 2011	Docket No. ACR2011

REPLY COMMENTS OF THE UNITED STATES POSTAL SERVICE
(February 17, 2012)

In Order No. 1095, the Postal Regulatory Commission solicited comments on the United States Postal Service's Annual Compliance Report (ACR) for Fiscal Year 2011.[1] On February 3, 2012, the Public Representative and a number of private parties submitted comments. The Postal Service hereby provides its reply comments, addressing the main proposals and arguments set forth by commenters.

I. Scope of the Annual Compliance Review

At the outset, before turning to the commenters' specific points, the Postal Service would like to address a threshold issue implicated by some of the comments – namely, the scope of the instant proceeding within the statutory scheme of the Postal Accountability and Enhancement Act (PAEA). Under section 3653, the Commission is directed to do four things in reviewing an Annual Compliance Report, two of which relate to compliance and two of which do not. As to compliance, the Commission is charged with determining: (1) whether any rates or fees in effect during the preceding year were not in compliance with chapter 36 and its accompanying regulations; and (2) whether any service standards in effect during the preceding year were not met.[2]

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[1] Order No. 1095, Docket No. ACR2011 (Jan. 3, 2012).
[2] 39 U.S.C. § 3653(b).

Separate from these compliance determinations, the Commission: (3) is directed to review whether the Postal Service has met its performance goals; and (4) it may advise the Postal Service as to the protection or promotion of the public policy objectives of title 39.[3] It is notable that the first three functions are entirely retrospective in nature.

In responding to the concerns raised by commenters, the Postal Service will focus largely on those that relate to the first two functions. The ACR and the Postal Service's responses to Chairman's Information Requests address the third function. In addition, some commenters have provided useful analyses that inform the fourth function. For example, both the Public Representative and Valpak discuss the effect of the Retiree Health Benefit Fund prefunding requirement on the Postal Service's financial condition and highlight the need for Congressional action.[4] However, the Postal Service will leave it to the Commission to review such comments and provide any advice it deems beneficial.

Beyond this, some commenters have discussed issues that clearly fall outside of the Commission's four statutory functions in the Annual Compliance Review. For example, Pitney Bowes and John Panzar argue for the issuance of a new rule governing workshare discounts.[5] While the Postal Service disagrees with both their reasoning and their conclusions, it will not delve into those points of disagreement in

[3] 39 U.S.C. § 3653(d).

[4] Public Representative Comments, Docket No. ACR2011 (Feb. 3, 2012) ("PR Comments"), at 4-5; Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association, Inc. Initial Comments on the United States Postal Service FY 2011 Annual Compliance Report, Docket No. ACR2011 (Feb. 3, 2012) ("Valpak Comments"), at 3-12.

[5] Comments of Pitney Bowes Inc., Docket No. ACR2011 (Feb. 3, 2012), at 5-7; Comments of John C. Panzar on Behalf of Pitney Bowes Inc., Docket No. ACR2011 (Feb. 3, 2012).

this docket.[6] Rather, the Postal Service trusts that, should the Commission ever decide to act in response to Pitney Bowes and Panzar's comments, or in response to other comments that fall outside the scope of section 3653,[7] the Commission will initiate a new docket, in which the Postal Service and other parties will be afforded the opportunity to provide comments and fully explore the relevant issues. In future Annual Compliance Review dockets, it would be useful for the Commission to remind parties to focus their comments on issues directly relevant to the Commission's review of the Postal Service's Annual Compliance Report.[8]

II. Workshare Discounts

Commenters primarily raise three issues regarding workshare discounts. First, some commenters state that the Postal Service has not, in their view, sufficiently justified or provided a plan for correcting all passthroughs that exceed 100 percent.[9] In

[6] For now, it would suffice to say that the Commission has already considered the precise issue raised by Pitney Bowes and Panzar. Specifically, in Docket No. RM2007-1, the Commission responded to those same parties' advocacy of a floor on workshare discounts, premised on efficient component pricing, by stating that, "[t]he Commission strongly believes that efficient component pricing should be used as a guiding principle in establishing and maintaining workshare discounts… Nonetheless, the Commission recognizes that other factors must also be considered, and that the PAEA grants the Postal Service substantial flexibility in setting rates." Order No. 26, Docket No. RM2007-1 (Aug. 15, 2007), at ¶ 2043.

[7] Another example of this practice is the Public Representative's recommendation that the Commission promulgate new monthly reporting requirements regarding the Postal Service's financial condition. PR Comments, at 12-13. So as not to perpetuate the tendency to treat the Annual Compliance Review as the stage for parties' regulatory wish lists, the Postal Service will refrain from responding in depth to the Public Representative's recommendation, apart from noting that the Postal Service's resources are finite, and that the sorts of requirements urged by the Public Representative would siphon vital resources away from postal functions to essentially constant reporting.

[8] The Postal Service will also reserve its reply comments regarding outstanding proposals to change analytical principles for a pleading to be filed in Docket No. RM2012-2, on February 23, 2012.

[9] *See*, *e.g.*, PR Comments, at 21-24.

this regard, the Postal Service notes that a filing made by the Postal Service subsequent to the February 3rd deadline for parties' comments further explained the justifications for some of the passthroughs exceeding 100 percent.[10]

In regard to correcting passthroughs, the Postal Service believes that the plans it has already laid out for correcting passthroughs are the only practicable plans available to it, given the limited number of tools at its disposal. As the Postal Service has stated previously, the process of managing passthroughs is iterative and imprecise. The primary tool available to the Postal Service in managing passthroughs is its price adjustment authority. However, the Postal Service must also consider issues other than passthroughs when it plans price adjustments, in order to strike the appropriate balance between operational efficiency and mitigating potential rate shock to customers. And, the working of the CPI-U price cap constrains how much pricing attention the Postal Service can devote to managing passthroughs. The Commission recognized this reality in Docket No. RM2007-1, where it stated,:

> The Commission views the provisions in 39 U.S.C. 3622 as a means to foster pricing flexibility, reduce burden, and facilitate swift rate changes. Requiring the Postal Service to plan specifically how it intends to reduce excess discounts in the future is inconsistent with this purpose.[11]

Moreover, the effect of price adjustments on passthroughs is complicated by changes in cost avoidances. While the Postal Service continually looks for ways to reduce costs, it cannot predict precisely how costs and cost avoidances will change from year to year. In summary, then, the tools available to the Postal Service to

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[10] *See* United States Postal Service Notice of Filing of Revision to Response to Question 1 of Chairman's Information Request No. 1 – Errata, Docket No. ACR2011 (Feb. 14, 2012); *see also* Response to Question 7, Chairman's Information Request No. 1, Docket No. ACR2011 (Jan. 27, 2012).
[11] Order No. 43, Docket No. RM2007-1 (Oct. 29, 2007), at ¶ 2108.

manage passthroughs are rather blunt and do not lend themselves to simple, short-term passthrough corrections.

The second major issue raised by commenters in regard to worksharing is the existence of passthroughs that are below 100 percent, and in particular the Postal Service's reference to excess mail processing capacity as a justification for such passthroughs in Docket No. R2012-3.[12] In response, the Postal Service first notes that Section 3622(e) does not prohibit passthroughs that are below 100 percent, and that the Commission's rules require only that the Postal Service "identify and explain discounts that are set substantially below avoided costs and explain any relationship between discounts that are above and those that are below avoided costs."[13] Without conceding that any of the passthroughs at issue are "substantially" below avoided costs, the Postal Service has already explained the salient ones in Docket No. R2012-3. Thus, there are no statutory or regulatory compliance questions at issue.

Nonetheless, for the purpose of providing customers and other parties with clarity regarding the Postal Service's intentions, the Postal Service would point out that it does not intend to use below-cost avoidance workshare discounts as the sole approach for addressing excess capacity. Rather, the Postal Service is undertaking serious, substantial efforts to reduce excess capacity, most recently with the service changes proposed in Docket No. N2012-1. However, given the present uncertainty as to whether and to what extent the Postal Service will be able to institute those changes, and given the general difficulty in removing excess capacity quickly enough to match

[12] *See*, *e.g.*, Joint Comments of the Direct Marketing Association, Inc., the Major Mailers Association, the National Association of Presort Mailers, the National Postal Policy Council, and the Parcel Shippers Association, Docket No. ACR2011 (Feb. 3, 2012).
[13] 39 CFR 3010.4(a)(6).

changes in mail volume, the Postal Service believes that deliberately keeping select passthroughs below 100 percent for the time being will improve the efficiency of the Postal Service. The Commission has already recognized the Postal Service's authority to take this course.[14]

The third major workshare issue raised by commenters is the need for the Commission to restart its workshare rulemaking.[15] The Postal Service reiterates its position that workshare relationships should not apply across products, and it echoes the views of several commenters that the growing differential between the unit contributions of presorted and single-piece First-Class Mail Letters & Cards is a serious cause for concern. The Postal Service therefore encourages the Commission to restart its workshare rulemaking.

III. Attributable Cost Coverages of Market Dominant Products

Commenters observe that, as was the case in FY 2010, one market dominant class and eight market dominant products did not cover attributable costs in FY 2011.[16] The Commission's finding of noncompliance with regard to Standard Mail Flats in the FY 2010 Annual Compliance Determination (ACD) is currently under review by the United States Court of Appeals for the District of Columbia Circuit. From a compliance perspective, the Postal Service reiterates the statements it made regarding this issue in Docket No. ACR2010, namely, that Commission precedent (prior to the FY 2010 ACD)

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[14] *Supra* note 6.
[15] *See*, *e.g.*, Comments of the National Postal Policy Council, Docket No. ACR2011 (Feb. 3, 2012), at 2-7.
[16] *See*, *e.g.*, PR Comments, at 13.

clearly states that the attributable cost floor of section 3622(c)(2) applies at the class level.[17]

Further, with respect to correcting class level cost coverage shortfalls, the Postal Service repeats its statements from Docket No. ACR2010 that the Postal Service cannot, with the tools that are available to it, remedy the cost coverage shortfall of the Periodicals class.[18] Thus, the Postal Service again encourages the Commission to determine whether it has the authority under the PAEA to raise rates beyond the price cap. Even if the Commission were to determine that it does not have this power, such a determination would clarify to Congress that, if Congress believes that the Commission should have the power to remedy class-level cost coverage shortfalls, Congress must explicitly grant the Commission such power.

IV. Service Performance

Commenters note the still developing state of some of the Postal Service's service performance measurement systems and the disappointing service performance

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[17] *See*, *e.g.*, Order No. 536, Order Adopting Analytical Principles Regarding Workshare Discount Methodology, Docket No. RM2009-3, September 14, 2010, at 26-29 ("The attributable cost floor [of Section 3622(c)(2)] applies to each 'class or type of mail.' While this phrase is broad enough to include an individual 'product,' it is not confined to an individual 'product.' . . . Thus, there is nothing in section 3622, the pricing section of the PAEA, that supports the Postal Service's theory that the PAEA contemplated regulation of market dominant prices primarily at the product level. . . . Congress identifies the services to which a pricing standard applies where that is its intent. For example, section 3622(b)(8) (establishing the 'just and reasonable' standard) specifies that it applies 'within, between, or among classes of mail.' Congress also specifies when a pricing requirement applies to individual 'products' and when a pricing requirement applies at a more general level. This conclusion is corroborated by noting that Congress also applies non-price requirements at the product level when that is its intent.")

[18] Of course, the Postal Service will continue to pursue efficiency enhancements wherever possible, and it will continue to use its full price cap authority whenever it adjusts Periodicals rates. However, these actions are unlikely to improve the class from 74.9 percent attributable cost coverage to 100 percent attributable cost coverage.

results for most market dominant products.[19] The Postal Service acknowledges that it needs to improve its service performance for market dominant products. The Postal Service set forth in its Annual Report on Service Performance for Market Dominant Products its plans for improving its service performance and its plans for further developing its measurement systems, particularly as the adoption of Full Service Intelligent Mail® grows.

V. Timing of Price Adjustments

Commenters state that the timing of the Postal Service's annual price adjustments under its recently revised price adjustment schedule reduce the efficacy of any recommendations contained in the Commission's ACD, because more than half a year will pass between the issuance of the ACD and the noticing of the next price adjustment.[20] In addition, one commenter states that any price adjustment that does not occur at the beginning of the fiscal year complicates the Annual Compliance Review, by necessitating the incorporation of revenues from two different sets of rates into the ACR.[21]

The Postal Service is sympathetic to these concerns. Ideally, price adjustments would occur soon after the issuance of ACDs. Furthermore, price adjustments would ideally occur at the beginning of the fiscal year. However, given that results from a fiscal year cannot be reviewed until that fiscal year closes, both of these interests cannot be served simultaneously. In addition, while it would be possible for the Postal Service to delay annual price adjustments until after the issuance of the ACD, requiring

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[19] *See*, *e.g.*, Initial Comments of Time Inc. on USPS FY 2011 Annual Compliance Report, Docket No. ACR2011 (Feb. 3, 2012), at Attachment A.
[20] *See*, *e.g.*, Valpak Comments, at 117-120.
[21] *Id.*

that the Postal Service do so would undermine the pricing flexibility accorded to the Postal Service under the PAEA. The Postal Service is best situated to determine when during the year it would be most efficient, both for the Postal Service's operations and for its customers, to schedule a rate adjustment.[22] Rescheduling of the ACR is a statutory matter that the Commission can recommend to Congress for legislative change, as Congress considers other postal reform legislation.

VI. Conclusion

The Postal Service appreciates the opportunity to comment on the major issues raised by the parties in their initial comments. Although it is not possible to resolve all of these issues within the framework of the Annual Compliance Review, the Postal Service looks forward to discussing these issues in more detail with the Commission in the coming year.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

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[22] In connection with its most recent price adjustment, which became effective in January 2012, the Postal Service notes that both of its major competitors also made their FY 2012 price adjustments effective in January 2012.